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FISCAL IMPACT REPORT

ORIGINAL DATE 2/1/2007

SPONSOR Sandoval LAST UPDATED _____ HB 368

SHORT TITLE Armed Service Retiree Income Tax Exemption SB _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
(\$2,520.0)	(\$10,330.0)	(\$8,700.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to SB493, SB43, SB492, HB541, HB207, HB497

SOURCES OF INFORMATION

LFC Files
Taxation and Revenue Department (TRD)

Responses Received From

Veterans Service Commission (VSC)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 368 exempts up to \$50 thousand of earned income of military retirees from the personal income tax.

FISCAL IMPLICATIONS

The fiscal impact of House Bill 368 is an \$8.4 million reduction in personal income tax revenues per year. It is assumed that the impact for FY07 occurs in the second quarter of 2007 and therefore only accounts for 30 percent of the tax year reduction or \$2.5 million. The FY08 impact is \$10.2 million, 70 percent of the tax year 2007 impact and 50 percent of the tax year 2008 impact. In FY09, the impact is \$8.7 million.

According to Taxation and Revenue Department,

The Department does not have detailed information about the earned income of military retirees in the state. To estimate the earned income of these individuals, we consulted federal tax returns filed by all New Mexico residents who reported some form of pension income. 39% of single taxpayers and 63% of married taxpayers with pension income reported some form of earned income during 2003. Applying these percentages to the population of 21,000 military retirees yields an estimate of 11,900 with earned income. We then assumed that the average earned income of military retirees is the same as the average of all taxpayers reporting pension income. In 2003 this average was \$26,000 for single taxpayers. We used the same value for married taxpayers because we are only interested in the earned income of the military retiree not that of the retiree's spouse. Applying inflation to the income figures, total earned income of military retirees would be approximately \$350 million. After applying the 50%/\$50,000 limit, this amount is reduced to \$166 million. The average effective tax rate on this exclusion would be 5%, yielding annual impacts of \$8.4 million in tax year 2007.

SIGNIFICANT ISSUES

Exempting earned income gives military retirees an incentive to either remain or relocate in New Mexico and augment the work force. The military trains career service men and women in a variety of occupations that are in high demand in the state, particularly high tech and health care.

Many retirees, however, are highly skilled and there is little evidence that military retirees are more likely to work in needed fields than other types of retirees, such as federal and state retirees. Further, military veterans that did not retire from the service have many of the same skills as retirees but do not receive an exemption under this proposal. Allowing one class of retiree an exemption from personal income tax creates a perception of inequity and narrows the base of the income tax and puts more pressure on the tax system to generate the same revenue.

Veterans Services Commission:

Young military retirees bring the following to the state:

- a. Service acquired skills that are immediately transferable to civilian requirements
- b. Entrepreneurial spirit
- c. Health and Dental care for themselves and their dependents
- d. High tech qualifications in demand in our high tech industries
- e. Desperately needed qualified health care skills

TRD:

By reducing state tax obligations, the proposed measure would tend to *increase* federal tax liability because state tax obligations are deductible against federal liability. Hence the net taxpayer benefit would be less than the \$700 per claimant mentioned above.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Below is an enumeration of the bills introduced so far in the 2007 session:

207	H	Cote	ARMED FORCES INCOME TAX EXEMPTION
368	H	Sandoval	ARMED SERVICE RETIREE INCOME TAX EXEMPTION
497	H	Foley	MILITARY RETIREMENT PAY TAX EXEMPTION
541	H	Anderson	ARMED FORCES INCOME TAX EXEMPTION
43	S	Robinson	MILITARY PENSION INCOME TAX EXEMPTION
492	S	Carraro	ARMED SERVICES INCOME TAX EXEMPTION
493	S	Carraro	MILITARY PENSION INCOME TAX EXEMPTION

ADMINISTRATIVE IMPACTS

TRD reports that the administrative impact would be relatively minor and would not require additional resources.

ALTERNATIVES

One alternative is to indicate particular occupations, such as education or health care, to encourage development in needed occupations.

ADDITIONAL ISSUES

TRD has provided a synopsis of legislation affecting military service men and women:

Present law treatment of military retirement income

Federal tax treatment of military retirement benefits:

Military pension income is treated as taxable income for federal income tax purposes. An exclusion is provided for survivor annuity payments. Veteran's benefits are excluded from income tax.

New Mexico Statutes:

New Mexico statutes follow federal law in the treatment of military retirement income. Persons over 65 years of age are allowed an exemption from taxable income of \$8,000 per person. This exemption is reduced for taxpayers with adjusted gross income of more than \$15,000 (\$30,000 married) so that no exemption is available if adjusted gross income is more than \$25,500 (\$51,000 married).

Other states' tax treatment of military retirement income:¹

Most states with a personal income tax allow some form of exclusion for retirement income, defined as government pension payments, Social Security, Railroad Retirement, private pension plans and public or private deferred compensation plans. Two purposes are cited for these provisions: to protect the income of retired persons and to encourage retired persons to re-locate or to remain in the state.

The U.S. Supreme Court has ruled that states may not discriminate against federal civil service or military pensions by providing better treatment of state pensions than is provided

¹ Description and table are from National Conference of State Legislatures publication "State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2005," published in January 2006.

for federal pensions. However, there is no federal impediment to a state providing better treatment for public pensions than is provided for private pensions.

The following table summarizes the treatment of military pensions by the 42 states that have a broad-based personal income tax. Of the 42 states, all but 7 provide some form of exclusion for military pensions. In most cases, this relief is also provided for federal civilian pensions, state and local government pensions and for Social Security income. Only 2 states (Connecticut and New Jersey) provide relief that is targeted uniquely at military pensions.

Description:	Number of States with Provision:	Notes:
Full exclusion	12	AB, HI, IL, KS, LA, MA, MI, MS, NJ, NY, PA, WI
Capped dollar amount	7	AZ, AR, KY, ME, NC, ND, WV
Capped amount and age threshold	10	CO, DE, DC, GA, ID, IN, IA, MD, SC, VA
Percentage of military pension	1	CT
Amount subject to income level	3	MO, MT, OK
No specific exclusion<1>	7	MN, CA, NE, NM, RI, UT, VT
Tax credits	2	OH, OR
Total	42	

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