

FUELING AN EQUITABLE RECOVERY



The strongest economy is one that works for everyone. One where workers earn livable wages and can provide their families with the basic necessities. But we've long known that our economy works best for those who already have the most money, and the faults in our economy have never been more clear than during the COVID-19 pandemic. While the recession has many workers facing food insecurity and homelessness, the nation's billionaires have been getting richer. We can build an economy that works for everyone while recovering from the recession with common-sense solutions – but only if we learn from the mistakes of the past.

Before the COVID-19 pandemic hit, New Mexico was moving steadily forward on a path to more broadly shared prosperity, where our communities could truly thrive and where our children had ample opportunities to realize their full potential. We started on this path in 2019, when we finally started making long-needed investments in the programs and services that help families build a brighter future – like quality public education, child care assistance for working parents, economic development initiatives, and mental health services.

In order to continue moving in the right direction, New Mexico needs to ensure that we have revenue that is both sustainable and is raised in a fair way for the long-term. But due to the economic downturn caused by the pandemic and an overdependence on highly volatile oil and gas revenues, our ability to continually invest in and protect our communities is at risk. Falling tax revenues and a bust in oil prices and production have left our state with a significant revenue shortfall.

In past economic downturns, we've handled these shortfalls by taking the misguided and harmful approach of austerity – cutting critical funding for many of the programs and services that help people recover and prosper in times of economic uncertainty. This stinginess has driven us to ranking 50th in the nation in poverty, education, and child well-being, and caused New Mexico to have one of the slowest economic recoveries from the Great Recession.¹ These unnecessary cuts – along with the ineffective tax cuts to the wealthy and well-connected we've given over the past two decades – have starved our schools and health care system of important funding, and made our tax system grossly inequitable while dangerously increasing our reliance on volatile oil and gas revenues.

Our dependence on oil and gas revenues will only become more problematic. While COVID-19 exacerbated the issue, and while the up-and-down volatility and unpredictability of oil and gas revenues is a defining feature of the industry, there is evidence that its decline as a major source of state revenues is a growing threat to our state's financial stability. A recent report shows that as the energy landscape changes to one that accounts for the growing threat of climate change, "the combined effects of high infrastructure costs, over-production and substantial shifts in the energy market have permanently weakened the oil and gas industry's revenues and profitability."² Our state's own fiscal experts have been warning of the same issue, noting in January of 2020 that "New Mexico's growing dependence on revenues from the extractives industry is at the core of the state's fiscal stability problem."³ The problem goes beyond volatility, and it cannot be addressed without diversifying our state's revenue system in order to make it strong and sustainable now and in the future.

THE POSITIVE IMPACT OF FEDERAL STIMULUS DURING COVID-19

While our state revenues have dropped, state economists report that much of the pain has been mitigated by the federal stimulus payments, increased unemployment insurance payments, and the Paycheck Protection Program – all of which kept cash circulating in our economy by propping up employment and income. This allowed many New Mexicans the means to purchase goods and services from local businesses, make their rent payments, buy school supplies for their children, and more – much of which puts revenue in the state treasury.



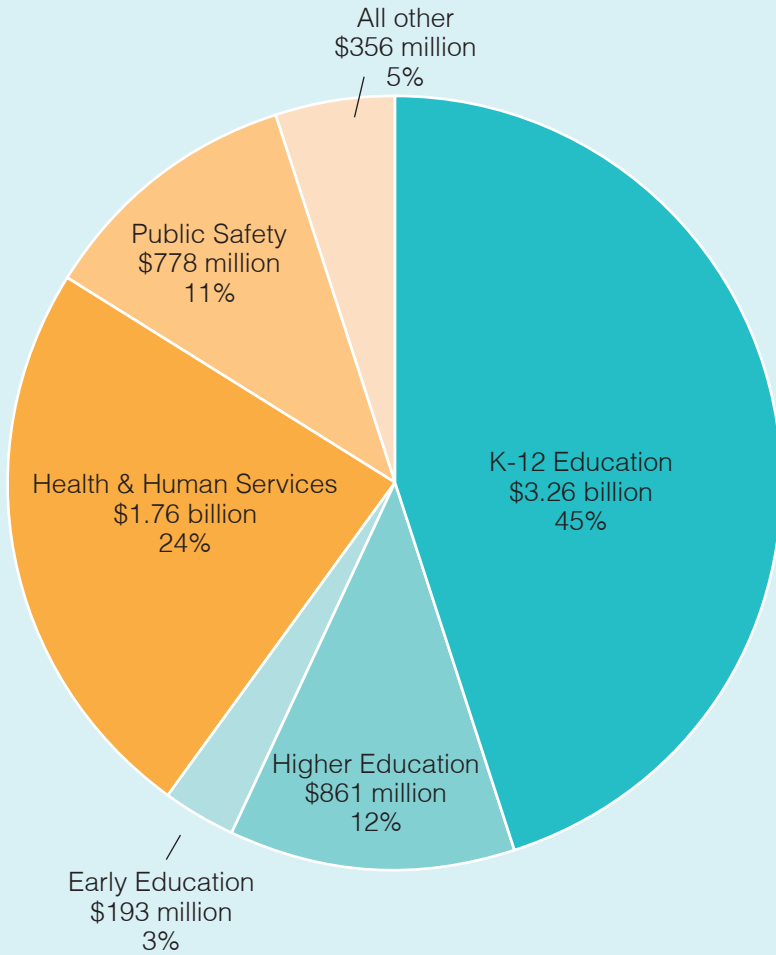
With the pandemic-induced recession and the inevitable decline in the oil and gas industry, economists agree that sustainable, fair revenue is needed now more than ever. Research shows that during a recession and a subsequent revenue shortfall, raising revenue – versus cutting spending on critical public programs or giving tax cuts to those at the top – is the best policy for a quicker, more equitable recovery. That's because public investments – not tax cuts – are what create jobs. No business can operate here or anywhere without a skilled and healthy workforce or customers with money to spend on their goods and services. Skilled workers are created when we invest in our human capital, and that takes revenue.

We also know that this is not a typical recession. Those at the high end of the income scale, along with their investments, have been largely unaffected by business closures, while those at the bottom have been more likely to lose their jobs or income and have little savings to rely upon. Raising revenue from wealthy individuals and profitable corporations that have come out ahead as a result of this pandemic is a common-sense way to keep this growing inequality in check and ensure a more fair recovery.

To accomplish a quick and equitable recovery so we can continue on our path to prosperity, lawmakers need to invest in all New Mexicans – regardless of their zip code, skin color, or immigration status. This journey begins by ensuring the state has all the financial resources it needs to make smart investments that will pay dividends for everyone well into the future. Given the uncertainty of additional federal aid for state and local governments, the bust in oil and gas prices and production, and potential revenue shortfalls in coming years, New Mexico needs to raise significant revenue for these critical investments in a way that is fair, sustainable, and adequate.



NEW MEXICO'S FY21 OPERATING BUDGET PRIORITIZES EDUCATION, HEALTH, AND PUBLIC



Source: 2020 Post Special Session Financial Report, Legislative Finance Committee, July 2020



TAXES, BUDGETS, AND RACIAL EQUITY

The COVID-19 pandemic has illuminated the long-standing health and financial inequities that exist for our communities of color because of systemic racism. Not only have people of color contracted and died from the virus at disproportionate rates, but they also have been more likely to lose their jobs or income and – with little savings or wealth to provide a financial buffer – are facing a higher rate of housing and food insecurity than are their white neighbors.

These inequities stem from racism's harmful legacy and ongoing oppression. Government policies and practices created and have further widened racial gaps – from slavery and Jim Crow laws, to the confiscation of tribal land and resources, from tax cuts that favor wealth over wages, to red-lining policies and the segregation of African Americans in lower-value neighborhoods coupled with the added difficulty of purchasing homes or starting businesses due to lending discrimination.

But just as state and local policies – including tax policy – have been used to deepen racial inequities, states can choose to raise revenue and fund public services in ways that have positive impacts on racial and ethnic equity. Tax policy is an important equity tool because it decides who pays their fair share of taxes, who doesn't, and who benefits most from the way the system is structured. Right now, low- and moderate-income New Mexicans – who are primarily households of color – pay a greater share of their income in state and local taxes than do the state's wealthiest – who are disproportionately white. And by allowing those with capital gains income – money that's made from the sale of stocks, real estate, and other investments of value – to deduct a portion from their taxes, New Mexico taxes wealth, which is held overwhelmingly by white households, at a lower rate than the wages of hardworking New Mexicans.

In order to build a more equitable New Mexico, policymakers need to prioritize our communities of color instead of the wealthy and well-connected when considering legislation on tax cuts, deductions, credits, and rates. See the Appendix for a table analyzing each revenue option for its impact on equity. To learn more about how tax policy can improve equity, see our Advancing Equity in New Mexico blog series.

THE PATH TO A STRONGER ECONOMY



There are many common-sense ways to raise new revenue that could be used to educate our workforce, create jobs, and bolster our economy. Income, wealth, property, sales, and excise taxes can all be reformed in a way that asks those with the means to pay their fair share in building a stronger New Mexico for all.

PERSONAL INCOME TAX

- Raise income tax rates for the state's wealthiest earners
 - In 2003, New Mexico cut the top three personal income tax brackets, benefiting only the highest-income earners in the state. This made our income tax system essentially flat. In 2019, legislators restored some progressivity by introducing a new bracket, but only for the highest 3% of earners. We can continue to fix our upside-down tax code and ensure the wealthiest pay their fair share by introducing additional brackets at the high end of the income scale.
- Reform or repeal itemized deductions
 - Itemized deductions are costly and provide little-to-no benefit to most people earning low- and middle-incomes. The opportunity to reform itemized deductions is ripe because the 2017 federal income tax law – by significantly increasing the standard deduction – curtailed the number of taxpayers who itemize. Now it's mostly affluent households that still itemize.⁴ New Mexico should consider reforming the itemized deductions it allows, like for home mortgage interest.
- Require high-income earners to pay the top rate on all their income
 - New Mexico's income tax code allows high-income earners to pay the top tax rate only on the portion of their income that falls in the highest tax bracket (called a standard graduated-rate income tax). This means, the lower tax rates that are intended to benefit lower- and middle-income New Mexicans benefit the wealthy as well. Enacting so-called "tax benefit recapture" would require high-income earners to pay the top rate on all of their income.
- Decouple from federal "Opportunity Zone" tax breaks
 - The 2017 federal tax law created new capital gains tax breaks for investments in designated "Opportunity Zones" (OZs). There is already considerable evidence that the program is merely a tax windfall for rich investors rather than for the intended beneficiaries of the policy: low-income residents in these identified zones. There's also no requirement that New Mexican tax payers who receive these tax breaks make these investments here in our state. If New Mexico doesn't disallow these breaks, we will continue to lose revenue to subsidize OZ investments in other states.⁵

WEALTH TAXES

- Enact an estate or inheritance tax
 - A large share of the nation's wealth is concentrated in the hands of very few, and taxes on inherited wealth – estate or inheritance taxes – can help build more broadly shared prosperity. An estate tax is a tax on property (like cash, real estate, or stocks) before it is transferred to the heirs of someone who has passed away, while an inheritance tax is levied on the recipients rather than the estate itself. Most states, including

New Mexico, used to have such taxes, but due to federal tax changes in 2001, only 17 states and D.C. now have an estate or inheritance tax.

- Fully repeal the capital gains preference
 - New Mexico is one of only nine states to tax income from capital gains (which are profits from the sale of assets such as stocks or real estate) at a lower rate than the wages of hard-working people are taxed. Currently, New Mexico allows 40% of this unearned income to be deducted from income taxes, making this an unnecessary and unfair tax break that overwhelmingly helps the wealthiest while taking revenue away from much-needed public investment.
- Enact a “mansion tax” on high-value homes
 - New Mexico can also adopt a tax on high-value housing, often called a mansion tax, to help fund crucial services. We can do this in one of two ways, either by levying a tax or fee at the time of sale (like a real estate transfer tax; see property taxes), or on an ongoing basis through existing property tax systems. No state has a graduated property tax rate for mansions, but seven states levy a surcharge on the highest-value homes or have a progressive bracket structure through their real estate transfer tax system.⁶

CORPORATE INCOME TAX

- Increase the corporate income tax
 - In 2013, lawmakers significantly cut corporate income taxes. This did not lead to increased economic activity, but it did substantially reduce revenues needed for the public investments that do create jobs and build a strong economy. Because of these cuts to the corporate income tax, hardworking New Mexicans have had to bear more of the responsibility in paying for the resources and services that both businesses and people use.
- Establish a corporate minimum tax of \$500 or more
 - Corporations benefit from New Mexico’s land and water, roads and bridges, and public services, yet many do not pay their fair share for these public goods. In fact, many states have no minimum corporate income tax, meaning large corporations can exploit the many loopholes that exist or claim numerous tax breaks and end up paying no income tax at all. New Mexico, at the very least, should have a flat dollar minimum tax of at least \$500.
- Establish a minimum tax on large S-corps and LLCs
 - S-corporations, partnerships, and limited liability companies (LLCs) – or “passthrough entities” – are not subject to corporate income taxes even though they receive almost all the benefits that taxable corporations do. A minimum tax helps ensure they pay some taxes for those benefits. Any minimum taxes imposed should match those imposed on taxable corporations and could be limited to passthrough entities earning profits above a certain amount.⁷
- Include foreign tax havens in mandatory combined reporting
 - New Mexico closed a corporate tax loophole in 2019 by passing a mandatory combined reporting law. However, corporations only have to report the combined profits from parent and subsidiary companies formed in the U.S. This means corporations can still form subsidiaries in tax haven countries to hide their profits from taxation. Six states have closed this loophole and required corporations to also report profits from subsidiaries formed in tax havens abroad.⁸





SALES TAX

- Repeal wasteful and ineffective tax breaks
 - o There are hundreds of tax breaks that have been carved out of the gross receipts tax (GRT) base over the years, many of which merely qualify as handouts to special interest groups. What's more, few of them have ever been evaluated for effectiveness. Repealing wasteful and ineffective tax breaks will allow lawmakers to put that money to work in our schools and communities where it will benefit everyone. Additionally, broadening the base will allow for a reduction in the overall GRT rate, benefitting lower- and middle-income families.

EXCISE TAXES

- Raise the gas tax
 - o The last time New Mexico increased the gas tax was 1993. Without increases to account for inflation, revenue from the gas tax has significantly eroded. While gas prices are low, New Mexico could enact a temporary increase to the tax of five or ten cents per gallon, set to automatically expire if gas prices rise to a certain level. Because gas taxes are regressive, New Mexico can offset the impact for low-income families by expanding the Working Families Tax Credit or Low-Income Comprehensive Tax Rebate.
- Raise the motor vehicle excise tax
 - o Despite an increase to the motor vehicle excise tax in 2019, the tax on motor vehicles is still lower than the general sales tax on most other goods purchased in the state. It's also lower than in surrounding states.
- Raise tobacco, e-cigarette, and alcohol taxes
 - o These taxes could increase revenue for public health services and promote greater wellness, particularly when they act as an effective disincentive for young people to take up smoking.

PROPERTY TAXES

- Enact a real estate transfer tax on second or high-value homes
 - o New Mexico has yet to join the 37 other states that have a real-estate transfer tax, which is a one-time tax that is collected after a home is sold and is typically a percentage of the sales price. New Mexico could levy a real estate transfer tax to be paid at the time of sale of a second or high-value home, ensuring that a large percentage of the revenue raised comes from higher-income households.
- Adopt different property tax rates for different kinds of property
 - o Different types of property (residential, commercial, agricultural) should be taxed at different rates (this is called a split roll property tax). There could be a higher set value for commercial properties, or an assessed value could be used for all types of property with a lower rate for residential versus commercial property. This would help with the fact that commercial property turns over less frequently than residential property, which shifts more of the property tax responsibility onto homeowners.

OTHER TAXES AND REVENUE OPTIONS

- Increase the distribution from the Land Grant Permanent Fund
 - o New Mexico has the nation's second largest Land Grant Permanent Fund. Legislators and voters should choose to increase the distribution of that fund, which would help us better fund K-12 schools and our higher education system, as well as invest a tiny portion in the early childhood education programs that will help our kids do better in school so more of them can attend college.
- Enact a health insurance premium surtax
 - o Congress recently repealed a fee on insurance companies that averaged 2.75% to 3%. This federal repeal provides an opportunity for New Mexico to collect a portion of the fee at the state level. We can use the revenue to improve health care affordability and coverage so all New Mexicans can access the care they need.
- Tax the full rental rate of hotels booked online
 - o New Mexico and its local governments lose significant revenues in annual lodging tax by failing to ensure that online travel companies collect and pay the full amount of tax on hotel rooms booked online. This loophole can be closed by redrafting state sales and hotel tax laws to make clear that the applicable taxes be based on the "retail" room rate charged to consumers rather than the "wholesale" room rate the online companies pay to the hotels.⁹
- Increase severance taxes on natural resource extraction (royalty payments)
 - o New Mexico should consider increases to the severance taxes we collect, like the oil and gas school tax, as well as increasing the royalty rate for production on state trust lands. This would help ensure New Mexicans are getting a fair return on the public resources that belong to all of us. We also need to ensure that the industry is adequately regulated, as natural gas wasted through venting and flaring harms the air we breathe and cheats New Mexico students out of millions of dollars of lost education revenue.
- Enact a new tax on diesel fuel
 - o A large portion of this tax would be paid by out-of-state entities like interstate trucking companies.
- Enact a heavy trucks permit fee
 - o A fee assessed on heavy vehicles operating on state highways makes sense, as heavier vehicles do more damage to our roads than do passenger cars. Increasing this fee can result in significant revenues.



APPENDIX

TAX CHANGES TO RAISE REVENUE AND IMPROVE EQUITY

	Low Equity-Improvement Impact	Medium Equity-Improvement Impact	High Equity-Improvement Impact
Low Revenue	<ul style="list-style-type: none"> • Raise the motor vehicle excise tax • Adopt different property tax rates for different kinds of property 	<ul style="list-style-type: none"> • Tax the full rental rate for hotels booked online • Repeal ineffective sales tax cuts in order to broaden the GRT base and lower the rate 	<ul style="list-style-type: none"> • Decouple from federal Opportunity Zone capital gains breaks • Reform or repeal itemized deductions
Medium Revenue	<ul style="list-style-type: none"> • Increase tobacco, e-cigarette, and alcohol taxes • Enact a new tax on diesel fuel and a heavy trucks permit fee 	<ul style="list-style-type: none"> • Establish a corporate minimum tax of \$500 or more • Establish a minimum tax on large S-corps and LLCs 	<ul style="list-style-type: none"> • Enact a mansion tax and/or a real estate transfer tax on high-value homes • Repeal ineffective capital gains tax breaks • Enact tax benefit recapture
High Revenue	<ul style="list-style-type: none"> • Increase (at least temporarily) the gas tax 	<ul style="list-style-type: none"> • Enact a health insurance premium surtax • Increase severance taxes • Increase corporate income taxes 	<ul style="list-style-type: none"> • Create new, higher tax brackets for those earning the largest incomes • Enact an estate or inheritance tax • Increase the distribution from the Land Grant Permanent Fund

*As actual revenue amounts will be more clear once specific legislation is drafted, these revenue categories are estimates

1 "Why States and Localities Should Increase—Not Decrease—Spending," Route Fifty, Sept. 22, 2020

2 "New Mexico's Risky Reliance on Oil Revenue Must Change: Industry Fundamentals Point to Long-Term Decline," Institute for Energy Economics and Financial Analysis, October 2020, p. 3

3 "Legislating for Results: Policy and Performance Analysis," New Mexico Legislative Finance Committee, January 2020, p. 13.

4 "State Itemized Deductions: Surveying the Landscape, Exploring Reforms," Institute on Taxation and Economic Policy (ITEP), February 2020

5 "States Should Decouple Their Income Taxes from Federal 'Opportunity Zone' Tax Breaks ASAP," Center on Budget and Policy Priorities (CBPP), April 2019

6 "State 'Mansion Taxes' on Very Expensive Homes," CBPP, October 2019

7 "Reforming the Tax Treatment of S-Corporations and Limited Liability Companies Can Help States Finance Public Services," CBPP, April 2009

8 "A Simple Fix for a \$17 Billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens," ITEP, January 2019

9 "State and Local Governments Should Close Online Hotel Tax Loophole and Collect Taxes Owed," CBPP, April 2011

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