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FISCAL IMPACT REPORT

ORIGINAL DATE 2/8/09
 SPONSOR Anderson LAST UPDATED 2/19/09 HB 277
 SHORT TITLE Uniformed Service Retirement Tax Exemption SB _____
 ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(\$32,900.0)	(\$22,760.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to HB276

SOURCES OF INFORMATION

LFC Files

Responses Received From

Veteran Services Department (VSD)

Taxation and Revenue Department (TRD)

Department of Military Affairs (DMA)

SUMMARY

Synopsis of Bill

House bill 277 exempts all of the retirement payments and survivor benefits paid by the federal government for “uniformed services,” defined as the army, navy, air force, marines, coast guard, and the commissioned corps of the National Oceanic and Atmospheric Administration (NOAA) and the US Public Health Service (USPHS). The exemption would be for tax years beginning 2009.

FISCAL IMPLICATIONS

TRD:

In 2007 approximately 20,000 retired military service personnel (RMSP) lived in New Mexico and received retirement payments of \$39 million.¹ Approximately 2,500 military survivors also lived in New Mexico during 2007 and receive monthly payments of nearly

¹ DOD Office of the Actuary. 2008. Fiscal Year 2007 DOD Statistical Report on the Military Retirement System.

\$3 million. These numbers were adjusted upward to account for retired NOAA and PHS commissioned corps personnel, and used to calculate the total value of military retirement and survivor benefit payments received by individuals living in New Mexico. The value of payments in subsequent years was estimated by assuming a 1.5% growth in the relevant population² and adjusting payments for inflation.³ Because the average 2007 New Mexico RMSP household income was approximately \$86,000,⁴ the revenue impact was estimated by applying a relatively high average marginal tax rate of 4% to total annual payments. The impact for FY2010 is higher than for other years due to the fact that the full effect of tax year 2009 and half of that for tax year 2010 occurs in FY2010.

NMSU conducted a study that yielded very different and lower results. The central assumption is the rate applied to income for the purposes of calculating income tax. TRD uses a *marginal* tax rate which is the rate that would be applied to the last dollar of adjusted gross income while NMSU uses an *average* rate which is effectively the total tax divided by the adjusted gross income. The marginal rate TRD uses is double the average rate that NMSU uses: this causes the results to be double. TRD has additional taxpayers in the data as well, adding to the fiscal impact.

The FY10 impact is much larger because the effective date is June 19th, 2009, halfway through calendar year 2009. This means that virtually all of the tax year 2009 withholding will occur in FY10 rather than half occurring in FY09 as would normally be the case. In other words, the full year of tax year 2009 and half year of 2010 will show up in FY10, causing the impact to be much higher than a normal year.

² The population of RMSP has historically grown by approximately 1.5% each year. (Arrowhead Center. 2009. The Economic Impact of Exempting Retired Military Service Payments from New Mexico Personal Income Tax.)

³ Military pay is adjusted annually for inflation.

⁴ Arrowhead Center. 2009.

SIGNIFICANT ISSUES

TRD:

Individuals with incomes and other circumstances similar to individuals receiving the proposed exemption are likely to view it as unfair, especially when they compete with the retirees for jobs and when the retirees have relatively high incomes. The measure may encourage military retirees to move to New Mexico. These individuals may possess substantial work skills that could benefit New Mexico economic development efforts. It is sometimes argued that such individuals place lower demands on public spending (education, law enforcement, etc.) than other segments of the population.

RELATIONSHIP

HB 276 exempts 50 percent of retirement pay.

TECHNICAL ISSUES

VSD reports concerns that including NOAA and USPHS among the eligible retirees could open the door to exempting the retirement pay of the estimated 25,000 other federal retirees in New Mexico.

NF/mt

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc