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# Leadership Tax Plan Hits Poor Hardest

## Poorest Families Would See Tax Hikes Eight Times Bigger Than Those Facing Wealthiest Taxpayers

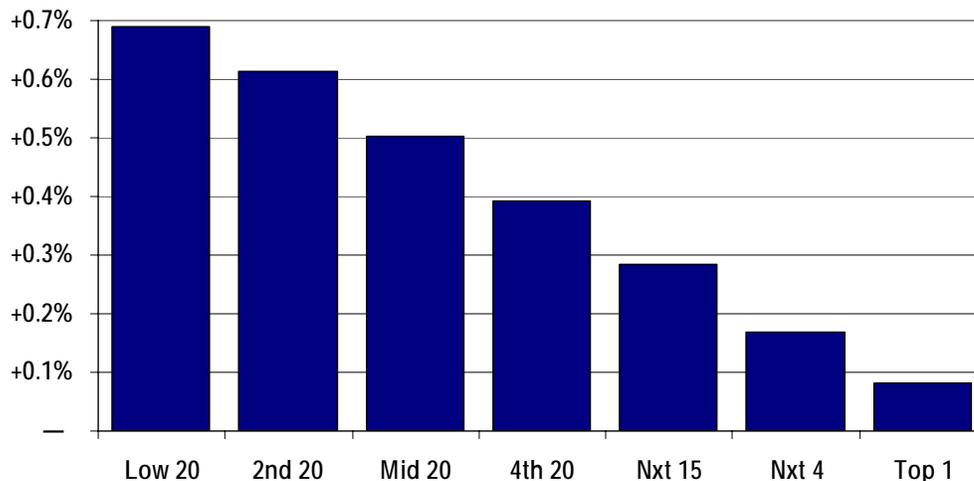
Media outlets are reporting that leaders in the New Mexico legislature reached a tentative agreement in the days leading up to this week’s special legislative session that would impose over \$220 million a year in new Gross Receipts Taxes (GRT) and cigarette taxes. Reports also indicate that the agreement does not include any provisions to increase the personal income tax, but does include a small expansion of a low-income tax credit to help offset the regressive impact of this agreement. This ITEP analysis shows that even with the proposed expansion to this credit, the agreed-upon tax changes would fall much more heavily on low- and middle-income families than on the best-off New Mexicans. The analysis also shows how substituting income tax increases for the proposed GRT changes could allow the state to raise additional revenues while reducing the tax increase on most families.

### Measuring the Impact of the Leadership Plan

As the chart on this page shows, low-and middle-income families would see by far the biggest tax hikes under the leadership’s plan:

- The best-off 1 percent of New Mexicans would see a tax increase averaging just under 0.1 percent of their incomes in 2011 under these proposals.
- Middle-income families would see a tax hike averaging 0.5 percent of their incomes—about 6 times bigger than the tax hike on the best-off families.
- The very poorest taxpayers would see a tax increase averaging 0.7 percent of their incomes—more than 8 times the tax hike on the wealthiest 1 percent of taxpayers.

Impact of Reported Budget Agreement:  
Tax Change as % of Income, All New Mexicans in 2011



## Leadership Plan Would Make An Unfair Tax System Even Worse

The unfairness of the agreed-upon plan is especially disturbing because it would further exacerbate the unfairness of the current tax system. The New Mexico tax system imposes much higher taxes on low- and middle-income families than on the best-off taxpayers.<sup>1</sup> The poorest families pay an average of 10.8 percent of their income in New Mexico taxes, more than twice as high as the 5.2 percent that the best-off 1 percent of New Mexicans must pay.

## Income Tax Reforms Would Reduce Additional Tax Bite for Most Groups

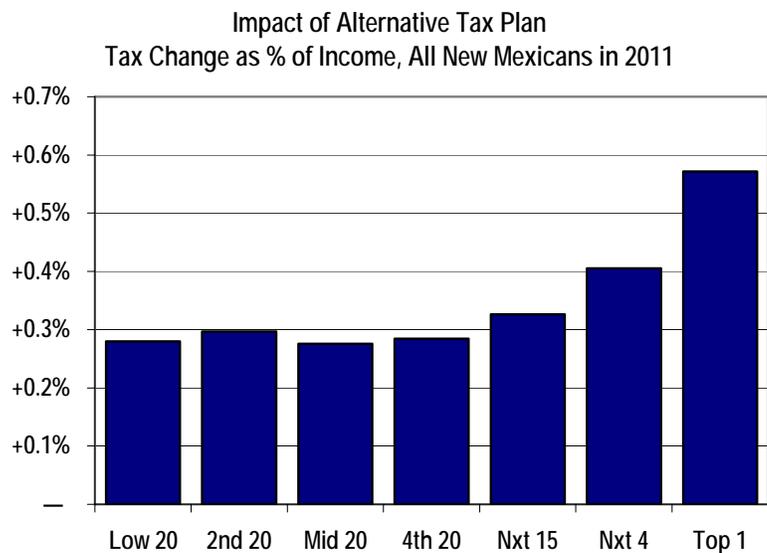
New Mexico lawmakers seeking to offset the unfairness of GRT increases with income tax reforms have a variety of sensible options.

- **Repeal capital gains tax breaks.** New Mexico is one of a handful of states that allow a deduction for 50 percent of capital gains. Virtually all of the benefits from this tax break go to the best-off New Mexicans.
- **Repeal income tax rate reductions.** Legislation enacted in 2003 gradually reduced the top income tax rate from 8.2 to 4.9 percent. The lion's share of the benefits from these tax cuts go to upper-income families.
- **Repeal itemized deductions for state taxes.** Itemized deductions are upside-down tax subsidies, offering the biggest tax breaks to the best-off taxpayers. And New Mexico is one of only a handful of states that bizarrely offer a state income tax deduction for its own income tax. Repealing the itemized deduction for state and local taxes would enhance the fairness of New Mexico's tax system without imposing higher tax rates.

The following chart shows the impact of modifying the leadership plan to repeal itemized deductions for state taxes and repeal the capital gains tax break, and using the added revenues to eliminate the grocery tax provision and some of the proposed GRT rate hike.

Notable features of this alternative approach include:

- ✓ The plan would raise the same amount of revenue as the leadership plan, but would impose smaller tax hikes on the poorest 80 percent of the state's income distribution;
- ✓ The plan would reduce federal taxes paid by New Mexicans by about \$25 million, because state income taxes can be deducted by federal itemizers.
- ✓ The plan would make New Mexico's tax system somewhat less unfair—although it would remain regressive overall.



<sup>1</sup> Institute on Taxation and Economic Policy. "Who Pays: A Distributional Analysis of the Tax Systems in All 50 States." November 18, 2009.

## Conclusion

More so than most other states, New Mexico relies primarily on its poorest residents to pay for needed public investments. The very best-off New Mexicans pay effective tax rates that are less than half what the very poorest families must pay. This upside-down tax system is primarily due to New Mexico's heavy reliance on regressive sales taxes, and its below-average reliance on the progressive personal income tax. If New Mexico lawmakers choose to enact a special-session revenue-raising package that focuses on increasing the state's Gross Receipts Tax and cigarette tax, while excluding revenue-raising income tax reforms, the net impact will be to make an already-unfair tax system substantially more so.

Fortunately, state policymakers have a variety of sensible tax reform options to choose from that can help to solve the state's budget dilemma while imposing smaller tax increases on the vast majority of New Mexicans. This can be done by expanding the tax base—as outlined in the “alternative plan” described above—or by imposing a high-income surtax of the sort approved by the state House earlier this year.

## Appendix: Impact of Shifting from Leadership Plan to Alternative Plan

