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FISCAL IMPACT REPORT

ORIGINAL DATE 1/23/16
LAST UPDATED 1/26/16 **HB** 146

SPONSOR Roybal Caballero

SHORT TITLE No Income Tax on Social Security Benefits **SB** _____

ANALYST Graeser

REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|-------------------|------------|------------|------------|------------|---------------------------|---------------|
| FY16 | FY17 | FY18 | FY19 | FY20 | | |
| 0.0 | (70,000.0) | (83,000.0) | (88,000.0) | (93,000.0) | Recurring | General Fund |

Parenthesis () indicate revenue decreases

Note: the federal and state offsets are not shown in this table. See “Other Substantive Issues” for information.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY16 | FY17 | FY18 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|--------------|------|------|------|-------------------|---------------------------|---------------|
| Total | 0.0 | 0.0 | 0.0 | 0.0 | Recurring | TRD Operating |

Parenthesis () indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of Bill

House bill 146 exempts social security income from state income tax beginning with taxable years beginning on or after January 1, 2016.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends or May 18, 2016.

FISCAL IMPLICATIONS

From IRS’s PIT Statistics of Income, total taxable social security benefits for TY2011 were \$1,211 million; for 2012, \$1,340 million and for 2013, \$1,459. This is an average of 5% growth. The average marginal tax is about 4.33% (since social security becomes taxable for total income

of \$32,000 for married joint and head of household and \$25,000 for other filing status. Assuming that taxable social security income will grow by 5% per year and that 90% of the tax reduction will be claimed within the fiscal year, revenue reductions are as shown in the table.

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.

SIGNIFICANT ISSUES:

As noted above, social security is not generally taxed. If other income plus half of social security income is above the “base amount”, then portion of social security benefits is taxable:

Base Amounts. The three base amounts are:

- \$25,000 – if you are single, head of household, qualifying widow or widower with a dependent child or married filing separately and lived apart from your spouse for all of 2014
- \$32,000 – if you are married filing jointly
- \$0 – if you are married filing separately and lived with your spouse at any time during the year

AARP explains it in the following way:¹

“If you file as an individual and your combined income — by this, Social Security means adjusted gross income and nontaxable interest plus one-half of your Social Security benefits— is below \$25,000, your benefits won't be taxed at all. If income is between \$25,000 and \$34,000, up to 50 percent of your benefits may be subject to tax. For income of more than \$34,000, up to 85 percent of your benefits may be considered taxable income.”

“If you and your spouse file a joint return with a combined income below \$32,000, your benefits are out of reach. For income between \$32,000 and \$44,000, up to 50 percent of benefits may be taxable, and up to 85 percent if combined income is more than \$44,000.”

About 13% of all New Mexico taxpayers reported taxable social security on their 2013 federal tax returns. However, the taxable amount represented only 3.3% of all income.

ADMINISTRATIVE IMPLICATIONS

Should cause moderate to low impacts to TRD.

OTHER SUBSTANTIVE ISSUES

With any personal income tax deduction on state returns, there is a potential to offset the benefits of this exemption because state and local income taxes are deductible from both state and federal income taxes. 55% of the taxpayers reporting taxable social security benefits (in 2013) itemize deductions. Thus every \$ of New Mexico tax benefit is taxed at 4.5% for the state and an average of 26% by IRS. The individual taxpayer enjoys only 70% or so of the tax exemption and the state treasury transfers on the order of \$1.5 million a year to the federal treasury.

¹ <http://www.aarp.org/work/social-security/info-2014/social-security-benefit-taxes.html>

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

With this bill, adequacy, efficiency, equity and simplicity are not improved. It may be somewhat difficult to ensure that the amount that this bill would cost the general fund would be reported.

LG/al/jle

| Tax Year | # Returns | Amount | Average per return |
|----------|-----------|-------------|--------------------|
| 2000 | 51,732 | \$390,580 | \$7,550 |
| 2001 | 51,435 | \$400,589 | \$7,788 |
| 2002 | 65,144 | \$544,830 | \$8,363 |
| 2003 | 62,983 | \$537,234 | \$8,530 |
| 2004 | 68,168 | \$606,108 | \$8,891 |
| 2005 | 75,483 | \$709,324 | \$9,397 |
| 2006 | 83,593 | \$830,505 | \$9,935 |
| 2007 | 92,666 | \$967,603 | \$10,442 |
| 2008 | 93,229 | \$985,020 | \$10,566 |
| 2009 | 95,494 | \$1,031,915 | \$10,806 |
| 2010 | 101,459 | \$1,135,109 | \$11,188 |
| 2011 | 105,697 | \$1,211,255 | \$11,460 |
| 2012 | 111,280 | \$1,339,941 | \$12,041 |
| 2013 | 116,410 | \$1,458,865 | \$12,532 |
| 2014 | 122,358 | \$1,565,229 | \$12,792 |
| 2015 | 127,484 | \$1,678,884 | \$13,169 |
| 2016 | 132,610 | \$1,796,406 | \$13,547 |
| 2017 | 137,736 | \$1,917,794 | \$13,924 |
| 2018 | 142,862 | \$2,043,049 | \$14,301 |
| 2019 | 147,988 | \$2,172,171 | \$14,678 |

2015 Single (federal) tax rates:

| Taxable Income | Tax Rate |
|------------------------|--|
| \$0 to \$9,225 | 10% |
| \$9,226 to \$37,450 | \$922.50 plus 15% of the amount over \$9,225 |
| \$37,451 to \$90,750 | \$5,156.25 plus 25% of the amount over \$37,450 |
| \$90,751 to \$189,300 | \$18,481.25 plus 28% of the amount over \$90,750 |
| \$189,301 to \$411,500 | \$46,075.25 plus 33% of the amount over \$189,300 |
| \$411,501 to \$413,200 | \$119,401.25 plus 35% of the amount over \$411,500 |
| \$413,201 or more | \$119,996.25 plus 39.6% of the amount over \$413,200 |

2015 Married Filing Jointly or Qualifying Widow(er) federal tax rates:

| Taxable Income | Tax Rate |
|------------------------|--|
| \$0 to \$18,450 | 10% |
| \$18,451 to \$74,900 | \$1,845.00 plus 15% of the amount over \$18,450 |
| \$74,901 to \$151,200 | \$10,312.50 plus 25% of the amount over \$74,900 |
| \$151,201 to \$230,450 | \$29,387.50 plus 28% of the amount over \$151,200 |
| \$230,451 to \$411,500 | \$51,577.50 plus 33% of the amount over \$230,450 |
| \$411,501 to \$464,850 | \$111,324.00 plus 35% of the amount over \$411,500 |
| \$464,851 or more | \$129,996.50 plus 39.6% of the amount over \$464,850 |