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

SPONSOR	Serrato	ORIGINAL DATE	2/14/21
		LAST UPDATED	2/16/21
SHORT TITLE	Real Estate Transfer Tax Act	HB	19
		SB	
		ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
	\$54,860.0	\$57,055.0	\$59,340.0	\$61,710.0	Recurring	General Fund --Real Estate Transfer Tax
	\$1,700.0	\$1,760.0	\$1,835.0	\$1,910.0	Recurring	Counties – 3% admin fee
	(\$43,000.0)	(\$45,000.0)	(\$47,000.0)	(\$50,000.0)	Recurring	General Fund – PIT Social Security Exemption

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	--	\$60.0	\$60.0	\$120.0	Recurring	RPD – FTE
	\$8.0	--	--	\$8.0	Nonrecurring	RPD – Contractual Services
	\$2.9	--	--	\$2.9	Nonrecurring	ASD – Staff Workload Costs
	\$2,857.1	--	--	\$2,857.1	Nonrecurring	ITD Contractual Resources
	--	\$332.6	--	\$332.6	Nonrecurring	ITD Staff Workload Costs
	--	\$322.2	--	\$322.2	Recurring	ITD – FTE
Total	\$2,867.1	\$704.8	\$60,0	3,641.8		TRD Operating

Parenthesis () indicate expenditure decreases

Relates to HB19, SB78, SB208, and SB162.

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of Bill

House Bill 19 proposes two dissimilar tax elements. It proposes a real estate transfer tax of 0.75 percent if the value of the property is from \$500 thousand to \$750 thousand and 1.25 percent for properties over \$750 thousand. Certain sales transactions are exempt from this transfer tax. The second tax element is an exemption from income tax of the amount of taxable social security benefits included in income, provided the taxpayer's adjusted gross income, adjusted for this exemption, does not exceed \$120 thousand for a married taxpayer filing jointly, a head of household, or a surviving spouses and \$72 thousand for a single taxpayer.

The effective date of Sections 1 through 3 (the real estate transfer tax) is July 1, 2021. Section 5 of the act is applicable to income tax years beginning on or after January 1, 2021. There is no effective date for the definition Section 4 of this bill. The assumed effective date of this section is 90 days after this session ends. (June 18, 2021). There is no delayed repeal date, but LFC recommends adding one, at least to the Social Security exemption portions of this bill.

TRD notes that the July 1, 2021 effective date for the real estate transfer tax is not feasible.

FISCAL IMPLICATIONS

This bill creates a tax expenditure with a cost that is likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base.

If, as discussed in “Technical Issues” below, the real estate transfer tax is held to be a property tax subject to the uniform and equal provisions of Article VIII, Section 1, of the Constitution of New Mexico, and the rate for all property sales was 0.75 percent, then the tax would generate about \$52.5 million.

TRD discusses the methodology used for the estimated revenue impact:

[Sections 1-4] The real estate transaction tax is estimated using 2020 transaction data from the New Mexico Association of Realtors and Zillow listing data to determine the number and value of residential real estate transactions that would be subject to the proposed tax. Commercial real estate transactions are estimated with 2019 commercial sales volume and price data. The average value per commercial real estate transaction is used to inform the distribution of transactions that would be subject to the tax.

The administrative fee of 3 percent is assumed for all qualified transactions.

[Section 5] The Taxation and Revenue Department (TRD) estimated the impact with base year 2017 microdata for New Mexico Personal Income Tax (PIT) taxpayers. To scale social security benefits to tax year 2021, 2017 social security income was increased by the actual cost-of-living-adjustments (COLA) in the last four calendar years, and by a net population

increase given the rate of individuals reaching social security eligible age and death rates. For fiscal years 2023 through 2025, the estimate was increased by the average COLA increase over the last five years and by the U.S. Census estimated population growth of individuals aged 65 and older. TRD's estimate of the exemption impact applies the adjusted gross income thresholds based on filing status. The estimate includes evaluation under the new TRD also assumed that taxpayers would select the exemption, either this new exemption, or the exemption pursuant to Section 7-2-5.2 NMSA 1978, which decreased their tax liability the most.

TRD's estimate based on microdata includes both resident filers and 'B' filers. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income. TRD notes the following important information about pension, annuity and social security benefits which are reported on line 3 of the form; if the filer is a non-resident, the taxpayer is to enter zero, as these benefits are prohibited from being allocated to New Mexico per federal law. If the filer is a part-year resident, first-year or full-time resident, then their taxable social security benefits are apportioned as per Section 7-2-11 NMSA 1978. TRD's estimate of the impact accounts for the apportionment of income for 'B' filers.

SIGNIFICANT ISSUES

TRD discusses the policies involved in the provisions of this bill:

[Sections 1-4] The proposed real estate transaction cost will increase the cost of selling and buying real estate in New Mexico that is valued at \$500 thousand and above. The increased transactional cost for housing may slow the pace of sales, negatively impacting the businesses associated with real estate, mortgages, property construction, etc. In some cases, a farm or ranch may be a retirement nest egg for a New Mexico family, and increasing the transactional costs associated with selling the property may reduce their savings or make the property more difficult to sell.

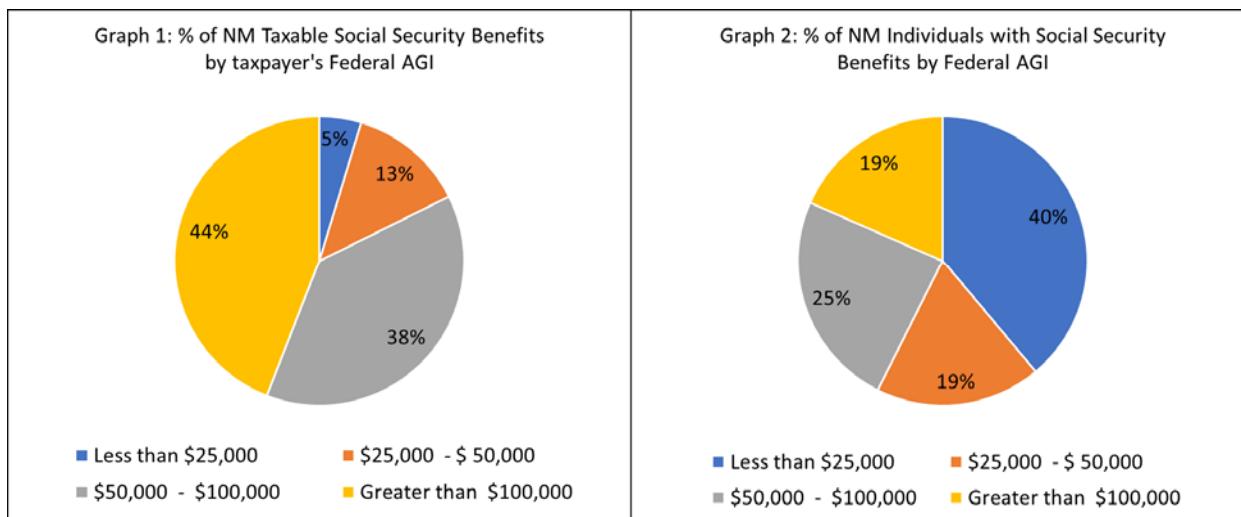
Increased revenue from the real estate transfer tax act would increase general fund revenue and bolster county budgets from the associated administrative fee. The increased revenue may result in lower taxes in other areas, increased capacity for government provided services, or both.

[Section 5] PIT represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states along with the District of Columbia, that impose a broad-based PIT. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayer's ability to pay.

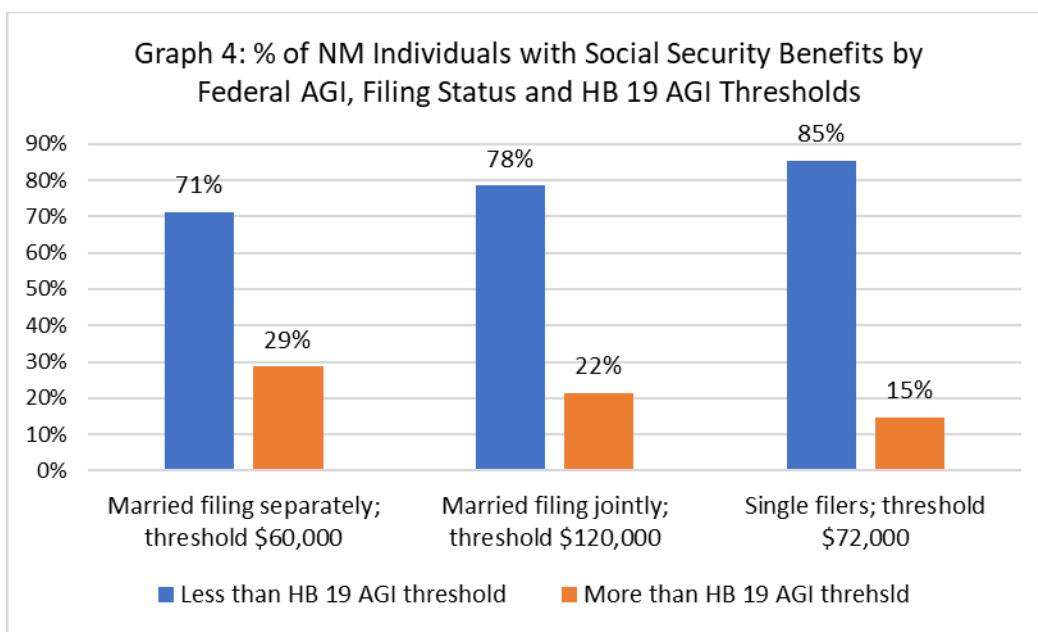
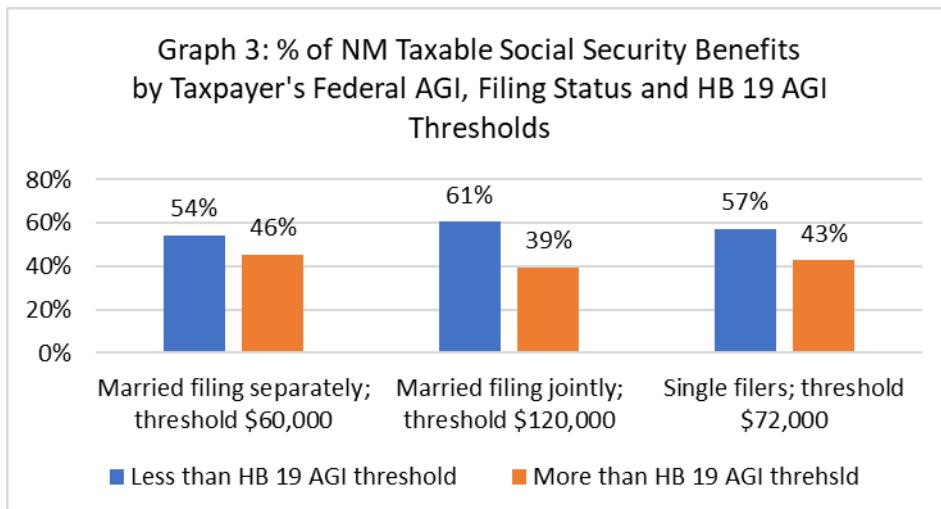
New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "conformity." As the federal tax code changes, such as under the 2017 Tax Cuts and Jobs Act (TCJA), states see impacts on their revenue collection from PIT, depending on their level of conformity. New Mexico's level of conformity is currently high, given that PIT starts with federal adjusted gross income (AGI), applies federal standard deductions, and uses Internal Revenue Service (IRS) definitions such as the definition for "dependents". With that conformity, New Mexico's treatment of social security benefits follows the federal application.

Since 1984, a portion of Social Security benefits have been subject to federal income taxes. The taxable portion is dependent on the level of the taxpayer's combined income, which includes 50 percent of the social security benefits, plus income from other sources, including interest on tax exempt bonds. Because the combined income thresholds for taxation of benefits have remained unchanged since they were introduced in 1984 and 1993, but wages have increased over the years, the proportion of beneficiaries paying tax on their benefits has risen over time.

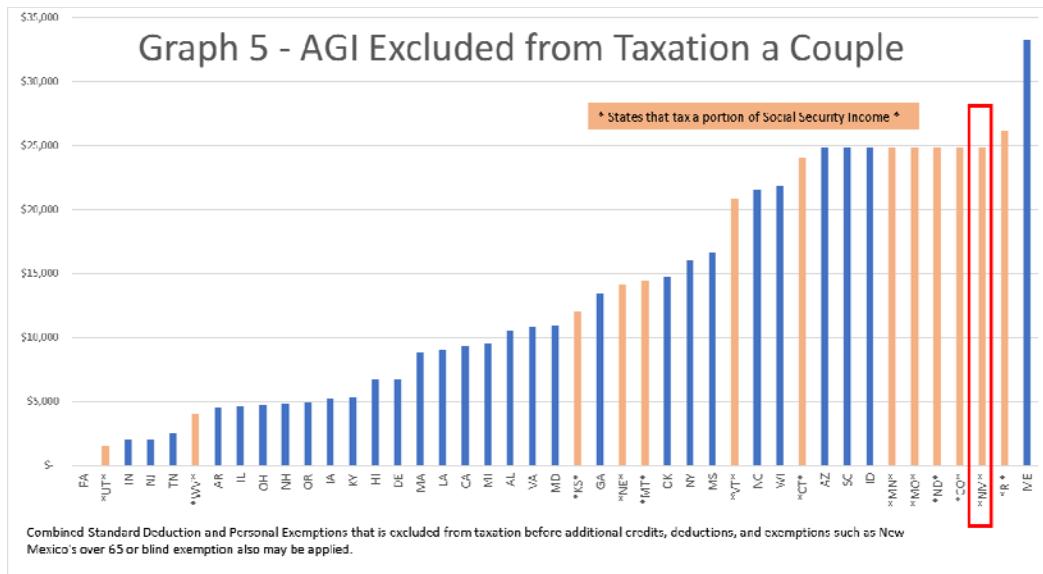
New Mexico's taxable PIT base for social security benefits is reasonably stable, and a large portion of social security income is earned by relatively high-income individuals who do not depend solely on social security benefits for their income, and who have other sources of income as well. This is illustrated in Graph 1: 82 percent of taxable social security benefits are earned by individuals with AGI over \$50 thousand. In contrast, Graph 2 illustrates that taxpayers with AGI over \$50 thousand represent only 42 percent of all taxpayers.



Since the exemption in Section 5 of this bill can only be claimed by relatively lower income individuals (married individuals filing separate returns with AGI of \$60 thousand or less; heads of household, surviving spouses and married individuals filing joint returns with AGI of \$120 thousand or less; single filers with AGI of \$72 thousand or less), the benefits of the exemption will mostly be enjoyed by those that are on a fixed retirement income. Graph 3 below shows that 54 percent of taxable social security benefits of married individuals filing separate returns are earned by individuals with AGI of \$60 thousand or less. Similarly, 61 percent (and 57 percent) of taxable social security benefits of heads of household, surviving spouses and married individuals filing joint returns (and single individuals) are earned by individuals with AGI of \$120 thousand (\$72 thousand). Graph 4 below shows that 71 percent of married individuals filing separate returns with social security benefits had an AGI of \$60 thousand or less. Similarly, 78 percent of heads of household, surviving spouses and married individuals filing joint returns had an AGI of \$120 thousand or less, and 85 percent of single filers with social security benefits had an AGI of \$72 thousand or less.



Thirteen states, including New Mexico, tax some portion of social security benefit income. However, those 13 states tend to have a higher threshold at which PIT takes effect. This essentially means that low-income individuals' income tax liability is generally lower in the benefits-taxing states, regardless of the source of their income. Graph 5 below compares the income level at which each state's initial income tax rate takes effect for a married couple. New Mexico, along with four other states that tax social security benefits, has the third highest income level (\$24. 8 thousand) at which a couple's income may begin to be taxed. At the other end, while Pennsylvania does not tax social security benefits, its income tax is applicable to most non-zero income.



New Mexico's current PIT exemption for persons 65 and older or blind is targeted at those with lower AGI. This new proposed social security benefits PIT exemption would have a higher AGI restrictions, and an individual claiming exemption under this proposal will no longer be eligible to claim the current exemption for persons 65 and older or blind. Low-income taxpayers tend to have lower taxable social security benefits included in their federal AGI due to federal tax statutes. At the state level, these same taxpayers are eligible for other credits and rebates such as the low-income comprehensive tax rebate (LICTR), exemption for low- and middle-income taxpayers, leaving them with little or no tax liability under current law.

Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on age, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not available to younger taxpayers at the same level of income.

Exemptions based on income threshold as laid out in this bill are susceptible to cliff effects - the sudden increase in tax liability as income rises. As a result, two taxpayers under identical economic circumstances may face quite different tax liability depending on which side of the income threshold they fall in. Such cliff effects raise both equity and efficiency concerns because they have the potential to penalize taxpayers and disincentivize efforts to move up the income ladder. It is imperative to ensure that legislation such as this do not make a taxpayer worse off post-tax simply because of higher pre-tax earnings.

Taxing social security benefits raises issues of double taxation because employee payroll tax contributions to social security are not deductible from the employee's income when determining their tax liability in the year the contribution is made. So, employee contributions are taxed, and it is argued that taxing social security benefits when they are paid out will entail taxing the same contribution again. However, social security benefits are a result of not just employee contributions, but also employer contributions. Employer contributions are deductible for the employer in the year the contribution is made. So, employer contributions are not taxed. Because employees pay half of the payroll tax, and their payroll tax contributions were already included in taxable income for earlier years, at most 50 percent of

the benefits should be excluded from future taxation. Social security benefits withdrawals for most workers, however, exceed their lifetime contribution. Goss (1993) estimated that the payroll tax contributions of current and future workers would equal less than 15 percent of the present value of their lifetime benefits¹. Therefore, if the ratio of lifetime contributions to benefits is less than 15 percent, then up to 85 percent of benefit income can be taxed without risk of double taxation.

There are many other reasons why states may exempt some income for those over 65, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. However, exempting social security from income taxation may not necessarily help in attracting retirees to the state. For example, Texas does not tax any income, social security or otherwise, at all. Yet, the state features as one of the least tax friendly states for retirees in the country because of its high property and sales taxes². Notably, New Mexico's property taxes are amongst the lowest in the nation. It is, therefore, necessary to take a holistic look at New Mexico's tax code, and attempts should be made to make the tax structure more simple, broad based, and equitable, without being punitive to any segment of the population.

LFC staff notes that the social security income exemption portion of this bill narrows the personal income tax (PIT) base, which appears counter to the base-broadening efforts over the last few years of tax system reform. This proposal would likely reduce the income elasticity of the personal income tax – income elasticity measures the growth in personal income tax collections driven by growth in personal income – negating the improvements to income elasticity embedded in PIT tax changes passed last year (Laws 2019, Chapter 270, House Bill 6).

The Aging and Long-Term Services Department points out that seniors with adjusted gross income level less than two to three times the poverty standard do not pay taxes and will see no impact from this bill. However, seniors and adults with disabilities who receive social security and have additional income sources, putting them into a taxable income bracket, will be affected by this bill. In addition, those seniors and adults with disabilities who live in assisted living facilities may be potentially impacted by this bill because approximately 67 percent of assisted living residents pay for their stays with private funds. Approximately 23 percent of assisted living residents pay for their stays from a need-based income source (14 percent from Supplemental Social Security Income and 9 percent from Medicaid).³

See “Other Substantive Issue” below for additional discussion.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met for the social security exemption portion of this bill because TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the exemption and other information to determine whether the tax expenditure is meeting its purpose.

¹ Goss, Stephen C. 1993. “Current Approach and Basis for Considering a Change to 85-Percent Taxation of Monthly OASDI Benefits.” Letter to Harry C. Ballantyne, Chief Actuary, Social Security Administration.

² https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

³ <https://www.nmhca.org/faq-facts/>

The LFC tax policy of accountability is not met for the real estate transfer tax portion of this bill, although TRD will include the revenue collections in its monthly GenTax reports and the consensus revenue estimating group (CREG) will estimate future revenues with each general fund revenue estimate. However, because apparently one purpose of the real estate transfer tax is to pay for the reduction in personal income tax revenue attributed to the AGI-limited social security exemption, the collections of the real estate transfer tax would be material in a report on the amount of social security exemption.

ADMINISTRATIVE IMPLICATIONS

Implementing the social security deduction provisions of this bill will create a moderate impact.

Implementing the real estate transfer tax provisions will pose significant difficulties for TRD.

TRD will need to create new forms and instructions, including PIT returns for 2021 and instructions. These will be incorporated into annual tax year implementation. The Revenue Processing Division (RPD) of TRD will require an additional FTE, a tax examiner advanced, to process the forms and reconcile county remittances for the new act. RPD also will incur \$8 thousand in contract and administrative costs. The Administrative Services Division (ASD) will incur \$2.9 thousand in staff workload costs, approximately 60 hours.

The bill has a high impact on TRD's Information Technology Division (ITD), as it includes update to tax year 2021 and a new tax, the Real Estate Transfer Tax.

1. The update to the income taxes for Tax Year 2021 are for the exemption of social security income, approximately 200 hours of effort or approximately 2 months and \$10,328 of staff workload costs.
2. The bill also includes implementing a new account type in GenTax for the new Real Estate Transfer Tax. Due to the nature and complexity of the effort required to implement the Real Estate Transfer Tax proposed changes in this bill, a contract with the GenTax vendor, FAST Enterprises, LLC is required.

There are two options for the new Real Estate Transfer Tax Type:

- I. **Option 1** is approximately 12 months and approximately \$3,179,258 (\$2,857,025 of contractual resources and \$322,234 of staff workload costs).
- II. **Option 2** is approximately 9 months and approximately and \$542,188 of contractual resources.

2.1 Option 1: If the Taxation and Revenue Department will collect details on real property transactions as part of the Real Estate Transfer Tax implementation, the impact is approximately 12 months and approximately \$3,179,258 (\$2,857,025 of contractual resources and \$332,562 of staff workload costs) the estimate for FAST to implement the changes is \$2,168,750 including gross receipts (at the current gross receipts tax rate of 8.4375 percent).

This estimate also includes the following support from FAST: development, technical project management, technical, testing and training support.

In addition to the contract with FAST, a full-time contract project manager and contract business analyst will be required at approximately \$428,545 including gross receipts. Due to the nature of

such an implementation, IV&V services would also be required at a cost of approximately \$259,730 including gross receipts.

2.2 Option 2: If the Taxation and Revenue Department **does not** collect the transaction information as part of the Real Estate Transfer Tax implementation, the impact is approximately 9 months and the estimate for FAST to implement the changes is \$542,188 including gross receipts (at the current gross receipts tax rate of 8.4375 percent).

After implementation is complete, one application developer, one business analyst and one database/system administrator FTE will be necessary for ongoing operations and support at an estimated recurring cost of \$322,234.

Considering the effort involved, the effective date of July 1, 2021 is not feasible. This July 1, 2021, TRD implements the conversion for the Combined Reporting System (CRS) redesign project, as was authorized by the legislature. Due to the effective date of July 1, 2021 for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces on July 1 to ensure complete readiness and testing of all processes. If several bills with similar effective dates become law, there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill. TRD recommends an effective date of date of January 1, 2022 or July 1, 2022 to ensure proper implementation of the legislation in TRD administration and system processes. Another option is that the implementation would use a phased approach, implementing registration, returns and payments for the initial rollout. Other functionality such as revenue distribution, audit, etc would be implemented after the initial rollout.

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring**	Fund(s) or Agency Affected
FY2021	FY2022	FY2023	3 Year Total Cost		
--	\$60.0	\$60.0	\$120.0	Recurring	RPD – FTE
\$8.0	--	--	\$8.0	Nonrecurring	RPD – Contractual Services
\$2.9	--	--	\$2.9	Nonrecurring	ASD – Staff Workload Costs
\$2,857.1	--	--	\$2,857.1	Nonrecurring	ITD Contractual Resources
--	\$332.6	--	\$332.6	Nonrecurring	ITD Staff Workload Costs
--	\$322.2	--	\$322.2	Recurring	ITD – FTE

* In thousands of dollars. Parentheses () indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

Although the administrative burden for the real estate transfer tax is primarily imposed on county clerks and treasurers, TRD will have to implement a new tax program in GenTax to account for the transfers from the counties and distribute these collections to the general fund.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB19, SB78 and SB208 propose an exemption of all social security amounts received. SB162 proposes a limit of \$30 thousand of taxable income.

TECHNICAL ISSUES

Delayed Repeal. This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

Real Estate Tax. Although the real estate tax is described as “an excise tax” in Section 1A of the bill, this may be to avoid the notion that it is a property tax, subject to the provisions of the New Mexico Constitution, Article VIII, Section 1, that declares

Section 1. [Levy to be proportionate to value; uniform and equal taxes; percentage of value taxed; limitation on annual valuation increases.]

A. Except as provided in Subsection B of this section, 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. Different methods may be provided by law to determine value of different kinds of property, but the percentage of value against which tax rates are assessed shall not exceed thirty-three and one-third percent.

The real estate transfer tax, as proposed, has several features that would sustain the characterization of the tax as a property tax: (1) It is imposed on sales of real property; (2) the tax would be collected as due by county clerks or treasurers in the same manner as the property tax; and (3) Section 1B requires that, if a price paid does not represent the value of real property, then the previous year’s property tax assessed value shall be used as the basis for imposing the tax.

If the real estate transfer tax portions of this bill were to be considered property taxes and not excise taxes, the progressive rates, with a substantial (\$500 thousand) exemption floor would not be permitted under the “equal and uniform upon subjects of taxation of the same class.”

Because of this concern that a tax on real estate sales would be considered a tax on property and subject to the equal and uniform restriction of Article VIII, Section 1, of the New Mexico Constitution, if the bill passes, it will probably be challenged on these grounds by commercial and industrial real estate owners and by owners of multi-family residential properties.

TRD notes two technical issues regarding the provisions of this bill.

[Sections 1-4] The bill creates a new Act to be administered under the Tax Administration Act (TAA). However, the new tax will be collected by the county clerks, not TRD. This creates a conflict because all the acts under the TAA are collected by TRD. If the new tax will be collected by county clerks, then the tax act should not be under the TAA.

Many transfers will be subject to standard mortgage lending practices. If a loan is funded, based on timing, interest rates locks, etc. the buyer is responsible for the loan and takes possession of the property. If a loan cannot be funded because a county clerk is waiting on a monthly receipt notification from TRD before they can record the transaction, interest rate locks may expire, and entire transactions may fail. It is recommended this type of tax collection occur at closing (at the title company). This would occur simultaneously with closing and taxes could be remitted by the title company to TRD on a monthly basis. Closing documents filed with the county clerk would indicate the tax has been appropriately collected.

As discussed above in Administrative & Compliance Impacts, due to the new Act being administered under the Tax Administration Act, clarity is required in the bill as to the level of transactional data to be collected by TRD in administering this new tax.

Single Subject Rule. The dissimilar tax elements of this bill – a new real estate transfer tax and a social security exemption from personal income tax – might be considered “logrolling” and in violation of the single subject restriction of the New Mexico Constitution. However, a modest amount of research indicates this objection is unlikely to be sustained. From the constitution:

Sec. 16. [Subject of bill in title; appropriation bills.]

The subject of every bill shall be clearly expressed in its title, and no bill embracing more than one subject shall be passed except general appropriation bills and bills for the codification or revision of the laws; but if any subject is embraced in any act which is not expressed in its title, only so much of the act as is not so expressed shall be void. ...

In general, the courts permit the Legislature considerable discretion and leeway in the prohibition of logrolling. Consider the annual tax package, which consolidates a number of provisions affecting taxes. According to the compiler’s notes, there has been only one successful challenge of the single-subject rule.⁴

Objections to be grave.— This section will not be broadened in its operation by the court, as the objections to a statute should be grave, and the conflict between the statute and the constitution palpable, before the judiciary should disregard a legislative enactment upon the sole ground that it embraced more than one object, or if but one object, that it was not sufficiently expressed by the title. *City of Albuquerque v. Garcia*, [1973-NMSC-036](#), [84 N.M. 776](#), [508 P.2d 585](#), 71 A.L.R. 3d 1, rev'd [1972-NMCA-093](#), [84 N.M. 168](#), [500 P.2d 453](#). at Article XIX, Section

OTHER SUBSTANTIVE ISSUES

TRD notes two substantive issues.

Sections 1-4] TRD may need to create regulations depending on conversations with the county and TRD on implementation.

[Section 5] The revenue impact is based on the current income tax rates in Section 7-2-7 NMSA 1978. Several bills in the 2021 legislative session are proposing changes to the tax rates especially for taxpayers with higher taxable income. If the current bill to exempt social security benefits income and the tax rate changes go into law, the revenue impacts for each respective bill would be significantly different and need to be reassessed.

New Mexico began taxing social security benefits in 1990. The action was contained in an omnibus bill enacted in response to the *Davis v. Michigan* and *Burns v. New Mexico*. At that time, state retiree's pensions were 100 percent exempt from personal income tax, but federal retirees only were allowed a \$3 thousand deduction. The U.S. Supreme Court found this differential treatment was in violation of federal law ensuring that state and federal workers must be treated equally and equitably. Per the Supreme Court opinion, retiree income was covered by the federal statute. In the relevant bill, New Mexico repealed both the federal and state

⁴ **Capitol building and state parks.**— Laws 1939, ch. 112, § 13, relating to the capitol building and state parks, contravenes this provision. *Kilburn v. Jacobs*, [1940-NMSC-024](#), [44 N.M. 239](#), [101 P.2d 189](#); *Johnson v. Greiner*, [1940-NMSC-017](#), [44 N.M. 230](#), [101 P.2d 183](#).

differential deductions. In addition, other source-specific deductions were included in the fix. These included repealing the total exemption for social security income.

ALTERNATIVES

If the intent of the bill is to provide support for lower income earners with social security benefits, a more targeted approach may be to expand the existing exemptions for persons aged 65 and older (Section 7-2-5.2) or for low- and middle-income taxpayers (Section 7-2-5.8).

LG/al/sb/rl