Progressivity of New Mexico's Tax System

Presentation to the

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LFC Principles of Good Tax Policy

Adequacy: revenue should be adequate to fund government services

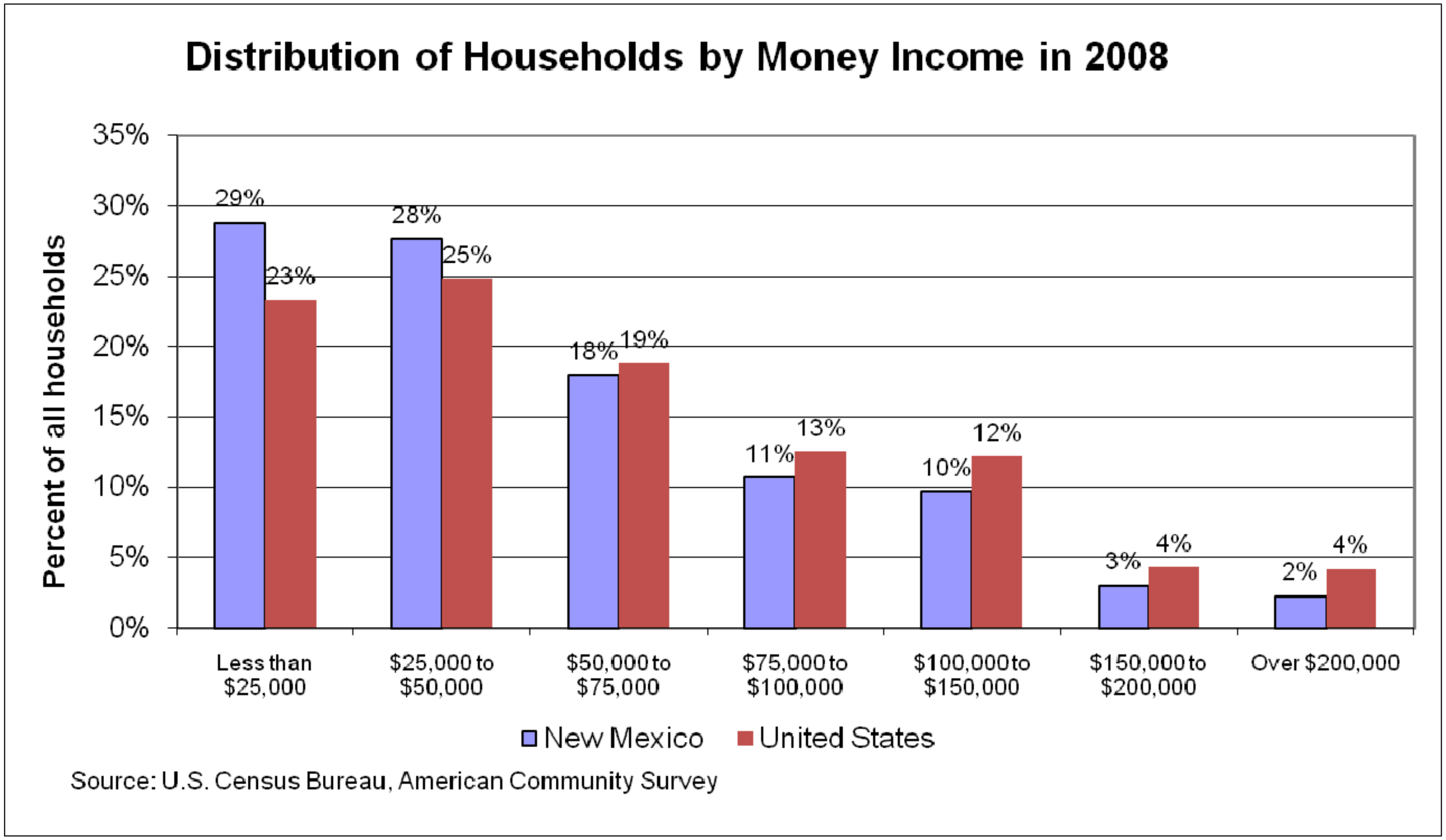
Efficiency: broad base with low rates; minimize distortion; avoid reliance on one tax

Equity: fairness to taxpayers in similar circumstances; fairness to taxpayers with different incomes

Simplicity: encourage compliance and minimize administrative costs

Accountability: tax preferences should be easy to monitor and should be reviewed periodically

Implementing principles requires making trade-offs



- *57% of New Mexico households make less than $50,000/year, vs 48% in the U.S.*
- *15% of NM households make over $100,000, vs 20% U.S.*
- *Money income excludes transfer programs, employee benefits, capital gains*

Estimated NM Tax Burden by Household Income

Albuquerque State & Local Taxes as a Percent of Household Income: 2008					
Household Income:	**$25,000**	**$50,000**	**$75,000**	**$100,000**	**$150,000**
Income Tax	0.0%	1.0%	2.3%	2.9%	3.5%
Property Tax	5.5%	3.7%	2.7%	2.3%	1.8%
Sales Taxes	3.9%	2.7%	2.4%	2.4%	1.9%
Auto Taxes & Fees	0.5%	0.3%	0.3%	0.3%	0.2%
Total	**9.9%**	**7.7%**	**7.7%**	**7.9%**	**7.5%**
Source: Government of the District of Columbia					

- *Annual study using hypothetical household of 3*
- *NM's direct taxes on households are regressive – low-income households pay a higher share of income than high-income households*
- *Property Tax and Sales Taxes are most regressive, Income tax is progressive*
- *Incidence of most taxes imposed on businesses not included*

NM Ranking: Taxes on Households

State & Local Taxes as a Percent of Household Income: 2008

City, State	$25,000	$50,000	$75,000	$100,000	$150,000
Albuquerque, NM	9.9%	7.7%	7.7%	7.9%	7.5%
Billings, MT	7.5%	4.4%	5.6%	6.1%	6.5%
Boise, ID	9.0%	6.2%	7.2%	8.0%	8.4%
Denver, CO	11.3%	6.6%	6.7%	7.3%	6.9%
Houston, TX	9.9%	6.1%	5.6%	5.4%	4.4%
Las Vegas, NV	9.8%	6.5%	5.4%	5.0%	4.0%
Los Angeles, CA	10.7%	10.0%	8.6%	8.5%	8.9%
Oklahoma City, OK	10.9%	7.3%	7.9%	8.2%	7.9%
Phoenix, AZ	11.6%	5.9%	5.8%	6.3%	5.9%
Salt Lake City, UT	11.4%	7.2%	7.7%	8.0%	7.7%
Average	**10.2%**	**6.8%**	**6.8%**	**7.1%**	**6.8%**

Source: Government of the District of Columbia.

- *NM burden on most households above average*
- *NM burden on low-income households below average*
- *NM burden on high-income slightly above average*

PIT Western States Rate Comparison

State	Range of Tax Rates*	Top Bracket Single/Married	Income Tax as % of Personal Income**
Arizona	2.59% to 4.54%	$150,000/$300,000	1.54%
California	1% to 10.3%	$1 million/$1 million	3.07%
Colorado	4.63%	All Income	2.17%
Idaho	1.6% to 7.8%	$25,440/$50,881	2.6%
Montana	1% to 6.9%	$15,600/$15,600	2.56%
New Mexico	**1.7% to 4.9%**	**$16,000/$24,000**	**2.11%**
Oklahoma	0.5% to 5.5%	$8,700/$15,000	2.49%
Utah	2.3% to 6.98%	$5,500/$11,000	2.85%

Sources: *2009 State Tax Handbook, CCH publishing. ** U.S. Census.

- *NM top tax rate is around the midpoint among states in the western region.*
- *Like several other states, NM has a relatively flat tax rate structure.*
- *NM tax as percent of income toward low end of states with income tax.*

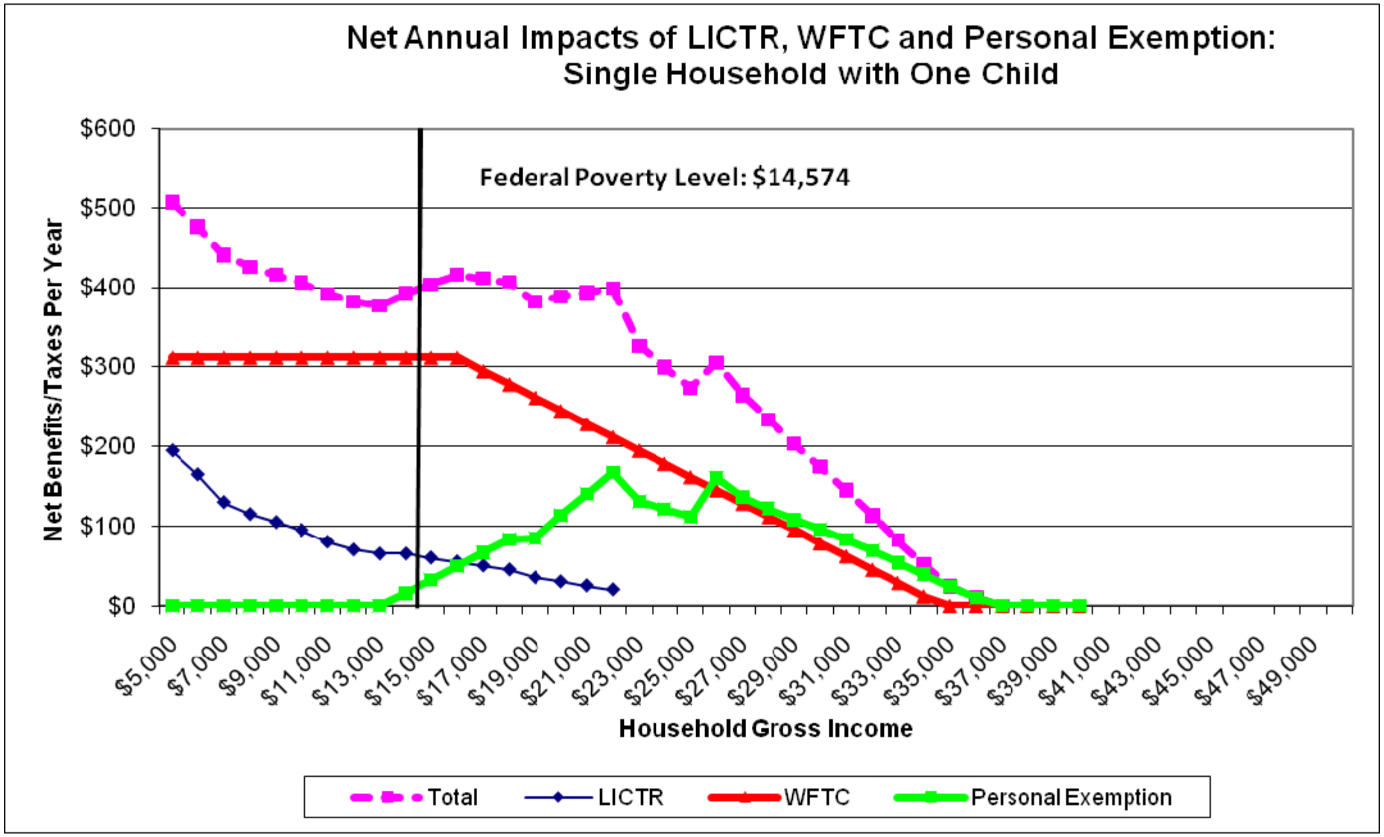
Income Distribution of PIT for New Mexico Residents

Distribution of Income and Tax Liability of New Mexico Residents Tax Year 2007

Gross Income Per Return	Number of Returns	Share of Total Returns	Share of Gross Income	Estimated Share of State Income Tax	Average Gross Income Per Return	Average State Income Tax Per Return*	Average State Tax Percent of Gross Income
Under $50,000	719,183	73%	29%	12%	$17,262	$200	1.2%
$50 to $75,000	112,179	11%	16%	15%	$61,360	$1,587	2.6%
$75 to $100,000	63,897	7%	13%	14%	$86,239	$2,581	3.0%
$100 to $200,000	66,476	7%	21%	26%	$132,075	$4,515	3.4%
$200,000 and up	18,499	2%	22%	33%	$498,138	$20,933	4.2%
All returns	980,234	100%	100%	100%	$43,666	$1,198	2.7%

Source: LFC calculations using I.R.S. Statistics of Income Division data from returns filed with a New Mexico address.
*Excludes approximately 300,000 returns with no liability.

- *PIT is "progressive," i.e. higher income households pay a higher share of income in tax*
- *Table does not reflect refundable rebates and credits for low-income*
- *1/3 is paid by 2% of households (over $200,000);*
- *59% is paid by the 9% earning more than $100,000, these households earn 43% of all income.*



- NM has several tax credits/rebates/exemptions designed to re-distribute income to low-income households
- Benefits apply to households with income well over the poverty level

Analyzing Incidence of State & Local Taxes

- "Incidence" = changes in income or wealth after economy has adjusted to changes caused by a tax.
  - Persons who pay the tax may shift its burden by modifying their behavior: e.g. consumers can switch to the internet to avoid sales and use taxes
- Incidence depends on what alternative is considered, i.e. another tax or a spending cut would have it's own incidence implications
- Economic theory is imprecise in predicting the incidence of most taxes. Empirical evidence is also lacking.
- Annual income may not be the best measure of a taxpayer's ability to pay and may lead to inaccurate perceptions about tax incidence.
  - E.g. sales tax on lifetime income/consumption is less regressive

What Role Should State & Local Governments Play in Income Redistribution?

- Economic theory predicts that policies to re-distribute income may reduce incentives to work, save and invest, thus reducing economic growth, thus there is a trade-off between equity and efficiency

- Mobility across state lines means that a state practicing highly re-distributive policies runs the risk that higher-income households that do not favor re-distribution will leave, while lower-income households will be attracted, the result being a higher burden on the higher-income households that stay

- Re-distribution may be best applied at the federal level to avoid these population pressures.

Incidence of State Government Spending

- Household benefits from state spending vary with household composition
- Families with children benefit from spending on public education and also potentially from spending on higher education
- Low-income households benefit from Medicaid spending and refundable tax credits
- Potential benefits are as much as 100% of family income for low-income households with children
- When spending and taxes are combined, state government creates a large re-distribution of income to low-income families with children