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FISCAL IMPACT REPORT

ORIGINAL DATE 1/31/22

SPONSOR Pope LAST UPDATED _____ HB _____

SHORT TITLE Tax Exemption For Military Retirement Pay SB 85

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	(\$17,300.0)	(\$17,500.0)	(\$17,800.0)	(\$18,600.0)	Recurring	General Fund

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	\$5.2			Nonrecurring	TRD Operating (ITD)

Parenthesis () indicate expenditure decreases

This bill is a duplicate of HB76, which provides a \$30,000 exemption for military pensions. It is apparently an alternative to SB128 which provides a three-year phased in exemption of up to \$50 thousand for military and uniformed personnel pensions.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Veteran's Services Department (VSD)

SUMMARY

Synopsis of Bill

Senate Bill 85 would create a new section in the Income Tax Act, and allow an armed forces retiree to claim an exemption in an amount equal to \$30 thousand of military retirement pay in net income. It defines "armed forces retiree" as "a former member of the armed forces of the United States who has qualified by years of service or disability to separate from military service with lifetime benefits."

There is no effective date of this bill. It is assumed that the effective date is 90 days following adjournment of the Legislature; or May 18, 2022. The provisions of the personal income tax credit are applicable to tax years beginning January 1, 2023. If both SB85 and HB76 are enacted

they are identical and can be construed together. If SB85 and SB128 are enacted, they could not be construed together and the later one signed by the governor would be compiled and eliminate the provisions of the earlier signed bill.

FISCAL IMPLICATIONS

This bill may be counter to LFC’s 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.

TRD describes the methodology for this estimate: “Two sources of data were analyzed to arrive at an estimated revenue impact. The first data source is the Department of Defense (DOD) annual *Statistical Report on the Military Retirement System* for the federal fiscal year that ended September 30, 2020. The second data source was a sample of New Mexico military retiree state income tax returns for tax year 2018. The analysis takes into account the new 5.9 percent marginal tax rate effective for Tax Year 2021 and beyond.”

TRD found that “As of September 30, 2020, New Mexico had 20,806 reported retirees and 2,812 survivor beneficiaries. Aggregate annual distribution of military retirement benefits for retirees (not including survivor benefits) was approximately \$568 million. This analysis assumes all retirees were qualified by years of service or disability to receive lifetime benefits.”

TRD used a “sample of military retiree returns [...] to establish an average personal income tax (PIT) decrease per retiree based on the maximum \$30 thousand exemption of military retirement pay. An average PIT decrease per year was calculated with the sample of 15,000 returns.”

TRD “assumed that the sample of approximately 15,000 military retiree returns is representative of the approximately 21,000 average annual reported retirees. The average PIT decrease per year was multiplied by the 21,000 retirees. The historical retiree numbers in the last four years from the annual *Statistical Report on the Military Retirement System* indicate a slight annual decline of -0.5 percent. To the extent the legislation causes more military retirees to move to New Mexico and military retiree population growth is positive versus flat or negative, the fiscal impact will be larger. Finally, the analysis assumes 100 percent of qualifying retirees will claim the deduction in the first year of eligibility.”

SIGNIFICANT ISSUES

TRD has carefully analyzed this bill a number of times and the following highlights a number of factors the agency identified as potential issues:

“...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 taxpayers’ ability to pay. Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on retirement status and profession, 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.”

“New Mexico, along with seven other states, has the third highest income level (\$25,100) at which a couple’s income may begin to be taxed. Conversely, Pennsylvania’s income tax is applicable to most non-zero income. So, while New Mexico taxes retirement income, including for military retirees, the state does not begin to tax a couple’s income until the \$25,100 threshold. New Mexico also provides PIT exemptions to low-income individuals aged 65 years and older or blind.”

“There are many reasons why states may exempt some income for retirees, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. ...[However,] the consideration of such exclusions and eroding horizontal equity must be placed in context of the federal and state tax structure, in its entirety.”

“Regarding attracting more retirees to the state, exempting retirement income is one of many factors that could help in achieving that goal. For example, Texas does not tax any income, military retirement 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 taxes¹. Notably, New Mexico’s property taxes are amongst the lowest in the nation. Looking at New Mexico’s tax code holistically, the proposed exemption may not be necessary, at least not to achieve this policy goal, especially if the exemption is contrary to other, over-arching tax policy goals of simplicity and equity.”

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since 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 exemption is meeting its purpose. TRD will report utilization data in its annual Tax Expenditure Report. However, TRD will not have access to data to establish if the bill actually increases the number of veterans, particularly highly skilled officers and senior enlisted retirees to relocate to New Mexico, which is the stated goal of this tax exemption.

ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and create new publications, forms, and regulations. These changes will be incorporated into annual tax year implementation and represents \$5,164 in workload costs

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill is a duplicate of SB76.

SB128; proposes a phased exemption limited after three years to \$50,000 and expands to uniformed retirees.

HJR6 and HJR7 propose property tax full or partial exemptions for veterans and the survivors.

¹ https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. This would allow the Legislature to determine if the exemption was efficient in encouraging skilled officers and senior enlisted personnel to retire in New Mexico.

TRD also has concerns about two technical issues:

(1) “The term armed forces might need further clarification to determine who qualifies as a military retiree. According to U.S. Code, Title 10, Chapter 1 – definitions, there is a distinction between armed forces and uniformed services. Armed forces mean the Army, Navy, Air Force, Marine Corps, Space Force, and Coast Guard. It does not include the commissioned corps of the National Oceanic and Atmospheric Administration or the commissioned corps of the Public Health Service, both of which are part of the uniformed services; and

(2) “This bill does not outline how TRD would verify the information to determine eligibility for the exemption. TRD may have to draft regulations to outline what information will need to be submitted with the return to verify this exemption. This exemption would most likely be added to the PIT-ADJ form, schedule of additions, deductions and exemptions.”

POSSIBLE QUESTIONS

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.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	This bill has previously been introduced and extensively debated. Most recently, SB277 (2021 Regular Session) was introduced, assigned to STBTC, but, apparently, not scheduled for hearing.
Targeted		The purpose of this bill is to encourage highly skilled officers and senior enlisted personnel to retire to New Mexico and aid in economic development of the state. However, this goal is not accompanied by any measureable target.
Clearly stated purpose	✗	
Long-term goals	✓	
Measurable targets	✗	
Transparent	?	
Accountable		LFC recommends the bill include a delayed repeal.
Public analysis	✗	
Expiration date	✗	
Effective		No purpose or goals are established in the bill.
Fulfills stated purpose	✗	
Passes “but for” test	?	
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

