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

ORIGINAL DATE 02/02/22
SPONSOR Serrato **LAST UPDATED** ____ **HB** 158

SHORT TITLE Real Estate Transfer Taxes and Social Security **SB** ____

ANALYST Faubion

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
--	$9,310.0	$13,090.0	$14,480.0	$18,240.0	Recurring	General Fund --Real Estate Transfer Tax
--	$290.0	$410.0	$420.0	$560.0	Recurring	Counties – 3% admin fee
--	($50,200.0)	($53,400.0)	($56,400.0)	($59,500.0)	Recurring	General Fund – Personal Income Tax

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$2,857.1	--	--	$2,857.1	Nonrecurring	TRD/ITD – contractual resources
$332.6	$5.2	--	$337.8	Nonrecurring	TRD/ITD – staff workload costs
--	--	$322.2	$322.2	Recurring	TRD/ITD – FTE
$4.6	--	--	$4.6	Nonrecurring	TRD/ASD – staff workload costs
--	$36.3	36.3	$72.6	Recurring	TRD/ASD – FTE
--	$60	$60	$120	Recurring	TRD/RPD - FTE
--	$6.4	--	$6.4	Nonrecurring	TRD/RPD – Staff workload costs
--	$4.3	$1.0	$5.3	Recurring	TRD/RPD – resources for FTE

Parenthesis ( ) indicate expenditure decreases

Conflicts with HB48, HB49, SB49, SB108, SB121, and SB184

Responses Received From
Attorney General's Office (NMAG)
Mortgage Finance Authority (MFA)
Taxation and Revenue Department (TRD)

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

The Attorney General's Office summarizes House Bill 158 (HB158) as follows:

> HB158 seeks to add a real estate excise tax to Chapter 7, the Tax Administration Act. HB158 also seeks to exempt social security income from taxable income for certain individuals based on their net income.
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> Section 1 would create the Real Estate Transfer Act.
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> Section 2 would impose an excise tax on all instruments conveying any interest in real property. For residential properties with a price paid between $500 thousand and up to $750 thousand, the amount of the excise tax would be equal to one half percent of the consideration paid for the interest in the property. For residential properties with a price paid of at least $750 thousand, the amount of the excise tax would be equal to one and twenty hundredths percent of the purchase price. If the price paid does not represent the value of the residential property, the amount of the excise tax shall be based on the prior year's assessed value of the residential property being transferred. A person who obtains more than one conveyance instrument for the same transfer of the same property would pay the excise tax only once with respect to that transfer. The excise taxes would be payable to the county clerk where the property is located. HB158 would exclude from the imposition of the excise tax certain types of property interest conveyed.
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> Section 3 of the bill would require the county clerk to report and submit all collections of the excise tax under this section of law to TRD at the end of each month, minus a 3 percent administrative fee on the amount of tax collected.
>
> Section 4 would amend Section 7-1-2 NMSA 1978 of the Tax Administration Act to make it applicable to the administration and enforcement of the Real Estate Transfer Act, as well as the other taxes listed.
>
> Section 5 adds a new section to the Income Tax Act allowing a social security income exemption for certain individuals, provided that the exempted amount shall not exceed the individual's net income
>
> 1. Married individuals filing separate returns with an adjusted gross income of $50 thousand or
> less;
> 2. Heads of household, surviving spouses and married individuals filing joint returns with

an adjusted gross income of $100 thousand or less; and
3. Single individuals with an adjusted gross income of $72,000 or less.

FISCAL IMPLICATIONS: REAL ESTATE TRANSFER TAX

Using data from the New Mexico Association of Realtors[1], housing trend statistics, TRD took a weighted average home price and number of transactions for 2020 and 2021 for Los Alamos, Santa Fe, and Taos Counties. While there will be transactions in other parts of the state that will meet the excise tax threshold, these three counties appear to have a weighted average price that will have a distribution of transactions meeting the minimum $500 thousand value in the near-term of the estimate period and represent the majority of real estate transactions in the state under these criteria.

The average home value is then grown at the average rate of increase in median home values in New Mexico between 2012 and 2019, to exclude the abnormal growth in property values witnessed between 2019 and 2021. By this method, Los Alamos county average home sale prices would hit the $500 thousand threshold in FY26. Taos and Santa Fe counties meet the $500 thousand threshold in FY23, with Santa Fe County hitting the threshold of $750 thousand in FY25. Without a full sample of transactions, an average does not provide for an indication of the distribution pattern of home sales and a statistical method cannot be applied soundly to assume what percentage of home transactions would be at $500 thousand versus the second tier of $750 thousand. All transactions for Los Alamos and Taos counties are assumed to be at the 0.5 percent rate for the average residential sale price. In FY25 and FY26, for Santa Fe County it is assumed 75 percent of transaction would be at the 0.5 percent rate and 25 percent at 1.25 percent using the average residential sale price. This method is likely conservative in the assumption of how many transactions would meet the 1.25 percent rate. This analysis also does not consider sales by owners and real estate contracts and thus is at the low end of a fiscal impact.

SIGNIFICANT ISSUES: REAL ESTATE TRANSFER TAX

TRD notes[2] that 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.

TRD also notes that at least 37 states impose a real estate transfer tax of some kind. These are fees paid as part of the closing costs that will transfer the home from the seller to the buyer. These taxes may be known as deed tax, mortgage registry tax, stamp tax or conveyance tax. In some cases, the tax is a flat fee (Arizona) in other instances it is a percentage of sale price or

[1] https://www.nmrealtor.com/2020-housing-trends/
[2] This section is from a similar bill proposed during the 2020 legislative session.

assessed value, and in still other cases the tax varies with the value of the property (Connecticut, Hawaii, New York, Vermont, Washington)[3]. The direct effect of imposing a tax such as this is that it increases the cost of buying or selling properties. Since the proposed legislation targets residential properties with a price of at least $500 thousand, the legislation will impact such transactions. Since the median sale price of a home in New Mexico in December 2021 was $290 thousand and the median varied from a low of $142 thousand in McKinley County to a high of $500 thousand in Santa Fe County, the proposed legislation will mostly impact buyers and sellers in high value counties and relatively higher income individuals buying and selling a home.

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.

The Mortgage Finance Authority's (MFA) comments that its mission is to provide affordable housing opportunities for low- to moderate-income New Mexicans. As this population would likely not be buying and selling properties in this price range, the real estate transfer tax would not affect MFA or the residents it serves.

PERFORMANCE IMPLICATIONS: REAL ESTATE TRANSFER TAX

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.

ADMINISTRATIVE IMPLICATIONS: REAL ESTATE TRANSFER TAX

This bill would have a high impact for divisions of TRD as it includes updates to tax year 2022 and a new tax, real estate transfer tax.

As relates to the new excise tax on real estate transfers:

> A new tax program requires implementing the program into GenTax, the tax system of record. It is assumed that all standard functionality for a new tax program will be included in the implementation including registration, returns, payments, e-services, audit, collections, non-filer, correspondence, reports. Due to the nature and complexity of the effort required to implement the Real Estate Transfer Tax, a contract with the GenTax vendor, FAST Enterprises, LLC is required. The associated cost is approximately 12 months and approximately $3,189,587 ($2,857,025 of contractual resources and $332,562 of staff workload costs). This estimate also includes the following support from FAST: project management, technical, testing and training support.
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> 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, Independent Verification & Validation (IV&V)

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[3] https://listwithclever.com/transfer-taxes/#transfer-taxes-by-state

services would also be required at a cost of approximately $259,730 including gross receipts.

Further, two state development resources and 1 state business analyst (FTEs) would be needed for the duration of the project at an estimated $322,234 of staff workload costs.

Implementing a new tax program, will also have an overall high impact on TRD's Administrative Services Division (ASD) requiring approximately 130 hours of effort totaling $4,640 in staff workload costs. ASD will need to work with DFA to update the accounting string in SHARE, and work with ITD to create a new distribution in GenTax and participate in extensive testing. During this time required production tasks will be performed outside of normal work hours, either as comp time or overtime, depending on the employee's FLSA status. Additionally, year-end financial statement reporting will require updating to include the new tax program. A new tax program requires recurring resources in the division at a recurring cost of ½ FTE at a pay band 70.

TRD's Revenue Processing Division (RPD) will need to expand resources to support the new tax program including payment processing functionality and one FTE at level Tax Examiner Advanced.

Due to the effective date of July 1, 2022 for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces July 1, 2022 to ensure complete readiness and testing of all processes. TRD will be in the first months of implementing the new cannabis excise tax program and working through any identified issues with this implementation of a new tax program. Based on this uncertainly there may be additional costs that cannot be estimated at this time.

Current proposed collection of the new excise real estate transfer tax is by county clerks, but administration of the tax is by TRD under TAA. As noted in the technical issues, this presents administrative barriers to running a new tax program and as such there are costs that cannot be estimated at time. The current effective date of July 1, 2022 is not feasible given the uncertainty of administrative and fiscal functions needed by TRD and the effort involved at minimum to collect tax revenue from counties.

TECHNICAL ISSUES: REAL ESTATE TRANSFER TAX

Although the real estate tax is described as "an excise tax" in 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. (…) 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 likely be challenged on these grounds by commercial and industrial real estate owners and by owners of multi-family residential properties.

TRD notes the following technical issues regarding the provisions of this bill:

This bill creates a new tax act to be administered under the Tax Administration Act (TAA) by TRD. However, payment of this tax will be to the county clerk for the county where the property is located. It would be difficult to administer many of the functions of this new excise tax without a return being filed with the department and a payment paid to the department. Late fees and interest, for example, would need to be assessed to the taxpayer under TAA but the department would be receiving funds from the county clerk rather than being paid by the taxpayer directly. Notably, property tax, which is also collected at the county level, is not administered under the TAA. TRD recommends that if this tax is under the TAA, then returns be filed with TRD and payments remitted to TRD.

This bill requires the proposed tax to be paid to county clerks. County treasurers are the officials elected to collect property taxes for their county, while county clerks collect lodger's taxes. A suggestion would be to require a title company to collect and remit this tax to county treasurers. Closing documents filed with the county clerk would indicate the tax has been appropriately collected. To facilitate timely recording, it is recommended the tax be paid to the county treasurer and then remitted to TRD.

Section 2 should be clarified to indicate whether the 0.50% tax applies to properties valued at $750,000, or only up to $749,999. There is presently an ambiguity in the statute as to what rate applies if the value is exactly $750,000.

Section 3 states the tax shall be remitted to the department by the end of the month. This appears to be inconsistent with other tax programs and may not be in sufficient time for the monthly GenTax close on the 10^{th} of each month. This may also be difficult for counties to administer. It is recommended this language be updated to something like "on or before the 25^{th} day of the month following the month in which the tax was collected.

This tax is established by the legislature and per GASB 84[4] is state sourced revenue which counties will maintain in custodial funds before transferring. This could impact counties' financial reporting processes. TRD recommends this legislation be further reviewed by the Department of Finance and Administration (DFA), Local Government Division and the Office of the State Auditor.

[4] Government Accounting Standards Board, statement no. 84 issued January 2017, provides guidance and establishes criteria for identifying fiduciary activities of all state and local governments

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FISCAL IMPLICATIONS: SOCIAL SECURITY EXEMPTION

To estimate the impact of the proposed legislation of exempting Social Security income from income taxation, the Taxation and Revenue Department (TRD) utilized data from the Individual Master File/Individual Return Transaction File (IMF/IRTF) extracts received from the Internal Revenue Service (IRS) for tax years 2018 and 2019.

To scale the impact of this exemption to tax year 2022 and into the forecast horizon of this bill analysis, TRD utilized a combination of a) the growth in Social Security outlays forecasted by the Congressional Budget Office (CBO)[1], b) the growth rate of the population 65 years and older in New Mexico relative to the United States[2], and c) the cost-of-living-adjustment (COLA) to Social Security and Supplemental Security Income (SSI) benefits for calendar year 2022[3,4].

The estimate is based on the taxpayer population in IRS data who filed a New Mexico personal income tax (PIT) return. This population was further filtered to only include those with taxable social security benefits that were either R-filers or B-filers[5] and who were either residents, first-year residents or part-time residents in New Mexico. Non-resident B-filers do not allocate any of their pension/annuity/social security benefit income to New Mexico and hence were excluded. It was further assumed that taxpayers would select either this new exemption or the exemption pursuant to Section 7-2-5.2 NMSA 1978, depending on which decreased their tax liability the most. The fiscal impact also accounts for the higher top personal income tax (PIT) rate that is effective beginning tax year 2021.

In general, 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. In this case, the amount of taxable social security is not reported directly to TRD. If this bill passes and is implemented, the annual cost cannot be determined exactly, because the federally taxable social security amount will be reported to TRD as an exemption and not a credit. TRD will have to recalculate all returns claiming this deduction/exemption.

This bill creates a tax expenditure with a cost that is somewhat difficult to determine because the data on which the model is based are indirect. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. 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.

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[1] https://www.cbo.gov/publication/57342

[2] Population Projections, United States, 2004 - 2030, by state, age and sex, on CDC WONDER Online Database, Sept. 2005.

[3] https://www.ssa.gov/cola/

[4] 2022 COLA adjustment at 5.9% was significantly higher than the average in the last five years of 1.6%. An adjustment was, therefore made to CBO's projected outlays to account for this higher than expected adjustment as well as to account for the current high inflationary expectations in FY2022 and FY2023.

[5] 'R' filers file based on the rate tables. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income.

SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

States that tax social security benefits broadly fall into four categories: (1) states that fully exempt social security benefits from their state income tax; (2) states that tax social security benefits the same way in which the federal government taxes them; (3) states that base benefit exemptions on certain factors such as age or income; and (4) states that do not tax income at all. Twelve states tax social security benefits to some extent (see Attachment A). New Mexico is one of two states that follow the federal rules for including a portion of social security benefits as part of taxable income, and the state also provides a deduction for persons over age 65 to help offset the tax on social security benefits.

At the federal level, if the taxpayer's adjusted gross income (AGI) including half of social security benefits totals less than $32 thousand for married couples filing jointly or $25 thousand for single filers, none of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax or state income tax. For AGI including half of social security benefits that exceeds $44 thousand for married joint and $34 thousand for single, then 50 percent to 85 percent of social security income is taxable.

The Aging and Long-Term Services Department (ALTSD) points out that seniors with adjusted gross income levels less than two to three times the poverty standard, do not pay taxes and will see no impact from this bill. Three times the poverty standard for 2022 is $38,640 for one person, $52,260 for two. 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.

See the *Other Significant Issues: Social Security Exemption* section of this FIR for additional discussion.

PERFORMANCE IMPLICATIONS: SOCIAL SECURITY EXEMPTION

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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 exemption is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS: SOCIAL SECURITY EXEMPTION

As related to the changes to PIT, the proposal will have a low impact on the TRD's Information Technology Division (ITD) of approximately 300 hours or about 2 months of development work at approximately $15,492. TRD will update forms, instructions, and associated publications. These updates will be incorporated into annual tax program revisions.

TECHNICAL ISSUES: SOCIAL SECURITY EXEMPTION

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

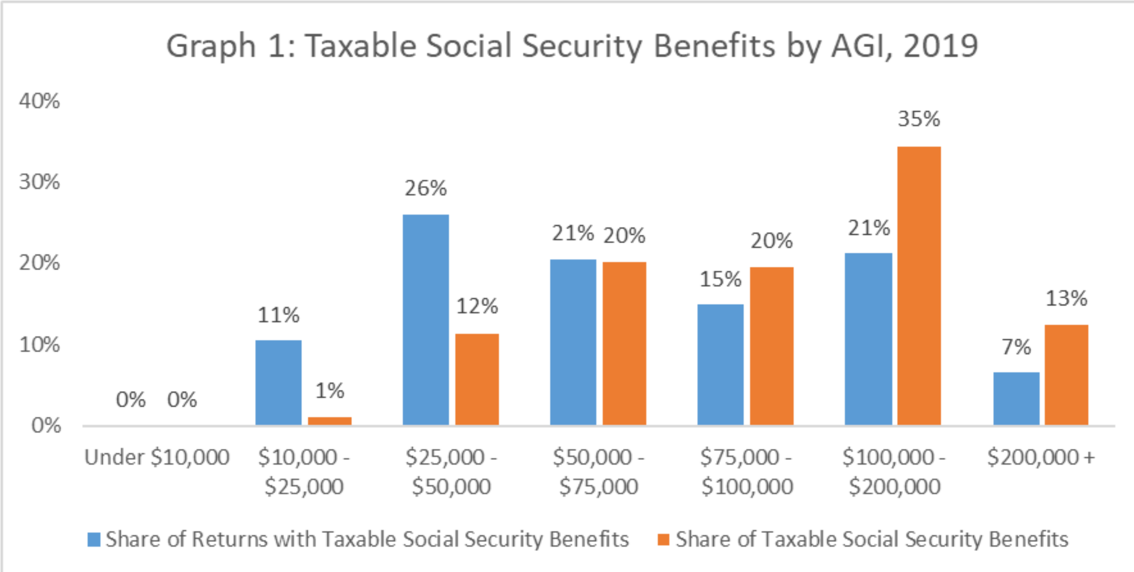
OTHER SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

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" problems. At that time, state retiree's pensions were 100 percent exempt from personal income tax, but federal retirees only were allowed a $3,000 deduction. The Supreme Court of the United States found that 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 differential deductions. In addition, other source-specific deductions were included in the fix. These included the total exemption for social security income.
An individual who is 65 years or older or who is blind may claim an exemption from PIT based on a sliding scale, not to exceed $8,000. This exemption is modest and cost the state $1.9 million in fiscal year 2021, with 105,436 claims, according to the most recent TRD Tax Expenditure Report. The current benefit amounts and bracket levels were established in 1987 and have not been adjusted since. Updating both the levels and the brackets by only 50 percent would cost the general fund approximately $15 million and would target the benefits to lower-income elderly or blind individuals.

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. 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.

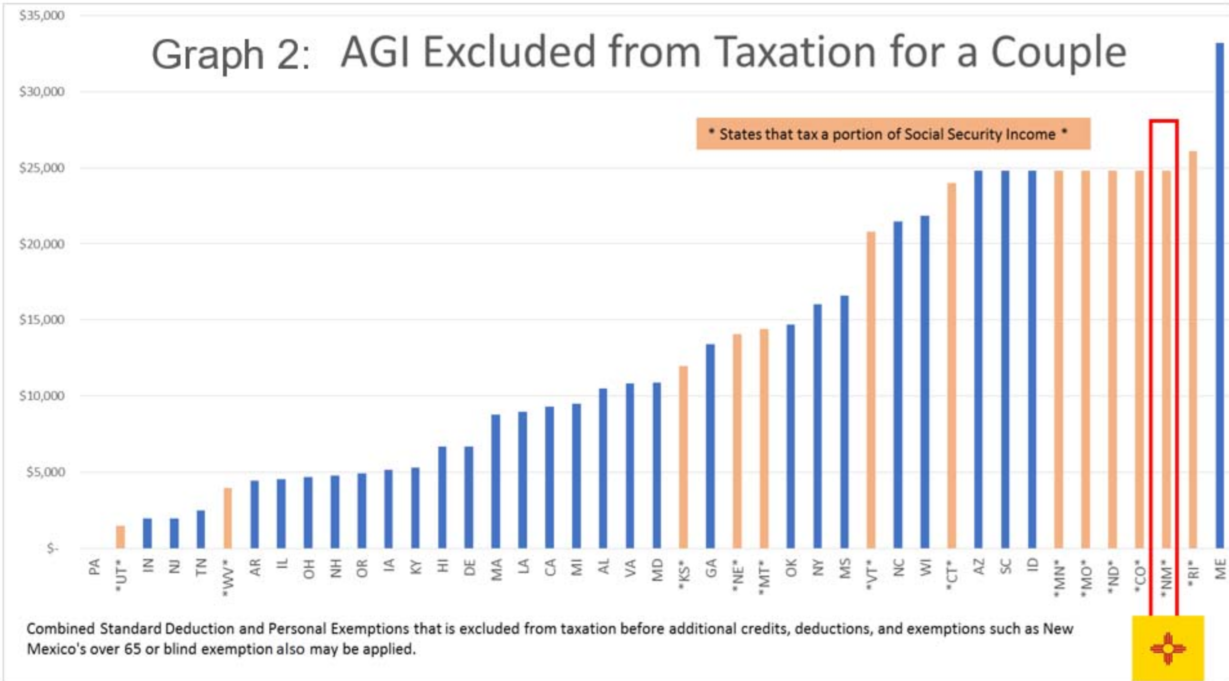
New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "conformity." As the federal tax code changes, such as under the 2017 Tax Cuts and Jobs Act (TCJA), states see impacts on their revenue collection from PIT, depending on their level of conformity. 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 major 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: 87 percent of taxable social security benefits are earned by individuals with AGI over $50 thousand. In contrast, taxpayers with AGI over $50 thousand represent only 63 percent of all taxpayers receiving social security benefits.

Twelve states, including New Mexico, tax some portion of social security benefit income. However, those 12 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 2 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 ($24,800) 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. 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), 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. However, 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.

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 benefits[6]. 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.

Reducing or eliminating income tax on social security benefits is often viewed as a mechanism for attracting or retaining retirees in the state. A 2018 publication by New Mexico State University included the following discussion:[7]

"Because New Mexico is listed as one of the "10 Least Tax Friendly" states for retirees (Kiplinger, 2017), additional research should be conducted on the impacts of reducing or eliminating taxes on retirement. However, it should be noted that while tax friendliness is often listed as a top criteria on "best places to retire" lists, other research has shown that tax policy changes have done nothing to attract retirees (Conway and Rork, 2012)."

Other factors – such as weather, cost of living (particularly cost of housing), and the location of family members – also affect migration decisions for retirees. A 2001 study published in the National Tax Journal found that, "in addition to cost-of-living and climate considerations, the elderly are attracted to states that exempt food from sales taxes and spend less on welfare. Low personal income and death taxes also encourage migration, depending on how these states taxes are measured."[8]

ALTSD points out that New Mexico seniors are facing substantial financial obstacles and 13.5 percent of adults ages 65 years and older live below the poverty level, the second highest in the nation.[9] Rates of poverty varied from 5.5 percent in Los Alamos County to 24.1 percent in McKinley County. In addition, those seniors and adults with disabilities who live in assisted living facilities may be potentially impacted by this bill, as approximately 75 percent of assisted living residents pay for their stay with private funds.[10] According to the State of Senior Hunger in America 2019 Annual Report, 12.4 percent of New Mexicans 60 years and older experience food insecurity, the 2nd highest rate in the United States. The Aging & Disability Resource Center (ADRC) serves older adults, people with disabilities, and their caregivers, regardless of income. The social security tax exemption would benefit some of the population that the ADRC serves.

New Mexico is also projected to have amongst the highest population over the age of 65 by the year 2030. TRD notes that even seniors with higher incomes who receive the bulk of the benefits of the exemption are more likely to spend their money, leading to increased economic activity, increased gross receipts for those serving that population, and consequently higher tax revenues for both the state and local governments. The exemption contained in this bill is capped by income level, meaning that the highest income retirees, who are least likely to spend any tax savings, do not receive the credit; therefore, the exemption is targeted towards those most likely to spend. Retirees are more likely to spend their money, and to have more discretionary income, as they are no longer saving for their retirement, and indeed are often required to begin taking

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[6] 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.

[7] *Potential Fiscal Impacts of a New Mexico Retiree Attraction Campaign*, December 2018 https://aces.nmsu.edu/pubs/_circulars/CR691.pdf

[8] Houtenville, Andrew & Conway, Karen. (2001). *Elderly Migration and State Fiscal Policy: Evidence from the 1990 Census Migration Flows*. National Tax Journal. 54. 10.17310/ntj.2001.1.05.

[9] U.S. Census Bureau's 2019 American Community Survey

[10] https://www.nmhca.org/faq-facts/

social security benefits or distributions from retirement plans. Any additional discretionary income they receive as a result of tax cuts, except for the very highest income individuals, are more likely to be spent. Due in part to the change to destination sourcing rules, the impact of increased spending by seniors living in New Mexico will be felt in the communities where those seniors live.

TRD also notes that studies have shown that seniors contribute to their communities in multiple significant ways. Seniors often contribute more than other groups through volunteer work. Many seek additional sources of income, and therefore perform part-time work that would not be done by non-retired individuals who need the income that full-time work provides. Especially at times such as now, where businesses struggle to find workers to fill jobs, and when unemployment is historically low, having a skilled senior population benefits businesses and the overall economy. Senior also often provide family support, attending for instance to some child-care or home-care responsibilities that working adults cannot perform, or lack adequate time to perform. Again, this factor is especially relevant today, when more adults are forced to work from home, when schools are still teaching remotely, and when daycare options have become more limited. Many grandparents care for grandchildren, or at least share in childcare responsibilities. Communities can therefore benefit both economically and socially from having a large senior presence.

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. As the graphs illustrate though, the consideration of exempting social security and eroding horizontal equity must be placed in context of the federal and state tax structure, in its entirety.

As far as attracting more retirees to the state is concerned, exempting social security from income taxation may not necessarily help in achieving that goal. 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 taxes[11]. Notably, New Mexico's property taxes are among 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.

PERFORMANCE IMPLICATIONS: SOCIAL SECURITY EXEMPTION

The LFC tax policy of accountability is <u>not</u> met for the social security exemption portion of this bill because TRD is <u>not</u> 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.

ALTERNATIVES: SOCIAL SECURITY EXEMPTION

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

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 NMSA 1978) or for low- and middle-income taxpayers (Section 7-2-5.8 NMSA 1978).

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. In general, the courts permit the Legislature considerable discretion and leeway in the prohibition of logrolling. 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. …

The Attorney General's Office notes that for clarity, the two issues should be separated into two different bills. The first issue, Real Estate Excise Tax is a proposed *new* section. The section dealing with Social Security is an *amendment*. Both are changes to the Taxation Administration Act, however, to include both in one bill is confusing.

Does the bill meet the Legislative Finance Committee tax policy principles?
Adequacy: Revenue should be adequate to fund needed government services.
Efficiency: Tax base should be as broad as possible and avoid excess reliance on one tax.
Equity: Different taxpayers should be treated fairly.
Simplicity: Collection should be simple and easily understood.
Accountability: Preferences should be easy to monitor and evaluate.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?
Vetted: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
Accountable: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
Effective: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	?	It is unknown if the issue has been discussed at an interim committee recently.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✘ ✘ ✘	No purpose, targets, or goals established.
Transparent	?	TRD will likely publish a cost estimate in its annual Tax Expenditure Report; however, no specific reporting on this exemption to interim committees is required.
Accountable Public analysis Expiration date	 ✘ ✘	 The bill contains no provisions for reporting. The bill does not include an expiration date.
Effective Fulfills stated purpose Passes "but for" test	 ? ?	Without a purpose statement or required reporting, it is not possible to determine if the exemption fulfills intended outcomes.
Efficient	✘	Without a purpose statement or required reporting, it is not possible to determine if the exemption is the most efficient means of achieving desired outcomes. However, current data and recent studies indicate this exemption would be inefficient in providing tax relief to low-income households receiving social security benefits and may not be a meaningful recruitment tool for retirees to the state.
Key: ✓ Met ✘ Not Met ? Unclear		

Attachments

1. State Taxation of Social Security Benefits

JF/acv

ATTACHMENT A

State Taxation of Social Security Benefits

State Taxation of Social Security Benefits	
Colorado	For beneficiaries younger than 65, up to $20,000 of Social Security benefits can be excluded, along with other retirement income. Those 65 and older can exclude benefits and other retirement income up to $24,000. Starting with the 2022 tax year, residents will be able to deduct all federally taxable Social Security benefits from their state income, part of a tax-code overhaul that Colorado lawmakers enacted in June 2021.
Connecticut	Social Security is exempt for individual taxpayers with federal adjusted gross income of less than $75,000 and for married taxpayers filing jointly with federal AGI of less than $100,000.
Kansas	Social Security benefits are exempt from Kansas income tax for residents with a federal adjusted gross income of $75,000 or less.
Minnesota	Social Security income is taxable, but a graduated system of Social Security subtractions apply if someone's provisional income is below $81,180 for a single filer or $103,930 for joint filers.
Missouri	Social Security benefits are not taxed for single taxpayers with adjusted gross income of less than $85,000 and married couples with AGI of less than $100,000. Taxpayers who exceed those income limits may qualify for a partial exemption on their benefits.
Montana	Social Security benefits are taxable. The taxable amount may be different from the federally taxable amount because Montana taxes some types of income that the federal government does not, and vice versa.
Nebraska	A taxpayer may subtract Social Security income included in federal adjusted gross income if a taxpayer's federal adjusted gross income is less than or equal to $58,000 for married couples filing jointly, or $43,000 for all other filers. Nebraska is phasing out taxation of benefits starting in the 2021 tax year when beneficiaries saw a 5 percent cut in taxes on their Social Security. The reduction will grow in steps to 50 percent by 2025, at which point state lawmakers will vote on whether to eliminate the tax on benefits altogether by 2030.
New Mexico	Benefits are taxed to the same extent as on the federal tax return. But Social Security income can be included as part of an overall retirement-income exemption of up to $8,000 per person, subject to income restrictions.
Rhode Island	Rhode Island doesn't tax Social Security benefits for single filers with up to $81,900 in adjusted gross income and joint filers with up to $102,400 in AGI.
Utah	Social Security benefits are taxed, but the state uses tax credits to eliminate liability for beneficiaries with less than $30,000 (single filers) or $50,000 (joint filers), with credits phasing out at 2.5 cents for each dollar above these thresholds.
Vermont	Vermont provides a graduated system of Social Security exemptions which kick in if a taxpayer's income is below $34,000 (single filer) or $44,000 (filing jointly)
West Virginia	West Virginia passed a law in 2019 to begin phasing out taxes on Social Security for those with incomes not exceeding $50,000 (single filers) or $100,000 (married filing jointly). Beginning in tax year 2020, the state exempted 35 percent of benefits for qualifying taxpayers. As of 2021, that amount increased to 65 percent, and in 2022, the benefits will be completely exempt for those taxpayers.

Sources: Tax Foundation, 2021 and AARP, 2022