

NM City Management Association

Tax System Design 101

James O'Neill

TSD 101

- What this discussion is about—
 - How to design a tax system
 - Principles
 - Pit Falls
- What it is not about—
 - Telling you what a revised NM tax system should look like.

TSD 101, Background

- NM's existing tax system actually was designed.
 - 1930's:
 - 20-mill limit on property tax in exchange for emergency school tax & oil and gas emergency school tax.
 - Almost all businesses subject to emergency school tax, including services like medical and legal.
 - 1960's:
 - Emergency school tax restructured as gross receipts tax
 - Tax on vendor, to reach federal dollars
 - Uniform rate on all products
 - Municipal rates absorbed into state rate, with distribution; two small county authorizations continued

TSD 101, Background

- No local option rates apply to compensating tax
- State & local taxes administered by state
- Personal and corporate income taxes modernized, based on federal taxable income
- Tax Administration Act – uniform admin rules across taxes
- Property tax
 - 20-mill cap on operating rates (1933)
 - Reformed administrative law: Property Tax Code (1973/74), includes sale of delinquent property by state instead of counties
 - Attack on “tax lightning” – limit on annual increase in residential valuation (1998) by CA

TSD 101, First things first

- Principles of Taxation
 - Adequacy
 - Efficiency
 - Equity
 - Administrability
- Evaluate system, not individual taxes

TSD 101, First things first

- Adequacy: Does it raise enough money?
 - Taxes exist to provide \$\$ for programs.
 - Problem: Not everyone benefits (equally) from every program.
 - So, adequacy actually measures the govt's agenda—on which opinions differ greatly.

TSD 101, First things first

- Efficiency: more technical than the other terms
 - (1) minimum use of resources to achieve end or most results from given amount of resources.
 - (2) method of taxing that interferes least with workings of the economy.
 - Taxes remove resources from private economy (but govt spending puts \$\$ back into the economy)
 - Taxes (& govt spending) affect prices.

TSD 101, First things first

- Equity: is it fair?
 - Horizontal: Are people in similar circumstances treated similarly?
 - Vertical: How does the tax burden (%) on those with higher incomes compare with that with lower incomes?
 - Intergenerational (“life cycle”): How are people of different ages treated?
 - In govt & politics, “fair” tends to mean “equal”.

TSD 101, First things first

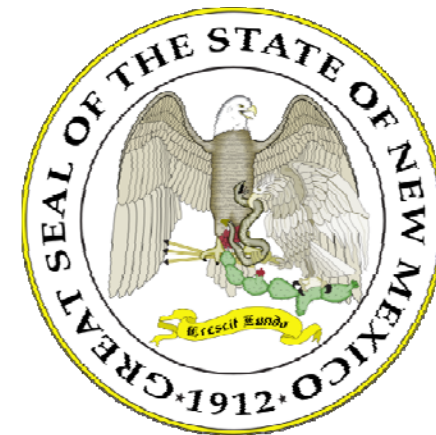
- Administrability
 - Can the taxpayer readily understand and comply with tax rules, procedures? Should minimize resources and time needed for compliance.
 - Can the tax administrator collect and process tax revenues in timely, inexpensive manner?

TSD 101, First things first

- The principles conflict
 - Example 1: efforts to fine-tune equity often create complexity in the tax code, reducing administrability and (often) adequacy
 - Federal income tax
 - NM GRT on medical services, devices and products
 - Example 2: NM GRT taxation of intermediate goods & services raises revenues but imposes additional efficiency costs on private economy.

TSD 101, First things first

- Constraints
 - Federal constitution
 - Federal law
 - New Mexico constitution



TSD 101, First things first

- Federal constitution:
 - Art 1, §8: Regulation of foreign, interstate & Indian commerce [includes “dormant” clause]
 - Art 1, §10: No impairment of contract; No import or export duties
 - Art 4, §2: Supremacy clause
 - Amds 5 & 14: Due process, equal protection
 - Amd 24: No poll tax

TSD 101, First things first

- Federal law (examples)
 - Exempts federally-chartered credit unions from all but property tax, Job Corps contractor receipts from operating Job Corps center/program & local (but not state) taxation of direct satellite service
 - Bars most state taxation of interstate railroad, bus and truck transportation

TSD 101, First things first

- New Mexico constitution
 - Art 8, §1:
 - “taxes levied upon tangible property shall be in proportion to the value thereof, and taxes shall be equal and uniform upon subjects of taxation of the same class”
 - Limit on annual increase in valuation of residential property
 - Art 8, §2: Limits on property tax rates
 - Art 8, §8: Personal property moving in interstate commerce exempt from property tax

TSD 101, The tax world

- Types of taxes
 - Income taxes
 - Excise taxes
 - Property taxes
- Traditional wisdom: tax system should be a balance of all 3 types.



TSD 101, The tax world

- Income taxes
 - Personal
 - Easiest to shape
 - Can rely in part on federal enforcement
 - Estate/trust
 - Corporate
 - Theoretical justification iffy
 - More limited ability to rely on federal structure, enforcement

TSD 101, The tax world

- Income taxes (continued)
 - Pass-through entities (LLCs, partnerships, joint ventures, etc.)
 - Entity level
 - Owner level

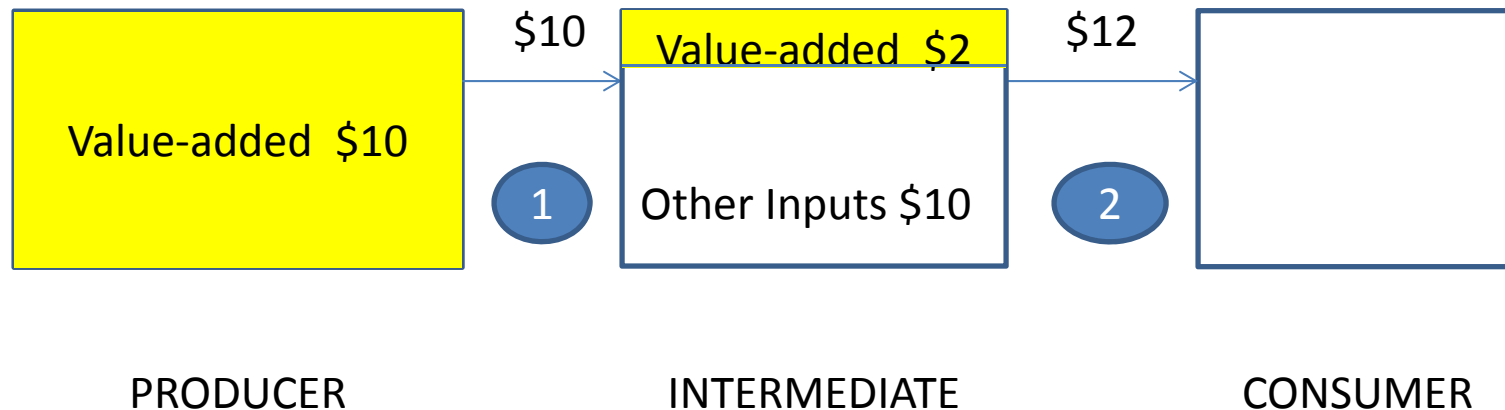
TSD 101, The tax world

- General excise taxes
 - (True) gross receipts or “turnover” taxes
 - Sales (consumption) taxes
 - Value-added taxes

 - Origin vs destination

TSD 101, The tax world

Illustration



Assume 5% tax rate

Gross receipts: (1) $\$10 \times 5\%$ + (2) $\$12 \times 5\%$ = \$1.10 tax

Sales: (2) $\$12 \times 5\%$ = \$0.60 tax

Value added: (1) $\$10 \times 5\%$ + (2) $\$2 \times 5\%$ = \$0.60 tax

TSD 101, The tax world

- Special excise taxes
 - Fuels
 - Alcohol
 - Tobacco
 - Minerals
 - Motor vehicles
 - Gambling
 - Telecommunications
 - Water
 - Sugar?



TSD 101, Getting to it

“Don’t tax you; don’t tax me.
Tax the fellow behind the
tree.”



TSD 101, Getting to it

- First decision: What is the goal?
 - Increase revenue
 - Spread burden more equitably
 - Cut costs of collection, evasion
 - Greater local control
 - Something else?

TSD 101, Getting to it

- Tax reform not a game; design affects people's lives & livelihoods
 - Especially true when changing an existing system
 - Winners and losers created; may have to consider how to compensate losers

TSD 101, Getting to it

- Can't tax what you don't have; federal rules on interstate commerce ensure this.
- So what do you have? Need understanding of jurisdiction's economy and resources.
 - Note: This is where economic development comes in. What features can be built into the tax system that will help push the economy into desired shape?
- Good data critical

TSD 101, Getting to it

- Neither people or economy are static. Try to anticipate how state and federal economies are changing and build in adaptability to expected trends
 - Example: NM's general taxation of services in the 1930s.

TSD 101, Getting to it

- Flexibility: put in law instead of constitutional or charter provision
 - Example: NM's constitution is almost silent on taxation other than property taxes. Property tax is tightly bound with constitutional fences on valuation, tax rates and even assessment practices. Bad – very difficult to adapt Good – steady revenues from one year to next
- Some battles are not worth fighting

Illustration: Sharer-Taylor (2015 version – SB346)

- Income taxes:
 - Flat 2.5% on income exceeding (high) thresholds (\$283,950 for MFJ, \$189,300 for single)
 - Excludes bond interest from AGI and gifts from MGI
 - Exempts donations to 501(c)(3) organizations
 - Repeals corporate income tax
 - Repeals estate tax
- Special excise taxes
 - Repeals MVET, Leased vehicle GRT, boat tax

Illustration: Sharer-Taylor (2015 version – SB346)

- General excise taxes
 - Repeals compensating tax
 - Sets state GR and GovtGR tax rates at 1%
 - Repeals slew of GR exemptions and deductions (receipts of some charitables still exempt)
 - Includes WAGES and some investment income in “gross receipts”
 - Provides a tax credit for low income people

Illustration: Sharer-Taylor (2015 version – SB346)

- General excise taxes (continued)
 - Local Option taxes
 - Repeals Supplemental municipal, Local hospital, County correctional facility GRTs
 - Cap of 0.5% on total municipal GRT rates and 0.5% on county GRT rates
 - Repeals Special county hospital gasoline tax
 - Kills permission for TIDDs to bond GRT increments

Illustration: Sharer-Taylor (2015 version – SB346)

- Distributions
 - Makes State GRT the funding source for small cities and small counties asst funds but ends 2 “additional” distributions from small counties
 - Repeals part of GRT distribution to state aviation fund

Illustration: Sharer-Taylor (2015 version – SB346)

- Credits/Tax credits repealed:
 - Income: Venture Capital Tax Credit Act, Rural jobs TC, Film production TC
 - GR: Investment credit, Laboratory partnership with small business TC, Technology jobs and research and development TC, high-wage jobs TC, Advanced energy combined reporting TC, Affordable housing TC, Alternative energy products manufacturers TC

Questions?

Fight the good fight!

