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

SPONSOR Anderson **ORIGINAL DATE** 1/27/2020 **LAST UPDATED** 2/03/2020 **HB** 141

SHORT TITLE Double Certain Income Tax Exemptions **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
	(770.0)	(770.0)	(770.0)	(770.0)	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY2020	FY2021	FY2022	FY 20-22		
--	($7.7)	--	($7.7)	Nonrecurring	Taxation and Revenue Department

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 141 doubles the amount of the Over 65 and Over or Blind exemption (7-2-5.2 NMSA 1978 from a maximum of $8 thousand to a maximum of $16 thousand. The bracket levels are not changed.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. However, the provisions of the bill are applicable to tax years beginning January 1, 2020. Because the taxable year is defined, the lack of an effective date is not material.

FISCAL IMPLICATIONS

This bill expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The intent of the bill is to financially assist lower income 65 and over taxpayers and blind taxpayers. This could be considered to improve equity.

In estimating the cost of this proposal, the tax reduction is the product of the amount of the exemption multiplied by the marginal tax rate at whatever level of taxable income is reported by the taxpayer. Considering the new levels of standard deduction effective as of the 2018 tax year, the appropriate marginal tax rate may be even lower than used to estimate the 2017 actuals.

There is some uncertainty in number of beneficiaries of the tax exemption. See a table of results from various editions of the TER. The difference between the $3 million level and the $1 million level as of the 2015 edition of the TER is attributed to using a modeled tax rate, rather than an average rate applicable to all taxpayers. There is no explanation, however, for the change from 17,000 claims to 100,000 claims over the various editions of the report. The American Community Survey (ACS) indicates approximately 100,00 total 65 and over income- qualifying taxpayers, but also indicates as many as 30,000 legally blind income-qualifying taxpayers. The TER indicates that this is a declining tax benefit. This is partially attributed to an aging population and increased amounts of social security benefits paid to the new retirees.

LFC analysis is shown in the table below with the 2018 TER and held it constant. Notice the discrepancy between the 2018 TER amount reported for 2017 and the amount reported in the table on page 1 for FY 2018, which is about 67 percent of the 2017 amount. One difference is that the 2017 amount is based on a fiscal year and the 2018 number used by TRD is based on a tax year.

Estimated Revenue					**Recurring or Nonrecurring**	**Fund Affected**
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
	(1,140.0)	(1,140.0)	(1,140.0)	(1,140.0)	Recurring	General Fund (PIT)

TRD discusses this methodology:

> The Taxation and Revenue Department (TRD) used as a base the 2018 tax year. TRD looked at taxpayers who claimed the persons sixty-five and older or blind exemption from Personal Income Tax (PIT) and had a tax liability. For many taxpayers the doubling of the exemption amount will not impact their taxable income as their taxable income is already zero given other credits, exemptions and deductions. TRD calculated the net change in tax liability given the doubling of the exemption amount currently allowed in statute.
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> TRD reviewed the historical claims for the persons sixty-five and older exemption from PIT as reported in the 2018 Tax Expenditure Report. The number of claims since the 2013 tax year has been relatively constant around 100,000 each year. This population is within the baby boomer population cohort which is the U.S. population born post-World War II up until mid-1964. The baby boomers started reaching the age of 65 in 2011 and are increasing the percentage of the population over the age of 65. By 2029, all baby boomers will be over the age of 65 and will represent 20 percent of the U.S. population.[1] Despite the baby boomer population increasing the number of New Mexico taxpayers over the age of 65, the number of claims received for this exemption has remained steady. TRD assumes

[1] The Baby Boom Cohort in the United States: 2012 to 2060 – Population Estimates and Projections, Colby, Sandra L. and Ortman, Jennifer M., May 2014, U.S. Census Bureau publication P25-1141.

> that despite a growing 65 and older population, the number of taxpayers meeting the adjusted gross income (AGI) threshold will remain constant. TRD therefore has kept the revenue impact flat for the forecasted period.

SIGNIFICANT ISSUES

Since 1987 when the 65 and Over and Blind exemption was last amended, the CPI-U has grown from 113.6 to 273.8, a growth of 141 percent. This growth nominally should apply both to the bracket levels and to the amounts. The doubling of the exemption proposed in this bill recovers none of the impact of fixed bracket amounts and only 100 percent of the growth in amounts.

Using ACS data, LFC approximately modeled the impact of increasing both the bracket levels and the amounts by 50 percent. This is far less than the 141 percent CPI inflation. However, this would increase general fund costs by about $16 million.

TRD also discusses the policies involved in the traditional tax deduction:

> PIT revenue represents a fairly consistent source of revenue for many states. PIT revenue is susceptible to economic downturns but also positively responsive to economic expansion. New Mexico is one of forty-two states along with the District of Columbia which impose a broad-based personal income tax. The personal income tax is seen as both horizontally equitable, the same statutes apply to all taxpayers and vertically equitable, due to the progressive design of the personal income tax. Progressive, in this context, meaning taxes where the average tax rate increase as the taxable amount increases.
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> This exemption, by excluding income based on age and AGI, maintains a level horizontal equity. Taxpayers over the age of 65 in similar economic circumstances are treated equally. This exemption has been in statute since 1985 with one amendment in 1987 and has a stable base of taxpayers applying for the exemption. The exemption is targeted at taxpayers 65 and older who more often than younger taxpayers are on a fixed retirement income. So while some horizontal equity is eroded due to this exemption not being applied to all taxpayers, it is targeted to low-income seniors whose disposable income is diminished. By doubling the exemption amount, taxpayers 65 and older especially at the higher end of the AGI ranges will see further tax liability reduction. While the tax exemption is a tax expenditure for the state and will increase under this bill, because of its benefit to seniors and ease in administering, it can be seen as one of many efficient policy tools to assist low and middle income individuals.

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. This reporting is accomplished with the annual edition of the Taxation and Revenue Department Tax Expenditure Report.

ADMINISTRATIVE IMPLICATIONS

TRD reports it will need to make information system changes and update forms and publications.

These changes will be incorporated into annual tax year implementation and represent $7,700 in workload costs.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

All five of the social security bills have a provision that any taxpayer claiming the full or partial exemption of social security income may not simultaneously claim a 7-2-5.2 NMSA 1978 exemption.

Bill ID	Title	Sponsor	
HB 29	SOCIAL SECURITY INCOME TAX EXEMPTION	Cathrynn N. Brown	100% Deduction
HB 77	SOCIAL SECURITY INCOME TAX EXEMPTION	Daymon Ely	Up to $24,000 per return exempt
HB 130	EXEMPT SOCIAL SECURITY INCOME FROM INCOME TAX	Gail Armstrong	100% Deduction
SB 68	SOCIAL SECURITY INCOME TAX EXEMPTION	Michael Padilla	Up to $25,000 per return exempt
SB 81	EXEMPTING SOCIAL SECURITY FROM INCOME TAX	James P. White	100% Deduction

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

ALTERNATIVES

1. Recast the entire table, updating the brackets and amounts to roughly provide a full exemption for low- to middle-income retirees from social security income.
2. Index both the recast brackets and amounts for each bracket level to account for CPI inflation.
3. Repeal this exemption for the 65 and older taxpayers in favor of the exemption for all or a part of taxable social security income, but retain the exemption for blind. Legally blind is defined as visual acuity less than 20/200 with corrective lenses.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	While this proposal has not been explicitly discussed, this exemption has been on the books in this form since 1987.
Targeted		

Clearly stated purpose	✘	This exemption was passed in 1987, before the growing concern about revenue adequacy and the problem of disclosure.
Long-term goals	✘	None stated.
Measurable targets	✘	None stated.
Transparent	✓	Costs reported annually by TRD.
Accountable		
Public analysis	✘	
Expiration date	✘	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	✘	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

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		FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
2014 TER	Expenditure	$3,530.6	$3,378.1	$3,352.1	$3,391.6	$3,278.8				
	Claims	18,521	17,601	17,167	17,221	16,449				
	Avg Tax Savings	$190.63	$191.93	$195.26	$196.95	$199.33				
2015 TER	Expenditure		$1,817.7	$1,975.4	$1,937.2	$1,912.0	$1,828.1			
	Claims		13,793	14,637	14,726	14,726	14,605			
	Avg Tax Savings		$131.78	$134.96	$131.55	$129.84	$125.17			
2016 TER	Expenditure			$1,058.8	$1,046.7	$1,029.0	$1,000.6	$983.1		
	Claims			88,674	90,241	92,321	99,487	97,225		
	Avg Tax Savings			$11.94	$11.60	$11.15	$10.06	$10.11		
2018 TER	Expenditure					$1,183.0	$1,163.0	$1,131.0	$1,136.0	$1,076.0
	Claims					99,790	97,955	100,912	101,624	93,470
	Avg Tax Savings					$11.85	$11.87	$11.21	$11.18	$11.51