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N.M. looks to tax pot and adjust revenues to buffer oil dependence

By

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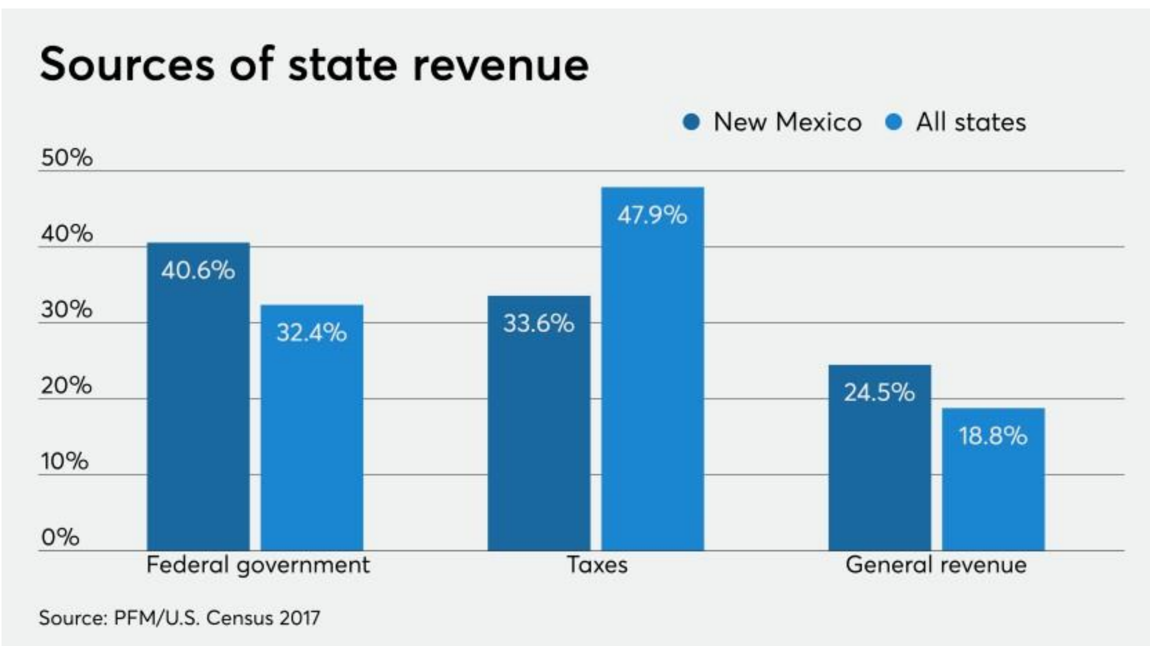
Wedged between two states that have legalized the sale of marijuana for recreational purposes, New Mexico is taking another look at the substance as a source of tax revenue.

New Mexico House Speaker Brian Egolf, D-Santa Fe, and Democratic Gov. Michelle Lujan Grisham have spoken in favor of legalizing and taxing marijuana to broaden the resource-dependent state's revenue stream.

Lawmakers in Santa Fe will consider proposals when the 2021 session begins Jan. 19. A bill introduced in the 2020 session passed the House but died in the Senate.



"I think the prospect for a recreational bill to pass this year are looking much better," said state Sen. Jacob Candelaria, D-Albuquerque, a sponsor of past recreational marijuana and drug decriminalization initiatives.

Legalization could produce $70 million in annual excise taxes even before including gross receipts tax, New Mexico's version of sales tax, according to Richard Anklam, the president and executive director of the New Mexico Tax Research Institute.

Colorado, Washington, Oregon and California have seen significant tax revenue increases in the past several years, he told New Mexico lawmakers.

More than 60% of voters in Arizona approved Proposition 207, which will legalize the sale of marijuana for recreational purposes and impose a16% excise tax that will support community colleges, mental health programs, maternal mortality programs, efforts to combat impaired drivers and other underfunded needs in the state. The tax will be levied in addition to state and local sales taxes totaling about 9%.

In fiscal year 2020, which ended June 30, Colorado brought in more than $300 million in recreational marijuana revenue, which amounts to only 1% of the state's total budget. Colorado voters approved recreational marijuana sales on Nov. 6, 2012. Voters in Washington state, and Massachusetts approved measures similar to Colorado's the same year, becoming the first states to legalize pot.

In the 2020 election, New Jersey, South Dakota, and Montana joined Arizona in legalizing marijuana. That raised the number of states to legalize to 15.

On Dec. 4, the U.S. House approved the Marijuana Opportunity and Expungement Act to decriminalize cannabis. The vote was the first time that a chamber of Congress acted on a stand-alone cannabis bill. The Senate, still controlled by Republicans, is unlikely to take up the bill that would allow states to set their own cannabis-related policy, eliminating federal intervention.

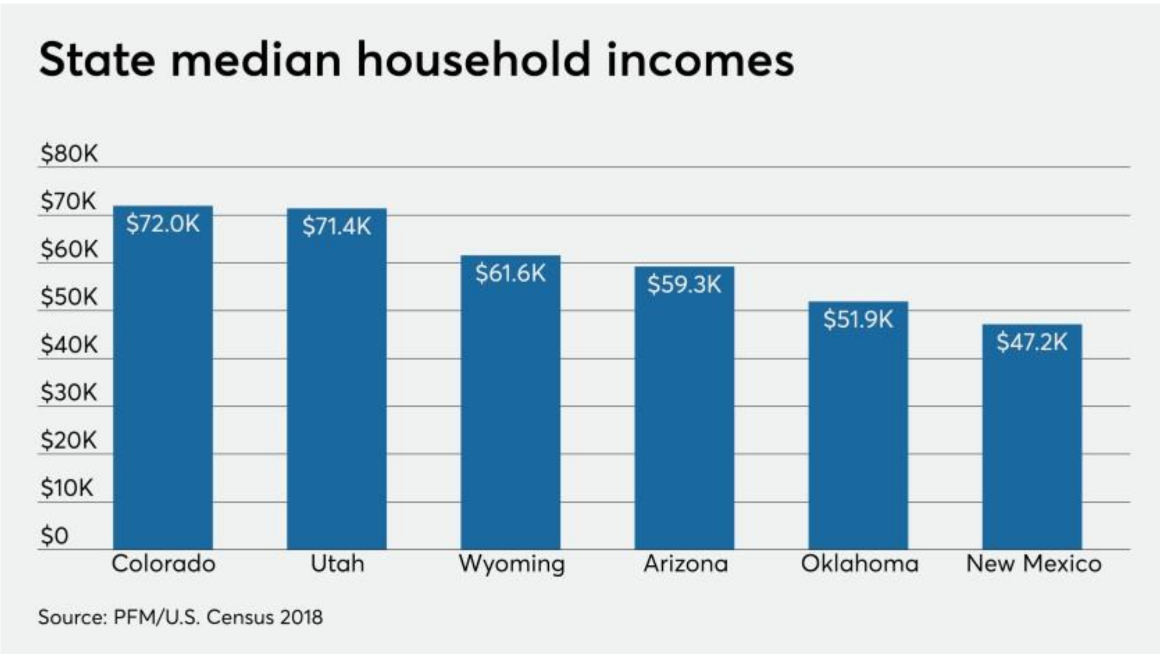
The bill would also require federal courts to expunge prior convictions for cannabis-related offenses and establish a 5% tax on cannabis product sales to establish a trust fund to reinvest in communities disproportionately impacted by the "war on drugs."

Congressional Research Service reported that all but three states have changed their laws to permit the use of cannabis for medical purposes.

For New Mexico, the issue is seen not only as a way to reduce the costs of enforcing laws against marijuana but also a way to diversify its revenue base. Like Colorado and Arizona, New Mexico is heavily invested in tourism.

In a recent report by PFM Group Consulting, the prospect of legalization was factored into a study of how New Mexico might become less dependent on the cycles of the oil and gas industry.

“Many states that are now legalizing marijuana are doing so because of its revenue potential — a recognition that its use via the black market is prevalent, and the state would benefit from regulating and taxing it,” the report said. “Current tax structures vary considerably, with tax collections ranging from $13 to $67 per capita. Tax collections in the range of $50 per capita for New Mexico would raise approximately $100 million a year.”



The oil and gas industry is dominant in New Mexico, as measured by share of GDP, and it is also generates a significant portion of state revenue.

“Given the bust in the industry combined with the pandemic-fueled national recession, it is not surprising that the New Mexico budget shortfall in the summer of 2020 was among the largest of the states as a percentage of the overall state budget,” the PFM report noted. When the New Mexico legislature met in special session in June 2020, the primary purpose was to deal with an estimated budget shortfall of between $1.8 and $2.8 billion. In July 2020, after the special session, the Legislative Finance Committee estimated the deficit for FY2021 at nearly $1 billion, per PFM.

“In fact, New Mexico finished FY2020 somewhat stronger than had been forecast, with actual revenue collections more than $300 million above earlier estimates,” the report added. “At the same time, the state still faces considerable economic and revenue headwinds, and the current forecast is for current year revenues to decline by 7% to 19% from FY2020."

Among PFM's recommendations are adjusting the personal income tax rate to restore higher marginal rates at higher income levels.

"New Mexico was one of several states that experimented with lowering top rates in the last 20 years to help attract high-income households and stimulate economic development," the report observed. "However, there is little evidence from New Mexico or other states that this strategy was successful."

The authors also recommended eliminating the capital gains income tax exemption, whose benefits go to higher-income earners.

Reinstituting an estate tax "is one of the few existing wealth tax options and will improve revenue adequacy and equity," the report said. Another proposal, increasing the motor fuel tax, would improve revenue adequacy, the authors said. New Mexico has one of the nation's lowest motor fuel taxes.

Lawmakers should also consider broadening the gross receipts (GRT) tax base to again include food, the report says, and couple it with a refundable income tax credit for lower income taxpayers.

At the same time, lawmakers should resist the temptation to increase the state GRT rate, the report said.

"The New Mexico combined average state and local rate ranks as the 15th highest among all states (when compared to state and local combined sales tax rates)," the report said. "While this is already above average, the overall GRT taxable base is much broader than nearly every other state sales tax base."

The state should also continue to expand excise taxes to align with new goods and forms of services, the report suggested.

Another structural move that could ease pressure on the state would be shifting greater local funding responsibility to the property tax and away from the gross receipts tax.

"Nationally, the property tax is the predominant local tax revenue source, but in New Mexico, it is the GRT," the report said. "While the state's history and reluctance to use the property tax are understandable, there are mechanisms that can be put in place to reduce its negative effects. Broadening the overall tax base would help improve tax adequacy and reduce volatility."

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