F I S C A L   I M P A C T   R E P O R T

SPONSOR Burt | **ORIGINAL DATE** 1/26/19 | **LAST UPDATED** 2/22/19 | **HB**

SHORT TITLE Military Retiree Income Tax Deduction | **SB** 330

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue						Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23	FY24		
	($610.0)	($14,380.0)	($19,320.0)	($26,520.0)	($27,290.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

Senate Bill 330 creates a personal income tax deduction for military retirees. The deduction is phased in as follows:

For Taxable Year	% of Military Pension Deductible	Deduction limit
2020	25%	$6,250
2021	50%	$12,500
2022	75%	$18,750
2023 et seq.	100%	$25,000

The purpose of the deduction is to encourage uniformed services retirees to make New Mexico the retirees' state of residency and to utilize the expertise of uniformed services retirees in New Mexico's workforce and business community.

TRD is required to compile an annual report of the number of taxpayers claiming this deduction and the costs to the general fund.

Uniformed services means army, navy, air force, marine corps and coast guard, as well as the commissioned officer corps of the national oceanic and atmospheric administration.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019). The provisions of the bill are applicable to taxable years beginning on or after January 1, 2020.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

Significant data is available, largely from the American Community Survey on the number of military retirees currently living in New Mexico. In 2017, 21,176 were resident in New Mexico. Department of Veteran's Affairs was unable to provide average pension amounts or any detail about the distribution of pension amounts, taxpayer filing status or total income of military retirees. LFC staff made assumptions to calculate a general fund cost of this bill. LFC staff used total pension numbers and average amounts of pension and estimated growth rates for both increases in number of retirees and average pensions. The data source used was the IRS Personal Income Tax Statistics of Income for the years 2013, 2014, 2015 and 2016. It was then assumed that military pensions would be distributed in the same fashion as all pensions. This led to the conclusion that 63 percent of pensions would be paid to retirees whose pension amount was less than $25 thousand annually. The average pension for this group was determined to be $18.2 thousand in 2016. For individuals with pensions over $25,000, the average pension was $44 thousand. It was assumed that the average tax rate for the lower pension individuals was 3 percent and 4 percent for the higher pension individuals. These assumptions or calculations were then combined to the estimate shown in the table.

In 2009, the Arrowhead Center published a study entitled, "The Economic Impact of Exempting Retired Military Service Payments from New Mexico Personal Income Tax". Total number of military retirees was "nearly 20 thousand", although Table 1 of the study indicated that New Mexico had 21,274 military retirees and that represented 1.08 percent of the population. Fifteen states with exemptions for Military Retirement pay or with no income tax averaged about .6 percent of the population, with only Alabama exceeding New Mexico's ratio. The US average was .66 percent of the population were military pensions. Later in the report, Dr. Popp estimated the cost of a full exemption for military retirement would be about $8.5 million. Unfortunately, the study assumed that the pension income/exemption would be taxed at average income tax rates of less than 2 percent, where the analysis contained in this FIR assumed a 3 percent marginal rate on the income for the lower income retirees and 4 percent for the higher income retirees. This difference is critical, because an exemption, as proposed here, would be taxed at higher marginal rates than average income for the population generally. The study makes no attempt to address the issue of "buying the base", but makes the comment, "The historical growth rate for retiree military service pensions is, on average 1.5 percent. If this growth rate was doubled [as a direct result of this exemption], the state would experience a positive yearly contribution due to increase personnel in year six and experience overall net benefits in year ten…"

On the other hand, the current estimate of military service retirees is 21.4 thousand, with virtually no net growth from 2007/2009 from the Arrowhead study. This probably implies that the WWII and Korean era, and some retirees who served in the Vietnam era are dying and new retirees are barely making up for the retirees who are dying.

The key question is whether the incentive here, which could be up to $1 thousand per year per retiree would be sufficient to change retirement location decisions. See also "Alternatives" below for an alternative proposal that provides incentives but does not "buy the base".

SIGNIFICANT ISSUES

The stated purpose of this deduction is to provide incentives encourage uniformed services retirees to make New Mexico the retirees' state of residency and to utilize the expertise of uniformed services retirees in New Mexico's workforce and business community. Available data indicates that this might not be necessary. One must assume that the majority of retirees will either return to their declared home state or will remain in the state of their last domestic posting. New Mexico is ranked 13th in the nation for the percentage of the population that are veterans. 9.6 percent of the state's civilian population are veterans. The national average is 7.9 percent.

On the other hand, military retirees generally retire relatively young and subsequently begin a second or even third career. Military retirees represent about 14 percent of New Mexico's veterans. Because of this, total median income of New Mexico's veterans was $37.1 thousand in 2014, compared to a median annual income of nonveterans of $21.8 thousand. New Mexico ranks 48th in median income for nonveterans and 21st for veterans.

New Mexico is one of eight states that fully tax military pensions. Twenty states do not tax military pensions, but do have a personal income tax. Thirteen more states provide partial deductions or exemptions. The list is appended to this review.

Medical personnel working for the Indian Health Service can opt to enroll in a uniformed service. Perhaps these personnel should be added to the list of uniformed services.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. However, TRD will only be able to report on the number taxpayers claiming the deduction and the total cost of the deduction. If the purpose of the deduction is to provide an incentive for military retirees to stay in New Mexico, TRD would not have any data.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

A number of bills this session propose amendments of various provisions of the income tax code.
HB18 proposes a child income tax credit based on Adjusted Gross Income.
HB6 proposes a restructuring of rates and brackets for personal income tax.
SB98 proposes a new 6.5 percent higher income tax bracket.
SB300 proposes a $4,000 child income tax deduction

SB330 proposes a phased-in deduction for military pensions.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. It is by no means certain that this deduction would increase the number of retirees staying or relocating to New Mexico. It would be appropriate, considering this uncertainty, to provide a delayed repeal date which will encourage the legislature to review whether the deduction remains effective in the stated purpose.

OTHER SUBSTANTIVE ISSUES

Many years ago (the provisions were repealed in 1990), New Mexico provided two important income-source deductions. One was a full exemption for PERA and ERA pensions. The second was a fixed deduction of $2 thousand for federal civil service retirees. As the result of a US Supreme Court decision (Davis v. Michigan), the differential treatment between state and federal retirees was held to be unlawful. This allowed the state the opportunity to repeal all income-source based deductions in favor of indexing personal exemptions and standard deduction amounts. This proposed deduction based on source of income puts New Mexico back into a position that it hasn't been in for almost 30 years.

ALTERNATIVES

This is ultimately an economic development incentive. The idea is to bolster the competence and experience of the workforce by inducing military retirees with at least 20 years of technical experience to retiree in New Mexico and take new jobs. This is certainly a desirable goal, but, in the opinion of LFC staff, the issue of "buying the base" and giving deductions to the 21 thousand military retirees already living in New Mexico imposes too great a cost. In international experience, many countries allow direct foreign investment a five-year tax holiday. After that time, the recruited businesses are expected to pay their full and fair share. Perhaps, New Mexico could experiment with this concept and allow new retirees a five-year, 100 percent deduction of their military pension.

Medical personnel working for the Indian Health Service can opt to enroll in a uniformed service. Perhaps these personnel should be added to the list of uniformed services.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

This bill fails the adequacy, efficiency, equity and simplicity principles. Accountability is also difficult, because although the utilization and cost of the deduction would be reported, there is no means of assessing whether the deduction (1) pays for itself in terms of additional tax revenues from additional retirees or (2) how many additional retirees can be attributed to the deduction.

LG/gb/sb

https://militarybenefits.info/states-that-do-dont-tax-military-retirement-pay/

States that Do & Don’t Tax Military Retirement Pay

2019 list of all 50 states that exempt (or don’t) all or a portion of military retirement pay. The laws differ depending on which of the 50 states you live in and some state tax laws are more complex than others. Depending on the state you may pay no income tax whatsoever, or you may find your military retirement pay is exempt from taxation up to a certain dollar amount.

Quick math: 9 states don’t have a personal income tax, 8 states fully tax military retirement pay, 20 states don’t tax retirement pay and 13 tax a portion.

9 States That Don’t Tax Personal Income

The following states don’t require military members to pay state income tax on military retirement pay because there is simply no state income tax collected:

- Alaska
- Florida
- Nevada
- New Hampshire (dividend and interest taxes only)
- South Dakota
- Tennessee (dividend and interest taxes only)
- Texas
- Washington
- Wyoming

8 States That Do Tax Military Retirement Pay

The following states have no specific state income tax exemption for military retirement pay:

- California
- Montana
- New Mexico
- North Dakota
- Rhode Island
- Utah
- Vermont
- Virginia

20 States Don’t Tax Military Retirement Pay (but do have state income tax)

- Alabama
- Arkansas
- Connecticut
- Hawaii
- Illinois
- Iowa
- Kansas
- Louisiana
- Maine
- Massachusetts
- Michigan
- Minnesota
- Mississippi

- Missouri
- New Jersey
- New York
- Ohio
- Pennsylvania
- West Virginia (as of 2018)
- Wisconsin

13 States With "Special Provisions" Or Other Consideration For Military Retirement Pay

- Arizona – Military retirement pay may be excluded from state taxation up to $2,500.
- Colorado – Depending on age, up to $24,000 of military retirement pay may be exempt from state taxes.
- Delaware – Taxpayers up to the age of 60 may exclude up to $2,000 of military retirement pay, military retirees aged 60 or older exclude up to $12,500.
- District of Colombia – Military retirement pay may be excluded from state taxation up to $3,000 for individuals 62 or older.
- Georgia – Georgia has a provision for any retirement income including military retirement pay. Taxpayers who are 62 or older, or permanently and totally disabled regardless of age, may be eligible for a retirement income adjustment on their Georgia tax return. Up to $35,000 ages 62-64 and $65,000 for 65 and older.
- Idaho – Retirement benefits to a retired member of the military 65 or older, or disabled and age 62 or older are excluded from state taxes. Such deductions must be reduced by retirement benefits paid under the Federal Social Security Act or the Tier 1 Federal Railroad Retirement Act. The total maximum deductions vary each year.
- Indiana – Military retirees may deduct the lesser of actual retirement pay or $5,000, whichever is less. Certain conditions may apply.
- Kentucky – All military retirement pay is exempt from state income tax for those who retired prior to 1997. For those who retired after 1997, military retirement pay is subject to state tax when the pay exceeds $41,110.
- Maryland – Military retirees don't pay state income taxes on the first $5,000 of their retirement income. Those over age 65, or who are totally disabled, or who have a spouse who is totally disabled, receive additional state income tax breaks which may vary from year to year.
- Nebraska – Retirees must choose (within two years of the retirement date) a seven-year exemption option of 40 percent or a lifetime exemption option of 15 percent starting at age 67.
- North Carolina – Military retirement pay may not be taxed at all if it meets certain requirements including if the veteran was "vested in the retirement system" for five years as of August 12, 1989. Otherwise, tax exemptions may be applicable up to $4,000 for single returns and $8,000 for joint returns.
- Oklahoma – Military retirement pay is exempt either up to 75 percent or $10,000, whichever is greater, but cannot exceed federal adjusted gross income.
- Oregon – Military retirees may qualify for a "federal pension subtraction". Those considered "special-case" Oregon residents will have their military retirement pay taxed as regular income.
- South Carolina – Military retirees with a minimum of 20 years of active duty may exempt up to $3,000 until age 65, after which an exemption of $10,000 applies.

  Read more:

https://militarybenefits.info/states-that-do-dont-tax-military-retirement-pay/#ixzz5dkwjhxlu