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

ORIGINAL DATE 01/27/15
SPONSOR Burt **LAST UPDATED** 03/15/15 **HB**

SHORT TITLE Uniformed Services Retiree Tax Deduction **SB** 316/aSCORC/aSFC

ANALYST Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18****	**FY19**		
			($5,000.0)	($10,000.0)	Recurring	General Fund

**Partial impact due to time difference between fiscal year 2018 and calendar year 2017
Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Department of Veteran Services (DVS)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 316 eliminates all SCORC amendments and adds language to phase-in the proposed deduction over four years. The deduction would be scheduled as follows:

- For tax year 2017 the deduction would be 25 percent, not to exceed $12,500;
- For tax year 2018 the deduction would be 50 percent, not to exceed $25,000;
- For tax year 2019 the deduction would be 75 percent, not to exceed $37,500; and,
- For tax year 2020 the deduction would be 100 percent, not to exceed $50,000.

The provisions of the act apply to taxable years beginning on or after January 1, 2017. Table 1 shows the long-run revenue impact of the bill.

Table 1. Long-Run Revenue (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
($37,000.0)	($49,000.0)	($50,000.0)	($51,000.0)	($52,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment to Senate Bill 316 adds language to phase-in the proposed deduction over four years. The deduction would be scheduled as follows:

- For tax year 2015 the deduction would be 25 percent, not to exceed $12,500;
- For tax year 2016 the deduction would be 50 percent, not to exceed $25,000;
- For tax year 2017 the deduction would be 75 percent, not to exceed $37,500; and,
- For tax year 2018 the deduction would be 100 percent, not to exceed $50,000.

Synopsis of Original Bill

Senate Bill 316 creates a new section of the Income Tax Act to create a deduction for the retirement or retainer pay of a uniformed services retiree or a surviving spouse. The bill caps the deduction at $50,000 per taxable year.

The purpose of the deduction is to encourage uniformed services retirees to move to the state. The bill describes the process of claiming the deduction as prescribed by TRD and requires the department starting in 2018, to compile and present an annual report to legislative committees on the deduction including the number of tax payers claiming the deduction, the aggregate amount of deductions claimed, and any other information necessary to evaluate the effectiveness of the deduction. The bill includes definitions of uniformed services and uniformed services retirees.

There is no effective date of this bill. It is assumed the new effective date is 90 days after this session ends. The provisions of the act apply to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

The SFC amendment allows the impact of the legislation to be phased-in overtime. Hence, the negative fiscal impact to the general fund would be reduced in the near term. TRD's analysis of the bill assumes there are about 21,357 military retirees[1] in New Mexico, with an average annual pay of $26,000 to each retiree by the Department of Defense. According to the report, there were about 4 million retirees nationwide in 2013, with an average annual salary of about $26,000. Using a 4 percent tax rate, TRD estimates that, on average, all retirees would qualify for the deduction which would result in about $49 million in foregone revenue when fully implemented.

[1] Statistical Report on Military Retirees by State, Department of Defense, September 30, 2013

TRD adds the bill would contribute increasing the disposable income of uniformed services retirees thereby increasing other tax revenue sources such as gross receipts tax, housing and thus putting the money back into the New Mexico economy. The department acknowledges the presence of increased number of retirees in the state would translate to increase in spending on services provided by the state to military retirees. TRD assumes a 2 percent growth every year after FY 2019 due to population growth as more retirees relocate to New Mexico.

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.

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. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

Because military retirement pay and pensions are taxed federally, according to TRD, other states that permit a deduction for military retirement pay/pension often attach a requirement that the deduction be taken by a taxpayer of a certain age, since individuals can retire from the military quite young. TRD notes the amendment addresses the fact that other states increase the deduction over time rather than making it available to 100 percent of taxable income immediately, thereby incentivizing long-term residency in the state.

New Mexico incentivizes hiring veterans in Section 7-2A-27 NMSA 1978, by providing a corporate income tax credit to an employer who demonstrates they have hired a veteran within two years of the veteran's date of honorable discharge.

DVS notes the average age of a military retiree in the state is 46 years old with an average annual retirement income of $50,000 or less. Military retirees that depend solely on this income will likely seek to be employed full or part-time to subsist. This means the military retiree's personal income received from their full or part-time employment is fully taxed under current law. According to DVS, most of the military retirees in the state are married and their spouse's income is also fully taxed. Also, the department believes the bill will have a positive effect in the state's economy through an increase in gross receipts tax revenue caused by higher spending levels of military retirees with higher disposable income.

According to DVS, figures provided by the Small Business Administration show approximately 10 percent of all small businesses are owned by military veterans and 47 percent of military retirees are self-employed. DVS assumes military retirees who are small-business owners will likely create jobs and further assist local economies if their personal income tax burden is reduced by the bill.

DVS reports there are currently approximately over 21,000 military retirees and surviving spouses living in the state. Only 28 percent of all military retirees come from the Officers Corps;

the remaining 72 percent of retirees come from the enlisted corps. According to the Retirement and Separations office at Kirtland Air Force Base, figures show that for FY13, 95 percent of those who retired decided to leave the state.

DVS reports the state is in a comparatively not favorable position with neighboring states as they offer the following incentives for military retirees:

1. Arizona - $2500 credit
2. Colorado – Up to $20,000 income exclusion
3. Texas – No state income tax
4. Utah – up to $9,600 exclusion
5. Oklahoma – up to $5,500 income exclusion

DFA reports during the 2011 legislative session, the Albuquerque chapter of Military Officers Association of America (MOAA) presented its analysis of the benefits of exempting retirement pay. In its analysis, the group reported that it was in the best interests of the state to attract retirees, because they would bring with them federal benefits such as Tri-Care health coverage and retirement income. According to DFA, MOAA also suggests that military retirees can provide New Mexico with increased human capital assets, and additional revenue through a multiplier effect, with little or no impact to social services. The report also emphasized the benefit to the New Mexico labor force of military retirees in education, medical services and business.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD reports a minimal impact. Forms, instructions and publications will need to be revised. The change would be made at no additional cost as part of the annual renewal of the income tax program. Changes required to GenTax, Taxpayer Access Point, etc. can be part of the annual tax year update.

TECHNICAL ISSUES

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

According to DFA, in 2008 Senate Memorial 27 was passed, which led to the establishment of a NMSU taskforce to study the economic benefit of providing a tax exemption to military retirees. The taskforce, made up of representatives from TRD, EDD, MOAA, veteran's organizations, and military widows, met over the interim before the 2009 legislative session and discussed the possible benefit of enacting an exemption.

DFA notes that according to NMSU, New Mexico has a fairly high share of veterans compared to the national average. Citing data from the Department of Defense, NMSU reports veterans as a percent of population for NM was 1.08 percent in 2007, much higher than the national average of 0.66 percent.

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

HD/je/aml/bb