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

SPONSOR	Burt/Moores/Gallegos	**ORIGINAL DATE**	2/1/22		
		LAST UPDATED		**HB**	
SHORT TITLE	Uniformed Svc. Retiree Income Tax Deduction			**SB**	128
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
	--	($8,200.0)	($16,400.0)	($24,200.0)	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

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Veteran's Services Department (VSD)

SUMMARY

Synopsis of Senate Bill 128

Senate Bill 128 adds a new section to the income tax act providing a deduction for the retirement income of a uniformed services retiree or the retiree's surviving spouse or the spouse of a uniformed services member who was killed in the line of duty while serving in the uniformed services. The deduction is 33 percent of military retirement income, not to exceed $16,333 for a taxable year beginning on or after January 1, 2023 and prior to January 1, 2024, 66 percent, not to exceed $33,666 for a taxable year beginning on or after January 1, 2024 and prior to January 1, 2025, and 100 percent, not to exceed $50,000 for taxable years beginning on or after January 1, 2025.

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.

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 U.S. Department of Defense (DOD) annual *Statistical Report on the Military Retirement System* published September 2021 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% marginal tax rate effective for Tax Year 2021 and beyond."
>
> "The *Statistical Report on the Military Retirement System* provides an aggregate number of retirees and survivor beneficiaries by state, and an aggregate amount of benefits distributed. As of September 30, 2020, New Mexico had 20,806 reported retirees and 2,812 survivor beneficiaries. Based on the DOD report, survivor benefits includes spouses of service members killed in the line of duty. Aggregate annual distribution of military retirement benefits for retirees and survivors was approximately $606 million. This analysis assumes all retirees were qualified by years of service or disability to receive lifetime benefits."
>
> "The sample of military retiree returns was used to establish an average personal income tax (PIT) decrease per retiree based on the percentage deduction amounts and maximum amounts per tax year up to 100% and no more than a $50,000 deduction in tax years after January 1, 2025. Retiree annuities were increased by a cost of living adjustment, which for most retirees per the DOD report is based on the Urban Wage Earner and Clerical Worker Consumer Price Index (CPI-W). All other taxable income reported on the returns was kept flat. Subtracting the deduction amount, a new taxable income was calculated, and the PIT rates applied to determine the new PIT due. An average PIT decrease per year was calculated with the sample of 15,000 returns."

SIGNIFICANT ISSUES

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

> "There are important social policy goals that may be served by exempting certain retirement income from personal income taxation. First, many seniors live at or near the poverty line, and retirement income can be fixed. Any reduction in the amount of tax they pay can be significant for them. For a couple with an adjusted gross income of only $25,100, the level at which their benefits currently become subject to income tax, even a small reduction in taxes can provide for better nutritional or health outcomes, or can allow them to create a small fund for emergencies. Even couples with an adjusted gross income of $50,000 may have a tight budget, and benefit from any amount of reduction in their tax liability.

> "The second policy benefit flows from this first point. Even seniors with higher incomes who receive the bulk of the benefits of the exemption are more likely to spend their money in the state 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. Retirees are more likely to spend their money, and to have more discretionary income. 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."

> "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. Seniors 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."

According to the New Mexico Human Services Department, "in 2019, 13.5% of New Mexico seniors were below the poverty rate, the highest rate of senior poverty in the nation. Rates of poverty varied from 5.5% in Los Alamos County to 24.1% in McKinley County. New Mexico is also projected to have amongst the highest population over the age of 65 by the year 2030."

"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 taxes[1]. Notably, New Mexico's property taxes are amongst the lowest in the nation. Furthermore, New Mexico already provides an attractive income tax exemption for individuals over 65 years of age under Section 7-2-5.2."

"Personal income tax 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 taxpayers' ability to pay."

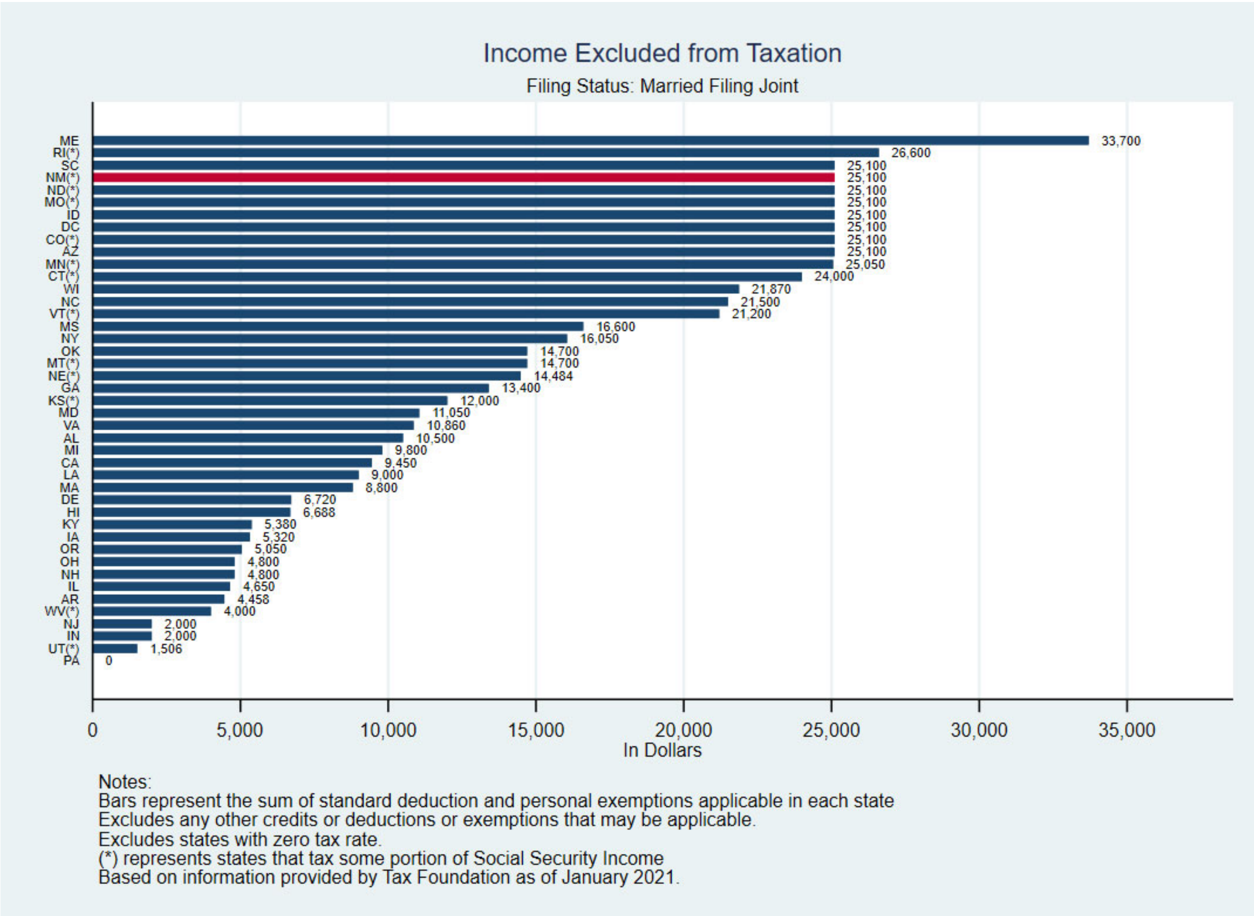
"Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on retirement status and profession, taxpayers

---

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

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."

Chart 1



"Chart 1 compares the income level at which each state's initial income tax rate takes effect for a married couple. 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 ranging from $1,000 to $8,000 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. As Chart 1 illustrates though, 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 taxes[2]. Notably, New Mexico's property taxes are amongst the lowest in the nation. Looking at New Mexico's tax code holistically, the proposed deduction may not be necessary, at least not to achieve this policy goal, especially if the deduction is contrary to other, over-arching tax policy goals of simplicity and equity.

"….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 taxes[3]. 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 <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. 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

---

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

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 SB85.

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.

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.

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.
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		
Public analysis	×	
Expiration date	×	LFC recommends the bill include a delayed repeal.
Effective		
Fulfills stated purpose	×	No purpose or goals are established in the bill.
Passes "but for" test	?	
Efficient	×	
Key: ✓ Met × Not Met ? Unclear		

LG/acv