New Mexico's Harmful Gross Receipts Tax: A Warning to Other States

Rio Grande Foundation Policy Brief

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Executive Summary

New Mexico is an unfortunate trendsetter. Although as a state we are often overlooked (some geographically-ignorant people have been known to lump us in with Old Mexico), when it comes to broad-based taxation and the taxing of services, The Land of Enchantment is quickly becoming a rather dubious model for other states. Some states like Ohio and Texas have recently enacted such taxes at relatively low rates (effectively less than one-half of one percent), but New Mexico has had a broad-based taxation mechanism for more than 40 years.[1]

Unfortunately, over the years, New Mexico's gross receipts tax (GRT) has evolved so as to become even more economically-burdensome, especially for small businesses. For that reason, the tax itself is now at a crossroads. Changes either need to be made to restore the GRT to what it was intended to be – a low-rate, broad-based, and equitable tax – or it needs to be altered to make it more like the sales tax regimes administered by most other states.

As we will show in this paper, New Mexico's experience with broad-based taxation has created an economically stifling burden relative to other states. New Mexico's GRT woes should be useful in illustrating the difficult decisions other states will face over time if and when they adopt broad-based transaction taxes.

New Mexico, Hawaii and South Dakota are the only states to have implemented similarly broad-based taxes, at rates that are comparable to sales taxes of other states. While Hawaii's rate is a relatively low 4.5 percent and South Dakota, which doesn't have an income tax, applies its GRT at 6 percent, GRT rates in most cities in New Mexico are above six percent with a highest rate of just under 7.9 percent.[2] But those similarities do not mean that New Mexico's GRT is similar to the sales tax regimes found in other states. As the New Mexico Taxation and Revenue Department explains:

> The gross receipts tax, very different from a sales tax, is a tax on the privilege of doing business in this state. It applies to the total amount of money or other considerations (barter, for instance) that a business receives for its transactions here in New Mexico. The

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[1] Carl Twibell, New Mexico Taxation and Revenue Department, telephone conversation, January 18, 2007.

[2] New Mexico Taxation and Revenue Department, "Gross Receipts Tax Schedule: 2007," http://www.tax.state.nm.us/pubs/gr_rates_jan_07.pdf.

> taxable amount is the gross amount – not net after business expenses – and the tax liability belongs to the business instead of the customer. The gross taxable amount includes all reimbursed expenses billed to the customer: meals, travel, hotels, shipping, handling, postage, etc.[3]

In short, New Mexico's GRT differs dramatically from a sales tax because practically all goods and *services* are taxed. The only relief from application of the tax to business-to-business transactions is that the cost of raw materials going into the production of goods is deducted from gross receipts before applying the tax. Services get no such relief.

This paper will discuss the problems associated with gross receipts taxes. It will also analyze the negative economic impact of levying a gross receipts tax in combination with an income tax as is done in New Mexico.

Necessity for Study

The need for analysis of taxation of services and broad-based gross receipts taxes is readily-apparent. As mentioned previously, Texas and Ohio have adopted gross receipts taxes within the past two years – Ohio's GRT is in addition to its income and sales tax revenue streams while Texas does not levy a personal income tax. In 2004 as states continued to react to weak economic growth in 2002 and 2003, 17 states considered proposals to expand their tax bases by taxing services.[4] As the economy cools and revenue growth slows, this trend will likely be renewed.

The service economy is growing rapidly. In the eyes of state revenue agents, the limited scope of the sales tax has allowed the service sector to escape taxation in too many instances. The idea behind replacing a sales tax with a gross receipts tax can be economically sound. "Broadening the base" is widely seen by economists as both fair and efficient as long as low tax rates are maintained.[5] Alternatively, it may be advantageous to broaden the base of transaction taxes in the event that taxes on income are reduced significantly or eliminated.

Problems Inherent in Broadening the Tax Base

There are several problems with adopting such broad-based taxes. One simple economic problem is New Mexico's lack of business competitiveness. Fred O'Cheskey, a former commissioner of revenue for the New Mexico Taxation and Revenue Department., called this lack of competitiveness "the biggest problem with the GRT." He went on to say that, "When local R&D firms charge for New Mexico's GRT, they are often outbid by out-of-state firms that don't tack on a gross receipts tax."[6]

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[3] New Mexico Taxation and Revenue Department, "What is the Gross Receipts Tax?" July 2006, http://www.state.nm.us/tax/pubs/WhatIsGrossReceipts98.pdf.
[4] *Ibid.*
[5] President's Advisory Panel on Federal Tax Reform, "America Needs a Better Tax System," April 13, 2005, http://www.taxreformpanel.gov/04132005.pdf.
[6] Susan Gaines, "New Mexico: Where the Livin' is Easy?" *New Mexico Business Journal,* November 1990, http://findarticles.com/p/articles/mi_m5092/is_n11_v14/ai_9225456.

The second major economic problem with New Mexico's GRT is "tax pyramiding." Simply put, tax pyramiding is the taxation of an individual economic activity multiple times. An illustration of the impact of pyramiding on a small business appears later in this paper, but suffice it to say that pyramiding dramatically increases the already high tax burden in New Mexico.

While the economic problems are very real, the political incentives created by New Mexico's GRT likely cause the tax's most serious repercussions. The fact is that broadening consumption taxes beyond the final point of sale of real goods creates a lack of transparency. In other words, it is hard to tell who is paying how much. This lack of transparency has led to economically-dubious special-interest carve-outs and political favoritism that hinders New Mexico's economic development.

For example, in addition to allowing businesses to deduct the costs of employee wages and most manufacturing inputs (both of which are logical and economically-necessary), New Mexico offers deductions specifically for the benefit of film production companies, the state's nascent "private" – albeit heavily subsidized – space industry, and for receipts of an aircraft manufacturer from selling aircraft.[7]

Each of these exemptions is designed for the express benefit of one or another special interest within the state of New Mexico. The film industry has been a darling of Governor Richardson from his first day in office, and it receives an array of extremely generous benefits.[8] The state also lured Eclipse, a private jet manufacturer, to New Mexico, in part, with gross receipts tax exemptions on the sale of aircraft.[9]

Yet another violation of the concept of broad and flat is the elimination of the tax on groceries – but not on food purchased in restaurants – that was adopted in 2004 and took effect at the start of 2005. A perfect example of the conflict between a broad tax with low rates and a narrower tax with high rates, the tax on groceries was eliminated, but taxes on all other taxable items was increased[10] by 0.5 percent.[11] These are just a few of the literally hundreds of permutations that make the tax so opaque and confusing to average citizens, while driving tax rates upward.

High Rates and Pyramiding Hinder Growth

While government officials and many civic boosters trumpet the job creation provided by targeted breaks, what they are missing are the unseen aspects of their policies. This ability to

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[7] New Mexico Taxation and Revenue Department, "FYI-105: Gross Receipts and Compensating Taxes: an Overview." July 2006, http://www.state.nm.us/tax/pubs/fyi-105.pdf.
[8] New Mexico Film Office, "Filming Incentives," http://www.nmfilm.com/filming/incentives/.
[9] New Mexico Economic Development Department, "Aerospace Repair and Manufacturing Facility to Locate in Rio Rancho," December 23, 2004, http://ww1.edd.state.nm.us/index.php?/news/entry/aerospace_repair_and_manufacturing_facility_to_locate_in_rio_rancho/.
[10] Eliminating the tax on groceries actually hurt the poor when the tax rate on other goods and services increased by one-half of one percent.
[11] New Mexico Department of Taxation and Revenue, "Frequently Asked Questions About the New Mexico 'Food Tax' Deduction," January 1, 2005, http://www.state.nm.us/tax/faqfood.doc.

perceive the unseen is what Frédéric Bastiat called "the only thing that separates a good economist from a bad one."[12] New Mexico's gross receipts tax has led the state to rely on politically-driven tax breaks in order to spur "economic development." Government officials are notoriously bad at allocating resources in order to attract economic growth and this is a big reason for New Mexico's historically poor political performance.

We begin our explanation with some basic tax principles. Taxes form a wedge between buyer and seller. The seller gets less than the buyer pays by the magnitude of the tax wedge. The wedge modifies behavior on both sides of the transaction. The burden of the tax is on both the buyer and the seller with the share of the burden determined by how each responds to the tax (economists describe these responses by "demand" and "supply"). Since New Mexico's individual income and gross receipts taxes are broad based, the overall share of the burden between buyer and seller is roughly 50-50. This is an important point in the economics of public finance, and it is missed in most discussions of how taxes affect behavior.[13]

The tax wedge is important to note because New Mexico's gross receipts tax is erroneously said to be "passed to the buyer" since it is calculated and added to the purchase price for the vast majority of transactions in the state. We discuss below the effects of the tax wedge from the perspective of the seller-entrepreneur by calculating her effective tax rate on income. New Mexico's gross receipts tax has five major negative effects:

1. GRT increases have raised the effective income tax rate for most entrepreneurs in spite of the statutory reductions in personal income tax rates;
2. It violates the principle of horizontal equity which holds that firms in similar financial condition are treated equally for taxes. Firms that have high percentage of costs relative to receipts face a higher tax burden than firms with lower percentage of costs;
3. Tax pyramiding (when businesses pay gross receipts tax in the sale of factors of production to other businesses) exacerbates the negative effect of the GRT;
4. High effective tax rates on income lead to wasteful favor-seeking on the part of well organized interest groups so as to exempt themselves from the GRT;
5. Resources are shifted away from their most effective use and into less effective areas. The exemption given to managed care health organizations, but not fee for service transactions is an ideal example of this. Another example is the tendency of firms to organize vertically in New Mexico so as to avoid the GRT, even if that is not the most economically-efficient model.

It is mostly meaningless to assess each tax (GRT, individual income tax) *in isolation*. We must recognize that Federal and state taxes are inextricably intertwined. Once we do so we can calculate effective tax rates on entrepreneurial activity with precision. And it is *effective tax rates* that modify behavior.

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[12] Frédéric Bastiat, "Selected Essays on Political Economy," The Foundation for Economic Education, 1995, http://www.econlib.org/LIBRARY/Bastiat/BasEss1.html.

[13] A leading textbook in public finance describes how taxes affect behavior on both sides of the transaction: See Browning, Edgar K. and Jacquelene M. Browning, *Public Finance and the Price System*, Macmillan, 4th edition, 1994, pp. 309-318.

In particular, we calculate the effective rate of tax on individual income for an entrepreneur who is selling a service by assessing the interdependence of New Mexico's *gross receipts tax*, its *individual income tax* and the *federal income tax (including Social Security and Medicare when they are applicable)*. We initially assume that our entrepreneur is a sole proprietor.[14]

We begin with New Mexico's GRT on services. When an entrepreneur sells her service, she has to pay tax on the *entire amount received* even though a sizable portion of her receipts may be necessary to cover her costs. The more costs she has relative to her receipts, the more burdensome the GRT. High overhead service providers, such as doctors, have been particularly hard hit by this tax in New Mexico.[15] GRT rates have increased substantially since 2003, going up by a little more than one percentage point in Albuquerque.

Next consider New Mexico's individual income tax. Its specific rate has been reduced from 8.2 percent to 5.3 percent since 2003.[16] It is deductible on both the state and federal individual income tax returns.

Her federal income tax liability depends on her overall receipts less state income tax payments, gross receipts tax payments, business expenses and exemptions and other personal deductions. The taxpayer's Social Security and Medicare "contributions" do not benefit from the state income tax deduction; but (thankfully) they are not applied until after gross receipts tax payment is subtracted as an expense.

The following is an example of the bottom line for a taxpayer-entrepreneur who itemizes her deductions: Say that her taxable income is 50 percent of the price she charges for her product (this is an assumption about the cost conditions of her firm – she pays various inputs to production that take half of her receipts and she gets the other half). Give our entrepreneur a somewhat modest income: she is in the 25 percent federal tax bracket, 5.3 percent New Mexico tax bracket, and makes "contributions" to social security and Medicare at the rate of 15.3 percent. Assume that the product she sells is priced at $100 per unit and that she is considering increasing her effort so as to sell an additional 100 units. The GRT rate applied in Albuquerque is 6.875%.

Suppose she sells the additional 100 units, adding the GRT tax to the price at the time of sale (GRT=6.875% times $100 times 100 units = $687.50). Her total revenue is $10,687.50 and her revenue net of the GRT is $10,000. Since (by assumption) her income is 50% of the price and she sold 100 units, her costs are $5,000. That leaves her with $5,000 of income subject to the state income tax, federal income tax and social security/Medicare tax.

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[14] Other forms of business organization may result in lower effective tax rates. But the differential effect of the GRT will not be affected; and it is how the GRT increases the tax burden in New Mexico vis a vis other states that is our main concern.

[15] A harmful and unfair law was passed and signed in 2004. For details see the Rio Grande Foundation paper: "Treat Sick Tax Policy: First, Undo the Harm from 2004 Legislature" of January 9, 2005, http://www.riograndefoundation.org/new/articles/?EC=ReadArticle&ArticleID=36.

[16] These top rates kick in at low levels of income, so they can be thought of as a flat tax in each case.

Her additional SS/Medicare tax is $765 (15.3% of $5,000). Her additional state income tax is $251.66 (5.033%[17] times $5,000). Her additional federal income tax is $1,187.08 (25% times the quantity $5,000 less the state income tax of $251.66).

Summarizing, we see that she has paid taxes from all sources in the amount of $2,891.25 (GRT $687.50, SS/Medicare $765.00, state income tax $251.66, and federal income tax $1187.08). In that case ***her overall effective rate of tax on income is 57.8 percent[18]***!

Table 1 documents the effective income tax rates for a sole proprietor in the 25% federal tax bracket and the 5.3% state tax bracket for varying taxable incomes as a percent of total receipts:

Table 1

Changes in Effective Tax Rates on Entrepreneur's Income in Albuquerque

Income as percent of gross receipts\year	2007 Effective Tax Rate on Income Net of Costs	2003 Effective Tax Rate on Income Net of Costs	**Change in Effective Income Tax Rate**
20%	78.5%	75.0%	3.4%
30%	67.0%	65.4%	1.6%
40%	61.3%	60.5%	0.8%
50%	57.8%	57.6%	0.2%
60%	55.5%	55.7%	-0.1%
70%	53.9%	54.3%	-0.4%
80%	52.7%	53.3%	-0.6%

Notice that direct effective rates have gone up for entrepreneurs whose percentage of income to total receipts is low (overhead is high relative to income net of overhead). For them effective tax rates have gone up, not down. For lower overhead entrepreneurs effective tax rates have gone down slightly (see "change in effective income tax rate" in the table).

Notice also the principle of horizontal equity is violated. Horizontal equity means that businesses with the same income should be treated equally by the taxing authority. But entrepreneurs with high overhead costs relative to their income (e.g. 20% or 30% income to gross receipts) have much higher effective tax rates than do low overhead firms. For example, a consultant operating out of a home business may have relatively few expenses. She needs office and computer equipment and supplies. But in her case income net of those costs are likely to be in the range of 80 percent or so.

[17] Since the state income tax paid is deductible on the state tax return it has the effect of slightly lowering the statutory rate of 5.3%.

[18] The algebra used to calculate the effective tax is easy but tedious. The Foundation has a spreadsheet available to calculate effective rates of tax on income. The user enters taxable income as a percent of total receipts, federal tax bracket, state tax bracket and local gross receipts tax rate. If you would like a copy of the spreadsheet, just ask.

In other words, for every 100 dollars of sales only 20 dollars go to maintain her office, equipment and supplies. A fee-for-service doctor's office, on the other hand, is more likely to be relatively expensive to maintain. It needs high tech equipment, receptionist, nurse and so forth. The doctor is likely to receive income net of those costs that are likely to be in the range of 80 percent or so. In other words, for every 100 dollars of sales 80 dollars are needed to run the office. Notice how differently the consultant and the doctor are treated for tax purposes when their incomes are the same: The consultant pays 52.7 percent of her additional income in taxes while the doctor pays 78.5 percent of her additional income in taxes.

Since the effective rate of tax on each dollar earned rises dramatically under a GRT regime, the adverse effects of "pyramiding" for New Mexico are particularly harmful to the economy. This can be seen by way of example for the tax wedge facing a firm (known as the "downstream firm") using the following assumptions. Assume that the first upstream firm provides an input (say steel) to production that is 33 percent of the downstream firm's costs. Assume that the 1st upstream firm also purchases an input from the second upstream firm and that the 1st upstream firm also pays 33 percent of its costs to the 2nd upstream firm. Our final assumption is that each of the upstream firms has income that is 50% of its costs (each upstream firm's effective tax rate in income is 57.825% from table 1 above). The series of business-to-business transactions (all subject to the gross receipts tax) is illustrated in the following diagram:

The Downstream Firm	First Upstream Firm	Second Upstream Firm
Purchases an Input to Production from First Upstream Firm	Purchases an Input to Production from Second Upstream Firm and Sells an Input to Production to the Downstream Firm	Sells an Input to Production to First Upstream Firm

For example, consider an accounting firm as the downstream firm. It purchases legal services from the 1st upstream firm. The law office then purchases its accounting services from the 2nd upstream firm (which may or may not be the same firm as the downstream firm). Of course this example is not limited to legal services. Cleaning, repairs of all kinds and dozens of other services also suffer from this effect.

Table 2: The Impact of Tax Pyramiding, Downstream Firm

Income as percent of gross Receipts/year	**Extra Burden from Pyramiding**
20%	7.9%
30%	5.2%
40%	4.5%
50%	3.7%
60%	3.0%
70%	2.3%
80%	1.5%

We have been assuming so far that our service producing firm is organized as a sole proprietor. If instead the firm was to organize so that income is taken as accounting profit (so as to avoid the SS/Medicare tax), then the tax burden would be reduced by 15.3% in each of the "effective tax rate on income net of costs" columns in table 1. But the "change in effective income tax rate" would be unaffected.

Obviously entrepreneurs would be helped substantially if GRT rates were reduced. Table 3 displays how effective rates of tax would be reduced as the GRT rate is reduced.

Table 3: Effective Income Tax Rates in the Absence of Pyramiding Effects

Income as percent of gross receipts\year	**Reduction** in Effective Tax on Income if GRT Rate Reduced by One Percent	**Reduction** in Effective Tax on Income if GRT Rate Reduced by Two Percent	**Reduction** in Effective Tax on Income if GRT Rate Reduced by Three Percent	**Reduction** in Effective Tax on Income if GRT Rate Reduced by Four Percent
20%	5.0%	10.0%	15.0%	20.0%
30%	3.3%	6.7%	10.0%	13.3%
40%	2.5%	5.0%	7.5%	10.0%
50%	2.0%	4.0%	6.0%	8.0%
60%	1.7%	3.3%	5.0%	6.7%
70%	1.4%	2.9%	4.3%	5.7%
80%	1.3%	2.5%	3.8%	5.0%

Some politically influential industries have successfully lobbied politicians to exempt themselves from the gross receipts tax. Unfortunately, this seeking of political favors is a wasteful activity, since it produces nothing of value. Economists call the wasteful activity "rent seeking." Economic rents are sought by firms as are profits. But the difference is that profits are obtained by innovation that creates value. Rents are obtained by lobbying activity; and the activity is wasteful because the resources used in lobbying could be reemployed to create something of value.

Some favor-seeking is successful and some of it is not. But it is all wasteful. An example of this behavior was the successful effort by managed care firms to gain an exemption from the gross receipts tax while the gross receipts tax for fee-for-service firms actually went up. Observe the difference in their treatment in table 4:

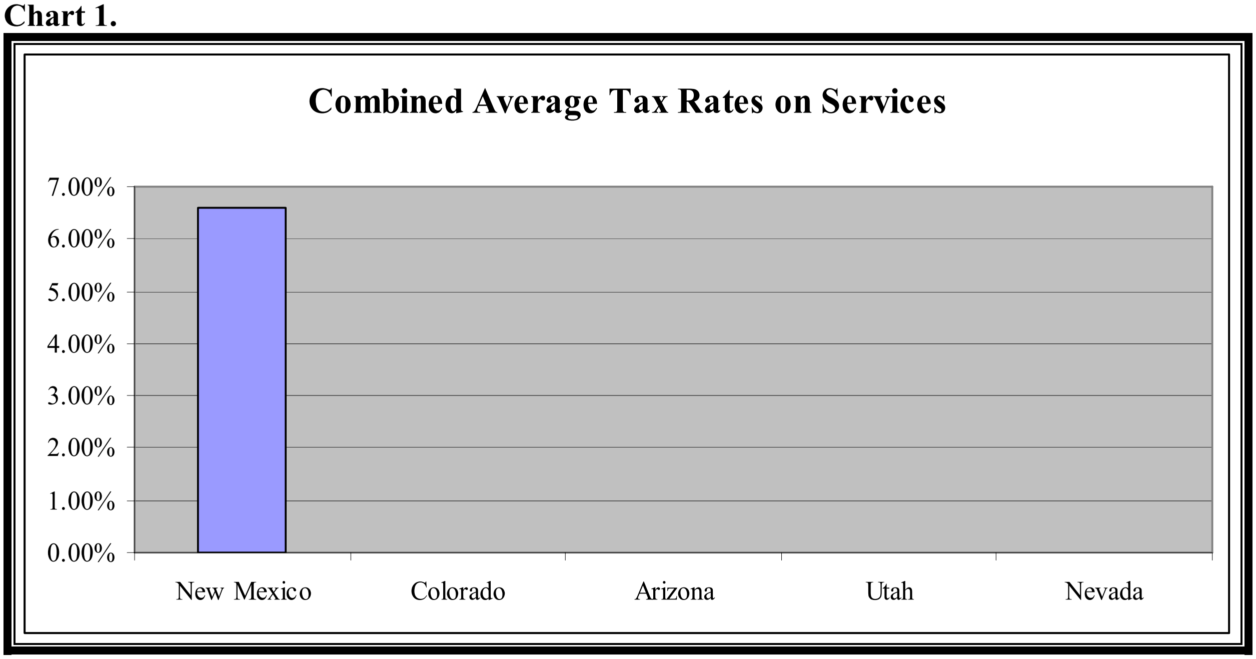
Table 4: **Effective Rate of Tax on Income for Two Types of Health Care Firms**

Income as percent of gross receipts/year	**NM Managed Care**	**NM Fee for Service Care**
20%	44.1%	78.5%
30%	44.1%	67.0%
40%	44.1%	61.3%
50%	44.1%	57.8%
60%	44.1%	55.5%
70%	44.1%	53.9%
80%	44.1%	52.7%

The GRT's Burden on New Mexico's Economy

Having discussed some specific problems associated with New Mexico's tax structure, it is important to understand exactly what impact the GRT actually has on New Mexico's economy, especially when compared with other states in the region. As noted before, New Mexico is one of the few states in the nation and the only state in the region that taxes services.

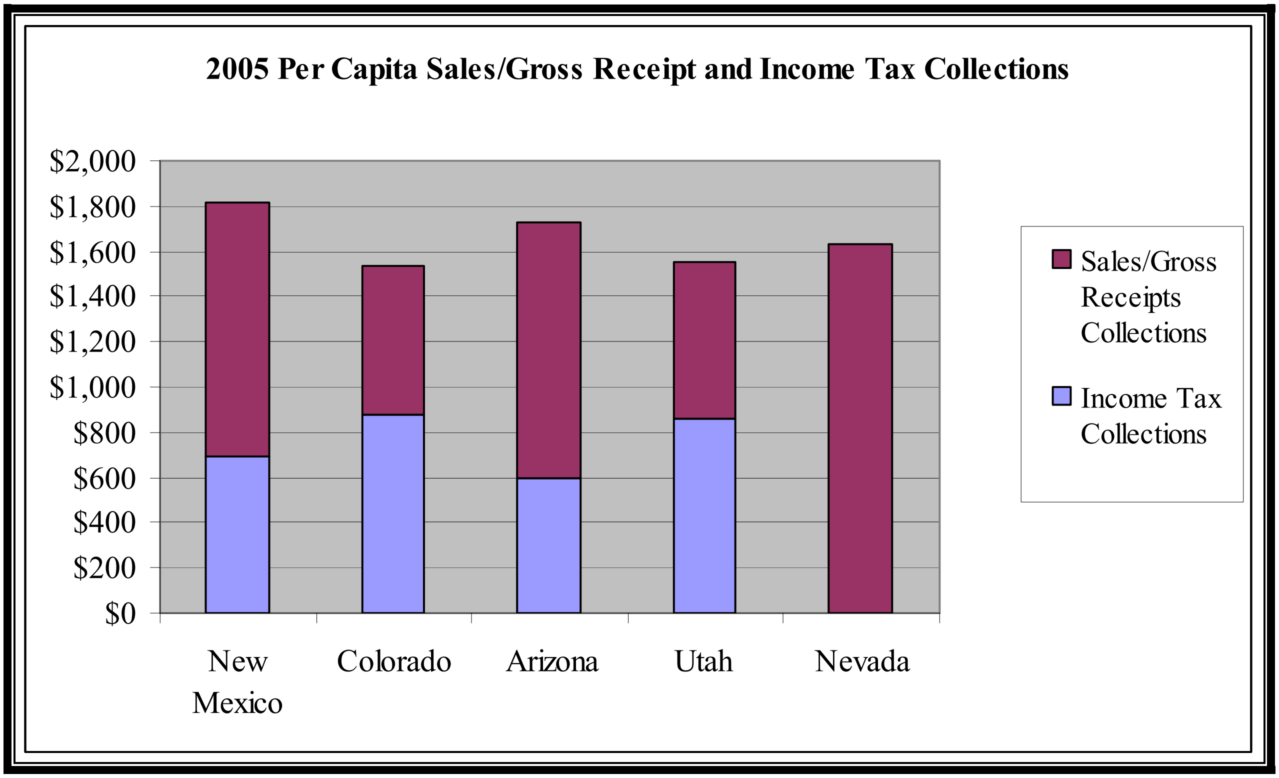
Chart 1.



When faced with paying no direct tax on its business or a tax of nearly 7 percent, service industries and businesses that rely heavily on services will do far better to locate elsewhere.

While income tax collections form a modest portion of the state's revenue stream, the GRT makes New Mexico's tax burden the heaviest in the region on a per capita basis as Chart 2 illustrates.

Chart 2.



As heavy as New Mexico's tax burden may be, the chart above includes the effects of significant income tax reductions since 2003. More troubling for the state's economic outlook is that while measuring per capita income tax collections gives a more accurate picture of real tax burdens than simply measuring top rates, the data actually underestimates New Mexico's real tax burden because ours is an economically-impoverished state with lower incomes than are found in surrounding states. In fact, according to 2004 data from the Washington Department of Revenue, New Mexico's state and local tax burden per $1,000 of personal income ranks is 9th-heaviest in the nation.[19]

More specifically, how do New Mexico's *effective tax rates* compare to other states? Take Texas as an example for comparison. Texas has no personal income tax. It levies a sales tax on consumer goods at the prevailing rate of 8.25%. We assume that its effective GRT rate is 0.5%[20] for all firms (consumer goods, intermediate goods and services). Using the assumptions above

[19] Don Taylor, "Comparative State/Local Tax Rates FY 2004," Washington State Department of Revenue, June 2006, http://dor.wa.gov/docs/reports/2006/Compare06/compare04_report.pdf.
[20] It is likely to be a little lower than this, depending on how the Texas firm chooses to deduct its costs from total receipts.

for a sole proprietor, including the effect of pyramiding in New Mexico we can see the effective tax rates and more importantly the ***difference in effective tax rates***[21] between the two states[22].

Table 5 New Mexico – Texas Tax Comparison

Effective Tax Rates on Entrepreneur's Income for Services and Intermediate Goods

Income as percent of gross receipts/year	NM Entrepreneur's 2007 Effective Tax Rate on Income Net of Costs	TX Entrepreneur's 2007 Effective Tax Rate on Income Net of Costs	**Difference in Effective Income Tax Rate**
20%	86.4%	40.3%	46.0%
30%	72.2%	40.3%	31.9%
40%	65.8%	40.3%	25.4%
50%	61.6%	40.3%	21.3%
60%	58.5%	40.3%	18.2%
70%	56.1%	40.3%	15.8%
80%	54.2%	40.3%	13.9%

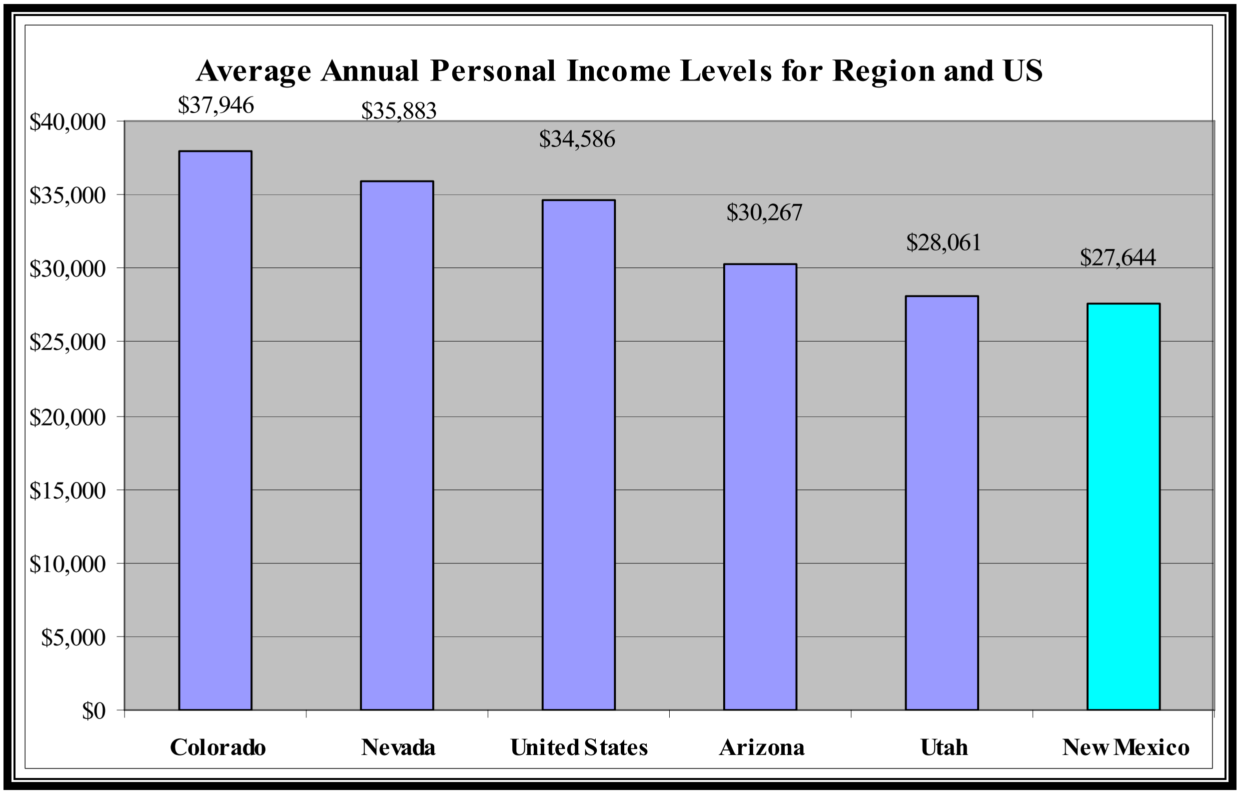
Such differences in effective tax rates will result in businesses going to other states or inefficient reorganization of businesses in New Mexico so as to avoid the tax, e.g. vertical integration rather than less costly horizontal integration

The following chart clearly illustrates New Mexico's lag in personal income levels as compared to both the region and the nation as a whole.

[21] Recall that the firm may organize so as to avoid the SS/Medicare tax and some federal tax. However it chooses to organize the difference in effective tax rates does not change.

[22] The difference is actually a bit smaller than displayed here in the case of intermediate goods since the cost of raw materials is deducted from total receipts.

Chart 3.



While New Mexico's heavy tax burden and low personal income levels are undoubtedly closely related, this coincidence does not point directly to our gross receipts tax as the culprit. That said, New Mexico's economic woes do not make its tax system particularly attractive as a model for other states to adopt.

Broadening the consumption tax base may seem attractive to governments and the implementation of a gross receipts tax may seem like the ideal way to achieve this goal, but New Mexico's experience should provide a cautionary tale. Not only are gross receipts taxes economically harmful in and of themselves, but they create incentives as we have seen for special interests to carve out exemptions for their own industries. These carve-outs ultimately threaten the viability of any broad-based tax by driving rates upward on industries that are not as politically-connected as others.

Other states should take a close look at New Mexico's model and do their best to avoid repeating our mistakes. These states should either place strict limits on the top rates that can be charged under their gross receipts tax regimes or they should consider specific exemptions that can be applied to all businesses, thus leveling the playing field and maintaining their states' competitiveness.

New Mexico policymakers are left with two options: Given the tremendous amount of revenue flowing into state coffers – the state has $720 million in "new money" this year – now is the time to dramatically lower the GRT rate.[23] While legislators should be encouraged to ameliorate the negative economic impact of the GRT by actually cutting taxes, even a revenue-neutral plan that eliminates many of the special interest provisions and re-imposes the tax on groceries could drop rates significantly.

Back when it was created in 1966, the GRT was 3 percent.[24] Although even the most robust GRT applied at a 3 percent rate might not generate the same level of revenue it does today, our best estimate is that if most exemptions, not including employee wages and most manufacturing inputs, were eliminated that the average rate statewide could be applied at a top rate statewide of between 4 and 5 percent. As important as any shift back to its original ideal as a low and broad tax may be, such reforms will only be temporary if legislators do not make Constitutional changes to limit the ability for future legislatures to create special-interest carve-outs.

Barring what will ultimately be a politically-difficult effort to re-broaden the GRT (after all, those special interests got their carve-outs for a reason), it makes sense for New Mexico to abandon the pretense of "broad" taxation and instead shift to simply taxing retail sales as is done in other states. Since the GRT is such a robust generator of revenue, a combination of using surplus revenues and fiscal restraint – something that has been extremely lacking in recent years – will be essential.

Regardless of what, if anything occurs in New Mexico by way of reform, rates cannot be allowed to continue to creep up. GRT rates have more than doubled in most cities statewide since the GRT was adopted in 1966, further rate hikes will create an untenable situation for many small businesses. Other states should beware what they wish for when they consider adopting their own GRT's. With a broad base can come tremendous economic harm.

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[23] Deborah Baker, "Lawmakers May Shell Out $720 Million in New Money," *The Santa Fe New Mexican,* December 13, 2006, http://www.freenewmexican.com/news/53472.html.
[24] Carl Twibell, New Mexico Taxation and Revenue Department, telephone conversation, January 18, 2007.

Paul Gessing is the president of, and Dr. Messenheimer a senior fellow with, the Rio Grande Foundation, a non-partisan, tax-exempt research and educational organization dedicated to promoting prosperity for New Mexico based on principles of limited government, economic freedom and individual responsibility.

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