Impacts of Revenue Raising Options on Good Tax Policy Principles

Presentation to the

Revenue Stabilization and Tax Policy Committee

December 16, 2009

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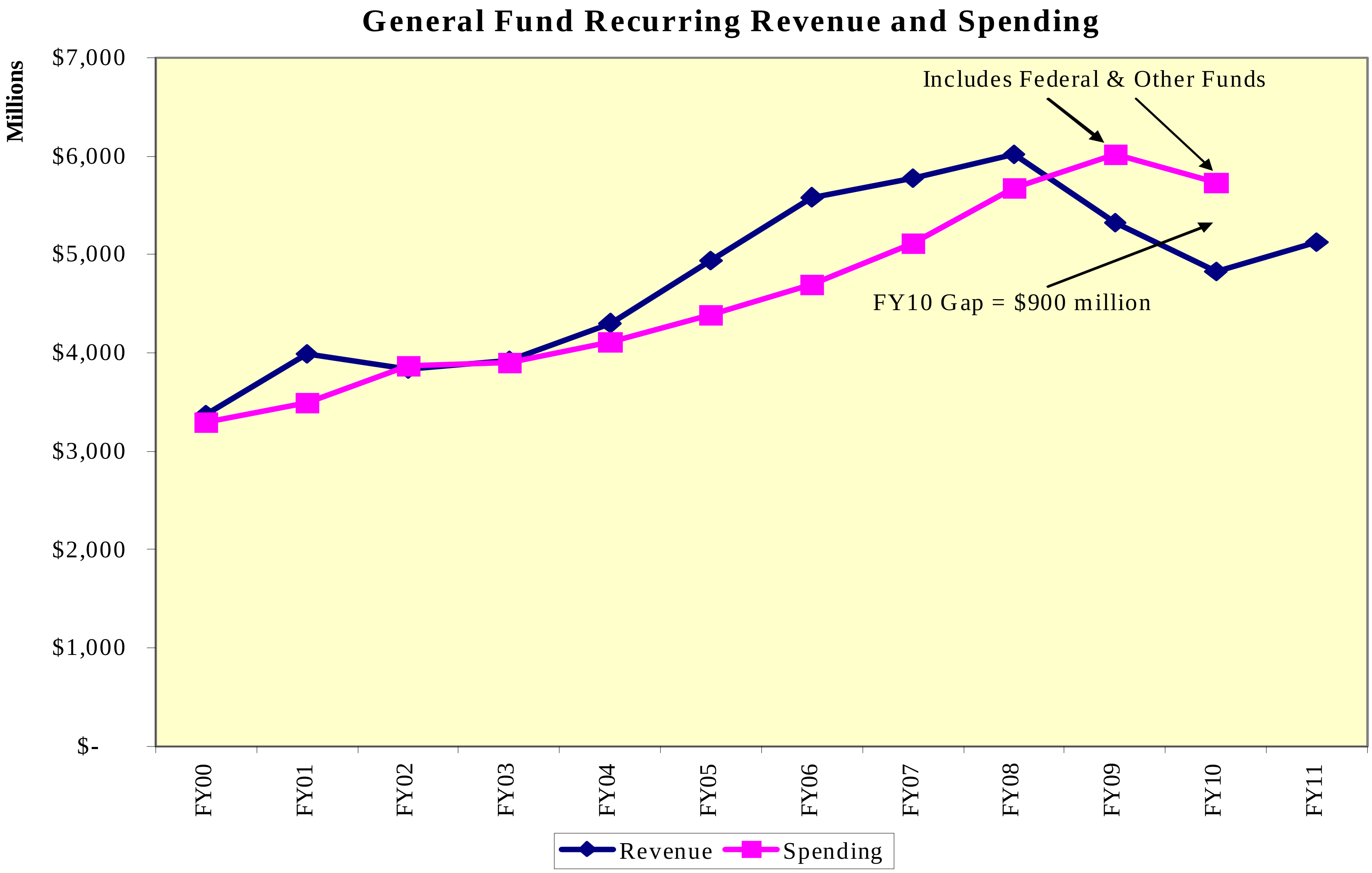
Overview

- List of revenue-raising options (last slide)
- Impacts of recently-enacted statutes on tax policy
- Implications of revenue-raising options for tax policy principles
- Summary of FY10 budget actions in other states

Effects of Recently Enacted Statutes on Adequacy

- General Fund revenue growth from FY03 to FY11 = 31% (3.4%/year)
- GF expenditure growth FY03-FY10 including temporary federal & other funds = 47% (5.7%/yr)
- FY10 gap = $910 million
- GF revenue measures since 2003 = -$600 million/year
  - 2003 PIT cuts: -$400 million/year
  - Food & Medical GRT Deduction + 0.5% credit: -$130 million/year
  - Tax incentives: -$100 million
  - Low-income relief: -$70 million



Even after two rounds of solvency cuts, FY10 spending including temporary federal and other funds is over $900 million higher than revenue

Effects of Recently Enacted Statutes on Efficiency

- Positive: PIT cuts improve NM’s competitive position
- Negative: Food GRT deduction narrowed base, raised rate
- Economic theory predicts that state taxes can affect economic performance; Evidence is mixed
- Recent comparison (COST) suggest that NM’s tax burden on businesses is about average among neighboring states
  - Businesses that purchase a lot of services are at a disadvantage while those with a lot of property are at an advantage
- NM’s tax burden on households is above average among neighboring states (D.C. Government)
  - Taxes on low income households are below average
  - Taxes on high income households are above average
    - Sales (GRT) tax above average, other taxes about average

Tax Policy Principles: Effects of Recently Enacted Statutes on Equity

- Equity—Horizontal:
  - Tax incentives create economic distortion, shift tax burden
  - Narrower GRT base and higher rate creates distortions
  - Higher GRT rate favors out-of-state vendors without nexus
- Equity—Vertical:
  - Food/WFTC/Low-income exemption increased progressivity
  - Decreased PIT reduced progressivity
  - DC study found NM’s system to be less regressive than other states in the region
    - Least regressive = Idaho
    - Most regressive = Nevada

Summary: Tax Policy Context

- Large gap between spending and revenue comes from a reduced rate of revenue growth not accompanied by a reduced rate of spending growth

- NM is about average in tax burden on businesses, slightly above average in burden on households: Thus any significant tax increase is likely to push the NM burden above average

- Although somewhat regressive, NM's system is relatively fair in the distribution of tax burdens between high-income and low income households

Implications of Income Tax Increase Proposals

- Raising taxes on high-income taxpayers improves vertical equity—the goal of adjusting tax burdens to ability to pay: Over 80% of 2003 rate change benefits went to households over $100,000 gross income

- Raising high-income taxes creates a narrower tax base with higher rates, thus impairing efficiency: 60% of tax is currently paid by 9% of households; Caution against raising tax rate too high

- Reliance on PIT has fallen to less than 1/3 of GRT

- PIT elasticity with personal income has fallen from 1.4 to 1.1

Implications of Income Tax Proposals (continued)

- Since State PIT payments are deductible for federal income tax purposes, net liability will increase by (1 – tax rate) for taxpayers who itemize deductions. 80% - 95% of taxpayers over $100,000 itemize, their average federal tax rate is approximately 30%.

- Most of capital gains deduction does not directly target NM investments

- NCSL Survey of 2010 budget actions:
  - 9 states have raised income tax rates on high-income households
  - 5 states have reduced itemized deductions
  - 4 states have raised tax on capital gains

Implications of Corporate Income Tax Increase Proposals

- CIT is a highly concentrated tax:
  - Applies to a minority of businesses
  - Top 250 taxpayers pay 90%

- NM’s tax rate one of highest in region

- Combined reporting revenue yield is uncertain

- NCSL Survey of 2010 budget actions:
  - 5 states have raised CIT rates
  - 6 states have expanded the base
  - 2 states have decoupled from federal tax law provisions
  - 1 state has limited the use of tax credits
  - 1 state (WI) has required combined reproting

Implications of GRT Options

- GRT is largely a tax on services, 1/3 or more of the base is business-to-business transactions; 70% of household purchases are exempt or deductible
- Raising tax rate increases pyramiding
- Eliminating food deduction broadens the base; combined with reinstating the 0.5% credit, this improves efficiency; Food deduction is poorly targeted since most of benefit goes to non-poor households
- Increasing GRT may be regressive but evidence is limited
- NCSL survey of 2010 budget actions:
  - 5 states have increased tax rates
  - 13 states expanded their tax bases
  - 7 states tightened collection procedures

Implications of Excise Tax Options

- Most NM excise tax rates are relatively high compared with neighboring states; exception = Motor Vehicle Excise Tax

- Revenue yield from cigarette tax is sharply limited due to tribal exemption

- “Sin” taxes probably have a regressive incidence

- Significant rate increases can lead to increased use of internet for non-taxed transactions

- NCSL survey of 2010 budget actions:
  - 9 states have raised tax rates – several on insurance premiums
  - 4 states have expanded the tax base
  - 4 states have eliminated or limited tax credits

Effects of Shifting Severance Tax Revenue to the General Fund

- General fund revenue gain roughly equals bonding capacity loss over time but there may be a greater loss of capacity in the short run due to effect on the statutory test for bond issuance

- Investor confidence in the severance bond program would likely be negatively affected; lower ratings and higher interest rates are likely

- Reduced supplemental bond capacity may adversely affect the state's ability to comply with the terms of the Zuni lawsuit

Other Options

- NCSL survey of 2010 budget actions:
  - 5 states have implemented some form of medical service provider tax
  - 3 states have imposed or expanded their estate tax
  - 9 states have approved a tax amnesty

General Fund Revenue Impacts of Various Revenue Raising Options
(Dollar amounts in millions)

Income tax options:	Effect. Date	FY10	FY11	FY12
1% income tax increase on current top bracket (married $24,000/single $16,000)	Tyba 1/1/2010	25.5	170.0	179.4
1% income tax increase over $100,000 (single), $150,000 (married)	Tyba 1/1/2010	5.0	56.1	59.4
Addback income tax deduction for state & local taxes	Tyba 1/1/2010	-	40.0	42.0
Reduce deduction for capital gains from 50% to 25%	Tyba 1/1/2010	-	18.0	20.0
Corporate income tax options:				
Require combined reporting for corporate income tax	Tyba 1/1/2011	-	12.0	30.0
Increase corporate franchise tax from $50 to $250 per year	Tyba 1/1/2010	-	7.5	7.5
Gross receipts tax options:				
Repeal GRT deduction for food	7/1/2010	-	228.0	238.9
Repeal GRT food deduction and reinstate 0.5% GRT credit in muni areas	7/1/2010	-	48.0	48.0
Repeal GRT deduction for medical services	7/1/2010	-	65.0	69.9
Apply compensating tax to in-state sales currently exempt from all tax	7/1/2010	-	13.2	13.8
Increase statewide GRT rate by 0.25%	7/1/2010	-	126.0	132.0
Excise tax options:				
Increase motor vehicle excise tax by 1.0%	4/1/2010	7.7	34.3	37.7
Increase O&G Emergency School Tax on oil by 1%	4/1/2010	10.1	40.4	41.8
Increase O&G Emergency School Tax on gas by 1%	4/1/2010	10.8	52.8	53.8
Increase liquor excise tax by 5 cents per drink	4/1/2010	10.0	40.0	40.7
Increase insurance premiums tax on health insurance by 1%	1/1/2011	-	22.0	47.0
Increase cigarette tax by $1 per pack from $0.91 to $1.91 per pack	4/1/2010	7.5	30.0	30.0
Increase cigarette tax by $1 with no exemption for tribal sellers for increase	4/1/2010	24.8	99.0	99.0
Increase tobacco products tax from 25% to 40%	4/1/2010	0.8	3.0	3.0
Options to reduce tax expenditures:				
Repeal angel investor tax credit	Tyba 1/1/2010	-	0.8	0.8
Reduce film production credit rate from 25% to 15% of expenditures	Tyba 1/1/2010	6.5	26.0	28.6
Reduce rate of high wage jobs tax credit from 10% to 7% of wages	7/1/2010	-	5.0	5.5
Reduce rate of technology jobs tax credit from 8% to 6% of expenditures	7/1/2010	-	1.5	1.7
Reduce rate of investment credit from 5% to 4% of expenditures	7/1/2010	-	1.6	1.8
Reduce renewable energy production credit by 20%	Tyba 1/1/2010	-	1.0	1.1
Freeze hospital GRT credit at FY10 level	7/1/2010	-	4.0	8.0
Reduce rate of credit for NMMIP assessments by 20%	7/1/2010	-	10.0	14.0
Eliminate GRT back to school tax holiday	7/1/2010	-	2.7	2.7
Reduce lab small business partnership credit by 50%	7/1/2010	-	2.0	2.1

"Tyba" = Tax years beginning on or after.