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

SPONSOR Tallman/Hickey **ORIGINAL DATE** 01/28/22 **LAST UPDATED** 01/31/22 **HB**

SHORT TITLE Exempt Social Security from Income Tax **SB** 49

ANALYST Faubion

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
--	$85.0	$84.0	$83.0	$82.0	Recurring	New Mexico Finance Authority (NMFA)/Credit Enhancement – Cigarette Tax
--	$9.0	$9.0	$9.0	$9.0	Recurring	UNM Cancer Center – Cigarette Tax
--	$102.0	$101.0	$100.0	$99.0	Recurring	NMFA/UNM Health Sciences – Cigarette Tax
--	$126.0	$125.0	$124.0	$122.0	Recurring	NMFA/Department of Health – Cigarette Tax
--	$41.0	$40.0	$40.0	$39.0	Recurring	Rural County Cancer Treatment Fund – Cigarette Tax
--	$38,400.0	$37,900.0	$37,600.0	$37,200.0	Recurring	General Fund – Cigarette Tax
--	$17,970.0	$18,480.0	$19,160.0	$20,070.0	Recurring	General Fund – Tobacco Products Tax
--	($65,200.0)	($69,300.0)	($73,200.0)	($77,200.0)	Recurring	General Fund – Personal Income Tax

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$1.7	-	-	$1.7	Nonrecurring	TRD - ASD
$40.0	$5.2	-	$45.2	Nonrecurring	TRD - ITD

Parenthesis ( ) indicate expenditure decreases

Conflicts with HB33, HB48, HB49, HB158, SB108, and SB121.

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Department of Health (DOH) [1]
Taxation and Revenue Department (TRD)
Aging and Long-Term Services Department (ALTSD)

SUMMARY

Synopsis of Bill

Senate Bill 49 (SB49) increases the excise tax rate for cigarettes, tobacco products, and e-liquids and closed system cartridges for electronic cigarettes. SB49 also decreases discounts for tax stamps sold in larger quantities during a calendar month and adjusts the percentages of the cigarette tax revenue distributed to the related healthcare entities. Lastly, SB49 exempts social security income from income tax for individuals with adjusted gross income (AGI) below specified thresholds.

OAG summarizes the bill as follows:

Section 1 of the bill amends Section 7-1-6.11 NMSA 1978; the distributions would change as follows:

- Statute Section A- to the board of regents of the university of New Mexico for the benefit of the comprehensive cancer center at the university of New Mexico health sciences center, decrease from .71 to .5 percent of the net receipts;
- Statute Section B- decrease from 7.52 to 5.3 percent on behalf of and for the benefit of the university of New Mexico health sciences center for its comprehensive cancer center, until payment of all principal, interest and other expenses or obligations related to the bonds authorized pursuant to Section 6-21-6.15 NMSA 1978 and the New Mexico finance authority certifies to the secretary of taxation and revenue that all obligations for the bonds have been fully discharged, to the credit enhancement account;

[1] DOH analysis is adapted from proposed HB33 which also addresses cigarette and tobacco product taxes.

- Statute Section C- decrease from 3.17 to 2.3 percent to the New Mexico finance authority for land acquisition and the planning, designing, construction and equipping of department of health facilities or improvements to such facilities;
- Statute Section D- decrease from 8.26 to 5.8 percent of the net receipts, exclusive of penalties and interest, attributable to the cigarette tax made to the New Mexico finance authority for deposit in the credit enhancement account created in the authority; and
- Statute Section E- decrease from .53 to .4 percent for the benefit of the rural county cancer treatment fund, to the New Mexico finance authority.

Section 2 of the bill amends Section 7-12-3 NMSA 1978 to increase the excise tax rate on cigarettes from .10 cents per cigarette to .15 cents per cigarette.

Section 3 of the bill amends Section 7-12-7 NMSA 1978 and modifies the three-tiered discount rate on tax stamps as follows:

- from .46 to .31 percent less than the face value of the first thirty thousand dollars ($30,000) of stamps purchased in one calendar month;
- from .36 to .24 percent less than the face value of the second thirty thousand dollars ($30,000) of stamps purchased in one calendar month; and
- From .22 to .15 percent less than the face value of stamps purchased in excess of sixty thousand dollars ($60,000) in one calendar month.

Section 4 of the bill modifies and streamlines the definitions section of Section 7-12A-2 NMSA 1978 by: (1) deleting the section of the definition of e-cigarette that excluded them as a product regulated as a drug or device by the FDA, (2) adding any product containing nicotine from any source to the definition of tobacco product, and (3) narrowing the definition of tobacco product to exclude cigarettes, cigars, little cigars, or any product regulated as a drug or device by the FDA.

Section 5 of the bill amends Section 7-12A-3 NMSA 1978 by removing cigars from excise taxes, increasing the excise tax rates on the manufacture or acquisition of tobacco products from 25 percent to 60 percent of the product value and including e-liquids in this category, and increasing the excise tax rates for the manufacture or acquisition of closed system cartridges from .50 cents to $2.40.

Section 6 of the bill is unrelated to the Tobacco Products Tax Act and instead seeks to amend the Income Tax Act by adding a new section that would allow for certain New Mexico tax filers to claim exemptions for social security benefits from adjusted gross income. These exemptions would be equal to the amount included in adjusted gross income pursuant to the Federal Internal Revenue Code, and provide for 3 tiers of income limits on the exempted social security income according to filing status: (1) $62 thousand or less for married individuals filing separate returns; (2) $124 thousand or less for heads of household, surviving spouses, and married individuals filing joint returns; and (3) $72 thousand or less for single individuals. The Section further provides that individuals claiming this exemption are not permitted to simultaneously claim the over 65 or blind exemption of Section 7-2-5.2 NMSA 1978.

The effective date of sections 1 through 5 is July 1, 2022. The effective date of section 6 is not stated and assumed to be 90 days after the end of the session.

The provisions of the act are applicable to taxable years beginning January 1, 2022. There is no delayed repeal date but LFC recommends adding one.

FISCAL IMPLICATIONS: CIGARETTE AND TOBACCO PRODUCT TAX INCREASE

TRD used the Cigarette Tax forecast published by the Consensus Revenue Estimating Group (CREG) in December 2021 to calculate the fiscal impact. Starting with the forecasted sales volumes of cigarette packs, TRD applied demand elasticities to estimate how many fewer packs of cigarettes would be bought because of the increased price of 15 cents per cigarette. TRD used an elasticity of -0.284 which is an average for active smokers and the total population published by G.A. Franz in the study "Price Effects on the Smoking Behavior of Adult Age Groups" (2008). Given the decline in cigarette consumption, TRD assumes a higher proportion of cigarette smokers are active smokers and weighted them more heavily in the elasticity. The next step applied the new tax of 20 cents per cigarette on the forecasted volumes with elasticity applied to them. Next, TRD applied the new discount rates to the estimated revenue. Lastly, TRD's analysis applied the new distribution percentages from the bill.

TRD used the Tobacco Products Tax forecast published by the CREG in December 2021 to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. The Tobacco Products Tax covers a variety of products. The bill proposes tax increases to all but one of the categories, cigars. Based on the bill language, cigars are no longer taxed at all and represent revenue lost for the Tobacco Products Tax. (See technical issues below.) TRD applied different demand elasticities to the remaining products: little cigars, e-liquid – for use in e-cigarettes, closed system cartridges – a single use e-cigarette and all other tobacco products. Based on a recent study of the impact of e-cigarette taxes on e-cigarette and other tobacco consumption by Cotti et al.[2], an average elasticity impact for different varieties of e-cigarettes (flavored, non-flavored, etc.) was applied. The study notes that cigarettes and e-cigarettes represent substitutable products. Due to the bill increasing both cigarette and e-cigarette taxes, the fiscal impact does not assume any substitution impacts to consumption between the two products. In addition, the overall price increase proposed in the bill for e-cigarette products is very significant, around 35 percent for closed system cartridges and 57 percent for e-liquid, representing around \$3 to \$5 in tax increases for various e-cigarette products depending on product values. The elasticity assumption from empirical work looked at a \$1 increase in taxes. Given the large increase in taxes, the drop-in consumption could be higher than what is modeled. Also, if consumption moves to the black market (see policy issues below), then the assumed drop in consumption could also be higher.

Little cigars are tied in statute to the rate charged on cigarettes. The consumption pattern has shown a decline like that of cigarettes. TRD applied the same elasticities assumption to little cigars as applied to cigarettes.

The Cotti et al. study noted that for other tobacco products such as chewing tobacco and loose tobacco, there was no significant impact to consumption with an increase in price. This appears logical given that users of these products are most likely older established users. The price increase to the other tobacco products is significant. TRD applied an elasticity for smokers from

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[2] Cotti, C.D., Courtemanche, C.J., Maclean, J.C., Nesson, E.T., Pesko, M. F., Tefft, N. (2020). The Effects of E-Cigarette Taxes on E-Cigarette Prices and Tobacco Products Sales: Evidence from Retail Panel Data. National Bureau of Economic Research, Cambridge, MA. Working paper 26724, http://www.nber.org/papers/w26724

the Franz study assuming that such a large increase in the tax rate may elicit a lower consumption rate among this population.

The Covid-19 pandemic and economic recession have altered consumption patterns for cigarettes and tobacco products. There was evidence of hoarding purchasing prior to the spring 2020 stay-at-home order. The continued economic impacts and stress associated with the pandemic and financial concerns could further alter the consumption of these products both upwardly and downwardly. The December 2021 accounts for the current pattern of consumption but, depending on the path of the pandemic, consumption could deviate from current assumptions.

Related Healthcare Entities. While SB49 adjusts the distribution percentages in existing law in such a way that decreases the percent of revenues disbursed to NMFA and other healthcare entities, the increase in revenues more than offsets the lower share resulting in higher disbursements.

SIGNIFICANT ISSUES: CIGARETTE AND TOBACCO PRODUCT TAX INCREASE

According to the Federation of Tax Administrators, as of January 1, 2022, the median tax on cigarettes in the United States was $1.78 per pack. The lowest rate was $0.17 per pack in Missouri, while the highest was $4.50 in the District of Colombia. New Mexico's Cigarette Tax is tied currently with 5 other states for the 18th highest rate in the nation.

This bill's proposed tax rate would make New Mexico's rate the 11th highest in the nation and would substantially exceed the tax rate of surrounding states (see Attachment A). A report published by the Tax Foundation, a non-partisan tax policy research organization, states New Mexico currently ranks 5th in the nation for inbound cigarette smuggling activity, with an estimated 37.2 percent of cigarettes consumed in the state derived from smuggled sources in 2019 (see Attachment B). The Tax Foundation states one notable consequence of high state cigarette excise tax rates has been increased smuggling as people procure discounted packs from low-tax states and sell them in high-tax states. Raising tax rates substantially higher than surrounding areas is likely to exacerbate the issue.

According to the Tax Foundation, 20 states and territories currently tax e-liquid and closed-system cartridges for use with e-cigarettes on a percentage of price (See Attachment C). Price subject to tax varies by retail or wholesale price. New Mexico's e-liquid tax of 12.5 percent of wholesale price is among the lowest of any state or territory that taxes e-liquid by price. Wholesale tax rates in other states include 15 percent in Illinois and Wyoming, 30 percent in Nevada, 56 percent in Utah, 59.9 percent in California, 92 percent in Vermont, and 95 percent in Minnesota.

The bill proposes to increase the tax rate on cigarettes, presumably to discourage their consumption, which can lead to negative health outcomes. By increasing the rate on cigarettes and e-cigarettes, the bill presumably negates substitution effects noted in studies between these products. From a health policy stand point, this is especially important for younger users who have become a larger market share of e-cigarettes and are more sensitive to price increases. By raising taxes on most tobacco products, it would presumably encourage overall lower consumption of the various products. It is notable then, that cigars are no longer taxed, and consumers could increase consumption of cigars if seen as a potential substitute. (See technical issues below.)

Significant increases in taxes may encourage consumers to buy products on the black market. The increased demand by consumers would presumably be met by an increased supply of e-cigarettes products within the black market. This raises safety concerns for consumers with a question of the quality of products being supplied and what may be contained, for example, within e-liquids with no oversight.
The following significant issues were raised by the Department of Health:

> According to the 2014 Surgeon General's Report on The Health Consequences of Smoking, there is sufficient evidence to conclude that "increases in the prices of tobacco products, including those resulting from excise tax increases prevent initiation of tobacco use, promote cessation, and reduce the prevalence and intensity of tobacco use among youth and adults."[3] In 2016, the National Cancer Institute and the World Health Organization reaffirmed that "significantly increasing the excise tax and price of tobacco products is the single most effective tool for reducing tobacco use." [4]
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> Cigarette use among New Mexico high school youth declined to a historic low of 8.9 percent in 2019.[5] However, declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes. In 2019, 34 percent of New Mexico high school youth surveyed reported using e-cigarettes, and 38 percent of youth reported using at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes). Factors contributing to these trends include pricing differences among tobacco products (i.e. higher taxes on cigarettes compared to other tobacco products), increased marketing of e-cigarettes, and the appeal of flavored e-cigarettes.
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> SB49 also proposes to increase the excise tax on other tobacco products to create tax equity between cigarettes and other tobacco products. As a result, the price of other tobacco products would increase and potentially lower their attractiveness among price-sensitive consumers, such as youth and low- income adults.[6] In New Mexico, 80 percent of adults favor increasing the tax on the other tobacco products (cigars, chewing tobacco and e-cigarettes) to a level that would match the cigarette tax if the money were used to increase funding for health programs and education.[7]
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> The intent of SB49 to create tax equity across all types of tobacco products could positively impact health disparities by decreasing the appeal of lower-priced tobacco products such as spit/chew, e-cigarettes, especially among youth. E-cigarettes use in New Mexico is prevalent among high school youth (34 percent and particularly high in certain counties such as Taos (58 percent Guadalupe (47 percent and Valencia (47 percent).[8]
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> SB49 would likely have a significant impact on youth, as nearly 4 in 10 (38 percent) of

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[3] https://www.hhs.gov/sites/default/files/consequences-smoking-exec-summary.pdf
[4] https://cancercontrol.cancer.gov/brp/tcrb/monographs/21/docs/m21_complete.pdf, p 151
[5] http://youthrisk.org/pdf/connections/YRRS_Connections_v7n2_July%202020_Tobacco%20Trends%202019_071420.pdf
[6] www.tobaccofreekids.org/assets/factsheets/0180.pdf
[7] https://www.nupacnm.com/wp-content/uploads/2021/01/Public-Opinion-on-Tobacco-Policies-in-NM-2020.pdf
[8] https://youthrisk.org/

NM high school youth reported using some form of tobacco, and most (90 percent) of that tobacco is in the form of e-cigarettes.[9] SB49 would not only increase the tax on cigarettes and other tobacco products, but more importantly, bring about tax equity across all tobacco products. Reduced e-cigarette use among New Mexico youth could translate into fewer youth, and eventually adults, who are addicted to nicotine and experience the negative health consequences.

TECHNICAL ISSUES: CIGARETTE AND TOBACCO PRODUCT TAX INCREASE

The language between the definition of "tobacco product" on page 8, Section 4 (L) and the imposition of the tobacco product tax on tobacco products on page, Section 5 (A) appears to have inadvertently left cigars with no tax imposition at all. The sections are written such that cigars are not subject to the rate of the tobacco products in Section 5(A) and the previous separate rate for cigars has been struck under Section 5(B). Whether this is the intent, the two sections are not clearly written for the administration of this tax. In addition to the language around cigars, TRD assumes that e-liquids are taxed at the proposed "tobacco product" rate of 60 percent and the original 12.5 percent of wholesale tax rate for e-liquids has been struck on page 9, Section 5 (D). If the sponsor of the bill would like to propose that cigars be taxable under the tobacco products excise tax rate of 60 percent, TRD recommends striking "cigars" on page 8, line 9.

To prevent hoarding of stamps before the tax increase effective date, TRD recommends amending Section 7-12-3.1 NMSA 1978 to include non-affixed and affixed stamps for the Cigarette Inventory Tax which is imposed when the cigarette rate increases. Currently, the statute only applies to non-affixed stamps.

ADMINISTRATIVE IMPLICATIONS: CIGARETTE AND TOBACCO PRODUCT TAX INCREASE

TRD will conduct staff training, update forms, instructions, and publications. Changes would be made to TRD's GenTax system, the system of record, to update tax rates, discount rates, and revenue distribution per the new percentages, requiring development and testing of TRD's GenTax system. TRD's Information Technology Division (ITD) estimates that the changes would incur approximately 200 hours of development with contractual services for a cost of $40 thousand. TRD's Administrative Services Division (ASD) will have 40 hours of staff workload effort related to updating and testing distributions in the GenTax system, including modifications to revenue and general ledger transactions and multiple revenue reports. The total estimated cost for ASD is $1,724.

Due to the effective date of July 1, 2022, for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces July 1, 2022 to ensure complete readiness and testing of all processes.

If several bills with similar effective dates become law there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill.

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[9] https://www.nupacnm.com/wp-content/uploads/2021/09/2022-Tobacco-Program-Fact-Sheet.pdf

FISCAL IMPLICATIONS: SOCIAL SECURITY EXEMPTION

To estimate the impact of the proposed legislation of exempting Social Security income from income taxation, the Taxation and Revenue Department (TRD) utilized data from the Individual Master File/Individual Return Transaction File (IMF/IRTF) extracts received from the Internal Revenue Service (IRS) for tax years 2018 and 2019.

To scale the impact of this exemption to tax year 2022 and into the forecast horizon of this bill analysis, TRD utilized a combination of a) the growth in Social Security outlays forecasted by the Congressional Budget Office (CBO)[10], b) the growth rate of the population 65 years and older in New Mexico relative to the United States[11], and c) the cost-of-living-adjustment (COLA) to Social Security and Supplemental Security Income (SSI) benefits for calendar year 2022[12,13].

The estimate is based on the taxpayer population in IRS data who filed a New Mexico personal income tax (PIT) return. This population was further filtered to only include those with taxable social security benefits that were either R-filers or B-filers[14] and who were either residents, first-year residents or part-time residents in New Mexico. Non-resident B-filers do not allocate any of their pension/annuity/social security benefit income to New Mexico and hence were excluded. It was further assumed that taxpayers would select either this new exemption or the exemption pursuant to Section 7-2-5.2 NMSA 1978, depending on which decreased their tax liability the most. The fiscal impact also accounts for the higher top personal income tax (PIT) rate that is effective beginning tax year 2021.

In general, 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. In this case, the amount of taxable social security is not reported directly to TRD. If this bill passes and is implemented, the annual cost cannot be determined exactly, because the federally taxable social security amount will be reported to TRD as an exemption and not a credit. TRD will have to recalculate all returns claiming this deduction/exemption.

This bill creates a tax expenditure with a cost that is somewhat difficult to determine because the data on which the model is based are indirect. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. 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.

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[10] https://www.cbo.gov/publication/57342

[11] Population Projections, United States, 2004 - 2030, by state, age and sex, on CDC WONDER Online Database, Sept. 2005.

[12] https://www.ssa.gov/cola/

[13] 2022 COLA adjustment at 5.9% was significantly higher than the average in the last five years of 1.6%. An adjustment was, therefore made to CBO's projected outlays to account for this higher than expected adjustment as well as to account for the current high inflationary expectations in FY2022 and FY2023.

[14] 'R' filers file based on the rate tables. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income.

SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

States that tax social security benefits broadly fall into four categories: (1) states that fully exempt social security benefits from their state income tax; (2) states that tax social security benefits the same way in which the federal government taxes them; (3) states that base benefit exemptions on certain factors such as age or income; and (4) states that do not tax income at all. Twelve states tax social security benefits to some extent (see Attachment D). New Mexico is one of two states that follow the federal rules for including a portion of social security benefits as part of taxable income, and the state also provides a deduction for persons over age 65 to help offset the tax on social security benefits.

At the federal level, if the taxpayer's adjusted gross income (AGI) including half of social security benefits totals less than $32 thousand for married couples filing jointly or $25 thousand for single filers, none of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax or state income tax. For AGI including half of social security benefits that exceeds $44 thousand for married joint and $34 thousand for single, then 50 percent to 85 percent of social security income is taxable.

The Aging and Long-Term Services Department (ALTSD) points out that seniors with adjusted gross income levels less than two to three times the poverty standard, do not pay taxes and will see no impact from this bill. Three times the poverty standard for 2022 is $38,640 for one person, $52,260 for two. However, seniors and adults with disabilities who receive social security and have additional income sources, putting them into a taxable income bracket, will be affected by this bill.

See the *Other Significant Issues: Social Security Exemption* section of this FIR for additional discussion.

PERFORMANCE IMPLICATIONS: SOCIAL SECURITY EXEMPTION

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the exemption and other information to determine whether the exemption is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS: SOCIAL SECURITY EXEMPTION

TRD will need to make information system changes and create new publications, forms and regulations. These changes will be incorporated into annual tax year implementation and represents $5,164 in workload costs.

TECHNICAL ISSUES: SOCIAL SECURITY EXEMPTION

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

OTHER SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

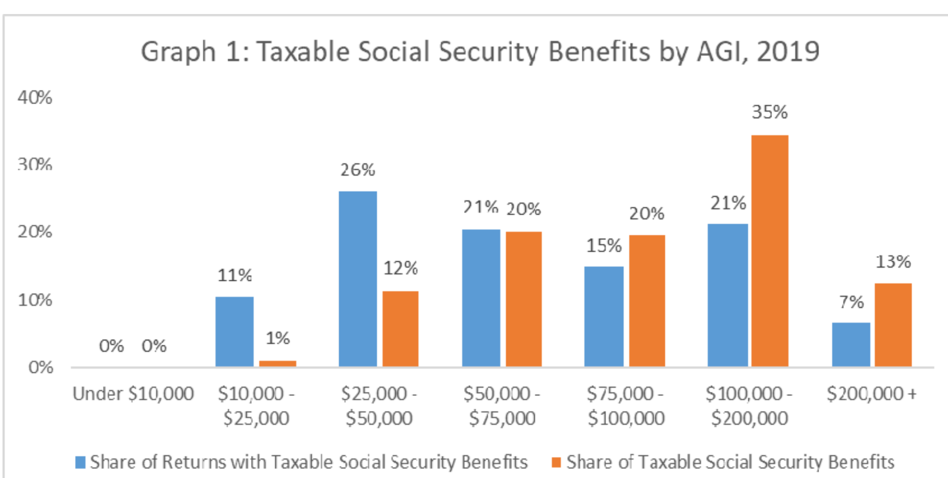
New Mexico began taxing social security benefits in 1990. The action was contained in an omnibus bill enacted in response to the "Davis v. Michigan" and "Burns v. New Mexico" problems. At that time, state retiree's pensions were 100 percent exempt from personal income tax, but federal retirees only were allowed a $3,000 deduction. The Supreme Court of the United States found that this differential treatment was in violation of federal law ensuring that state and federal workers must be treated equally and equitably. Per the Supreme Court opinion, retiree income was covered by the federal statute. In the relevant bill, New Mexico repealed both the federal and state differential deductions. In addition, other source-specific deductions were included in the fix. These included the total exemption for social security income.

An individual who is 65 years or older or who is blind may claim an exemption from PIT based on a sliding scale, not to exceed $8,000. This exemption is modest and cost the state $1.9 million in fiscal year 2021, with 105,436 claims, according to the most recent TRD Tax Expenditure Report. The current benefit amounts and bracket levels were established in 1987 and have not been adjusted since. Updating both the levels and the brackets by only 50 percent would cost the general fund approximately $15 million and would target the benefits to lower-income elderly or blind individuals.

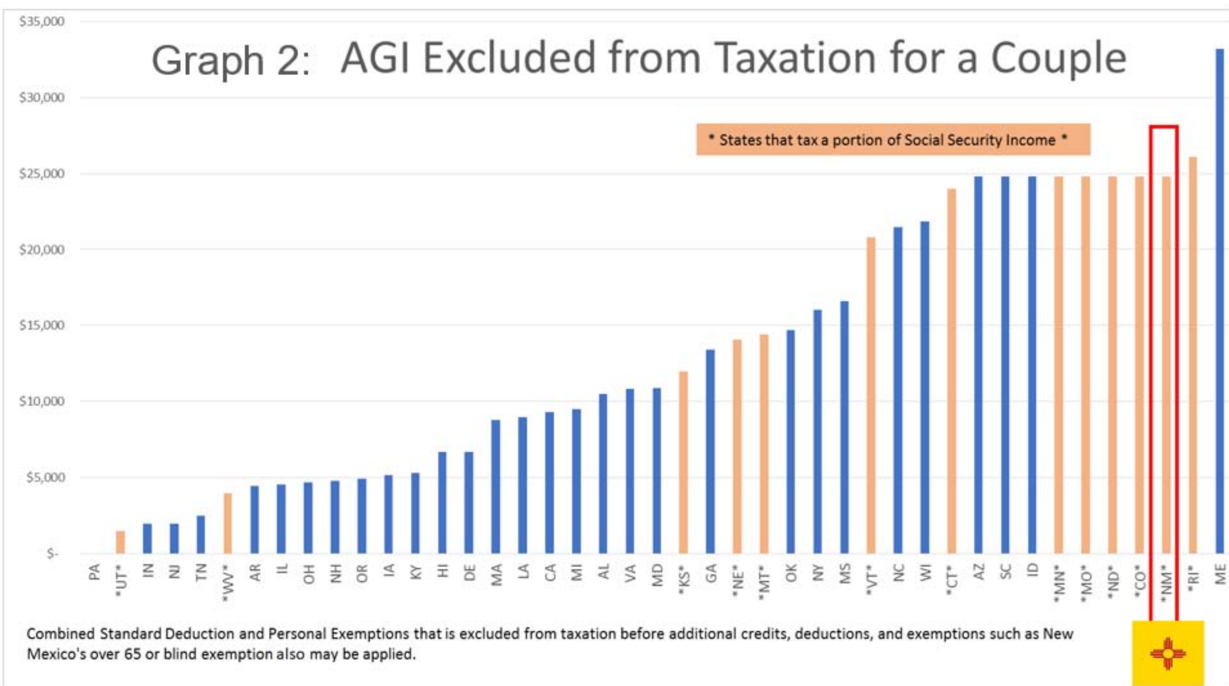
PIT represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states along with the District of Columbia that impose a broad-based PIT. PIT is an important tax policy tool that has the potential to further both horizontal equity by ensuring the same statutes apply to all taxpayers and vertical equity by ensuring the tax burden is based on taxpayer's ability to pay.

New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "conformity." As the federal tax code changes, such as under the 2017 Tax Cuts and Jobs Act (TCJA), states see impacts on their revenue collection from PIT, depending on their level of conformity. New Mexico's level of conformity is currently high, given that PIT starts with federal adjusted gross income (AGI), applies federal standard deductions, and uses Internal Revenue Service (IRS) definitions such as the definition for "dependents". With that conformity, New Mexico's treatment of social security benefits follows the federal application.

Since 1984, a portion of Social Security benefits have been subject to federal income taxes. The taxable portion is dependent on the level of the taxpayer's combined income, which includes 50 percent of the Social Security benefits, plus income from other sources, including interest on tax exempt bonds. Because the combined income thresholds for taxation of benefits have remained unchanged since they were introduced in 1984 and 1993, but wages have increased over the years, the proportion of beneficiaries paying tax on their benefits has risen over time.



New Mexico's taxable PIT base for social security benefits is reasonably stable, and a major portion of social security income is earned by relatively high-income individuals who do not depend solely on social security benefits for their income, and who have other sources of income as well. This is illustrated in Graph 1: 87 percent of taxable social security benefits are earned by individuals with AGI over $50 thousand. In contrast, taxpayers with AGI over $50 thousand represent only 63 percent of all taxpayers receiving social security benefits.
Thirteen states, including New Mexico, tax some portion of social security benefit income. However, those 13 states tend to have a higher threshold at which PIT takes effect. This essentially means that low income individuals' income tax liability is generally lower in the benefits-taxing states, regardless of the source of their income. Graph 2 below compares the income level at which each state's initial income tax rate takes effect for a married couple. New Mexico, along with four other states that tax social security benefits, has the third highest income level ($24,800) at which a couple's income may begin to be taxed. At the other end, while Pennsylvania does not tax social security benefits, its income tax is applicable to most non-zero income.



New Mexico's current PIT exemption for persons 65 and older or blind is targeted at those with lower AGI. An individual claiming exemption under this proposal will no longer be eligible to claim the current exemption for persons 65 and older or blind. Low-income taxpayers tend to have lower taxable social security benefits included in their federal AGI due to federal tax statutes. At the state level, these same taxpayers are eligible for other credits and rebates such as the low-income comprehensive tax rebate (LICTR), leaving them with little or no tax liability under current law.

Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. However, by excluding income based on age, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not available to younger taxpayers at the same level of income.

Taxing social security benefits raises issues of double taxation because employee payroll tax contributions to social security are not deductible from the employee's income when determining their tax liability in the year the contribution is made. So, employee contributions are taxed, and it is argued that taxing social security benefits when they are paid out will entail taxing the same contribution again. However, social security benefits are a result of not just employee contributions, but also employer contributions. Employer contributions are deductible for the employer in the year the contribution is made. So, employer contributions are not taxed.
Because employees pay half of the payroll tax, and their payroll tax contributions were already included in taxable income for earlier years, at most 50 percent of the benefits should be excluded from future taxation. Social security benefits withdrawals for most workers, however, exceed their lifetime contribution. Goss (1993) estimated that the payroll tax contributions of current and future workers would equal less than 15 percent of the present value of their lifetime benefits[15]. Therefore, if the ratio of lifetime contributions to benefits is less than 15 percent, then up to 85 percent of benefit income can be taxed without risk of double taxation.

Reducing or eliminating income tax on social security benefits is often viewed as a mechanism for attracting or retaining retirees in the state. A 2018 publication by New Mexico State University included the following discussion:[16]

> "Because New Mexico is listed as one of the "10 Least Tax Friendly" states for retirees (Kiplinger, 2017), additional research should be conducted on the impacts of reducing or eliminating taxes on retirement. However, it should be noted that while tax friendliness is often listed as a top criteria on "best places to retire" lists, other research has shown that tax policy changes have done nothing to attract retirees (Conway and Rork, 2012)."

Other factors – such as weather, cost of living (particularly cost of housing), and the location of family members – also affect migration decisions for retirees. A 2001 study published in the National Tax Journal found that, "in addition to cost-of-living and climate considerations, the elderly are attracted to states that exempt food from sales taxes and spend less on welfare. Low personal income and death taxes also encourage migration, depending on how these states taxes are measured."[17]

ALTSD points out that New Mexico seniors are facing substantial financial obstacles and 13.5 percent of adults ages 65 years and older live below the poverty level, the second highest in the nation.[18] Rates of poverty varied from 5.5 percent in Los Alamos County to 24.1 percent in McKinley County. In addition, those seniors and adults with disabilities who live in assisted living facilities may be potentially impacted by this bill, as approximately 75 percent of assisted living residents pay for their stay with private funds.[19] According to the State of Senior Hunger in America 2019 Annual Report, 12.4 percent of New Mexicans 60 years and older experience food insecurity, the 2nd highest rate in the United States. The Aging & Disability Resource

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[15] Goss, Stephen C. 1993. "Current Approach and Basis for Considering a Change to 85-Percent Taxation of Monthly OASDI Benefits." Letter to Harry C. Ballantyne, Chief Actuary, Social Security Administration.
[16] *Potential Fiscal Impacts of a New Mexico Retiree Attraction Campaign*, December 2018 https://aces.nmsu.edu/pubs/_circulars/CR691.pdf
[17] Houtenville, Andrew & Conway, Karen. (2001). *Elderly Migration and State Fiscal Policy: Evidence from the 1990 Census Migration Flows*. National Tax Journal. 54. 10.17310/ntj.2001.1.05.
[18] U.S. Census Bureau's 2019 American Community Survey
[19] https://www.nmhca.org/faq-facts/

Center (ADRC) serves older adults, people with disabilities, and their caregivers, regardless of income. The social security tax exemption would benefit some of the population that the ADRC serves.

New Mexico is also projected to have amongst the highest population over the age of 65 by the year 2030. TRD notes that even seniors with higher incomes who receive the bulk of the benefits of the exemption are more likely to spend their money, leading to increased economic activity, increased gross receipts for those serving that population, and consequently higher tax revenues for both the state and local governments. The exemption contained in this bill is capped by income level, meaning that the highest income retirees, who are least likely to spend any tax savings, do not receive the credit; therefore, the exemption is targeted towards those most likely to spend. Retirees are more likely to spend their money, and to have more discretionary income, as they are no longer saving for their retirement, and indeed are often required to begin taking social security benefits or distributions from retirement plans. Any additional discretionary income they receive as a result of tax cuts, except for the very highest income individuals, are more likely to be spent. Due in part to the change to destination sourcing rules, the impact of increased spending by seniors living in New Mexico will be felt in the communities where those seniors live.

TRD also notes that studies have shown that seniors contribute to their communities in multiple significant ways. Seniors often contribute more than other groups through volunteer work. Many seek additional sources of income, and therefore perform part-time work that would not be done by non-retired individuals who need the income that full-time work provides. Especially at times such as now, where businesses struggle to find workers to fill jobs, and when unemployment is historically low, having a skilled senior population benefits businesses and the overall economy. Senior also often provide family support, attending for instance to some child-care or home-care responsibilities that working adults cannot perform, or lack adequate time to perform. Again, this factor is especially relevant today, when more adults are forced to work from home, when schools are still teaching remotely, and when daycare options have become more limited. Many grandparents care for grandchildren, or at least share in childcare responsibilities. Communities can therefore benefit both economically and socially from having a large senior presence.

There are many other reasons why states may exempt some income for those over 65, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. As Graphs 1 through 3 illustrate though, the consideration of exempting social security and eroding horizontal equity must be placed in context of the federal and state tax structure, in its entirety.

As far as attracting more retirees to the state is concerned, exempting social security from income taxation may not necessarily help in achieving that goal. For example, Texas does not tax any income, social security or otherwise, at all. Yet, the state features as one of the least tax friendly states for retirees in the country because of its high property and sales taxes[20]. Notably, New Mexico's property taxes are among the lowest in the nation. It is, therefore, necessary to take a holistic look at New Mexico's tax code, and attempts should be made to make the tax

[20] https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

structure more simple, broad based, and equitable, without being punitive to any segment of the population.

ALTERNATIVES: SOCIAL SECURITY EXEMPTION

If the intent of the bill is to provide support for lower income earners with social security benefits, a more targeted approach may be to expand the existing exemptions for persons aged 65 and older (Section 7-2-5.2 NMSA 1978) or for low- and middle-income taxpayers (Section 7-2-5.8 NMSA 1978).

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.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	?	It is unknown if the issue has been discussed at an interim committee recently. The issue was discussed in 2019 at the Revenue Stabilization and Tax Policy Committee prior to the 2020 Legislative Session, but without endorsement.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✘ ✘ ✘	No purpose, targets, or goals established.

Transparent	?	TRD will likely publish a cost estimate in its annual Tax Expenditure Report; however, no specific reporting on this exemption to interim committees is required.
Accountable Public analysis Expiration date	 ✘ ✘	 The bill contains no provisions for reporting. The bill does not include an expiration date.
Effective Fulfills stated purpose Passes "but for" test	 ? ?	Without a purpose statement or required reporting, it is not possible to determine if the exemption fulfills intended outcomes.
Efficient	✘	Without a purpose statement or required reporting, it is not possible to determine if the exemption is the most efficient means of achieving desired outcomes. However, current data and recent studies indicate this exemption would be inefficient in providing tax relief to low-income households receiving social security benefits and may not be a meaningful recruitment tool for retirees to the state.
Key: ✓ Met ✘ Not Met ? Unclear		

Attachments

1. State Excise Tax Rates on Cigarettes
2. Cigarette Smuggling by State
3. Vapor Taxes by State
4. State Taxation of Social Security Benefits

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ATTACHMENT A

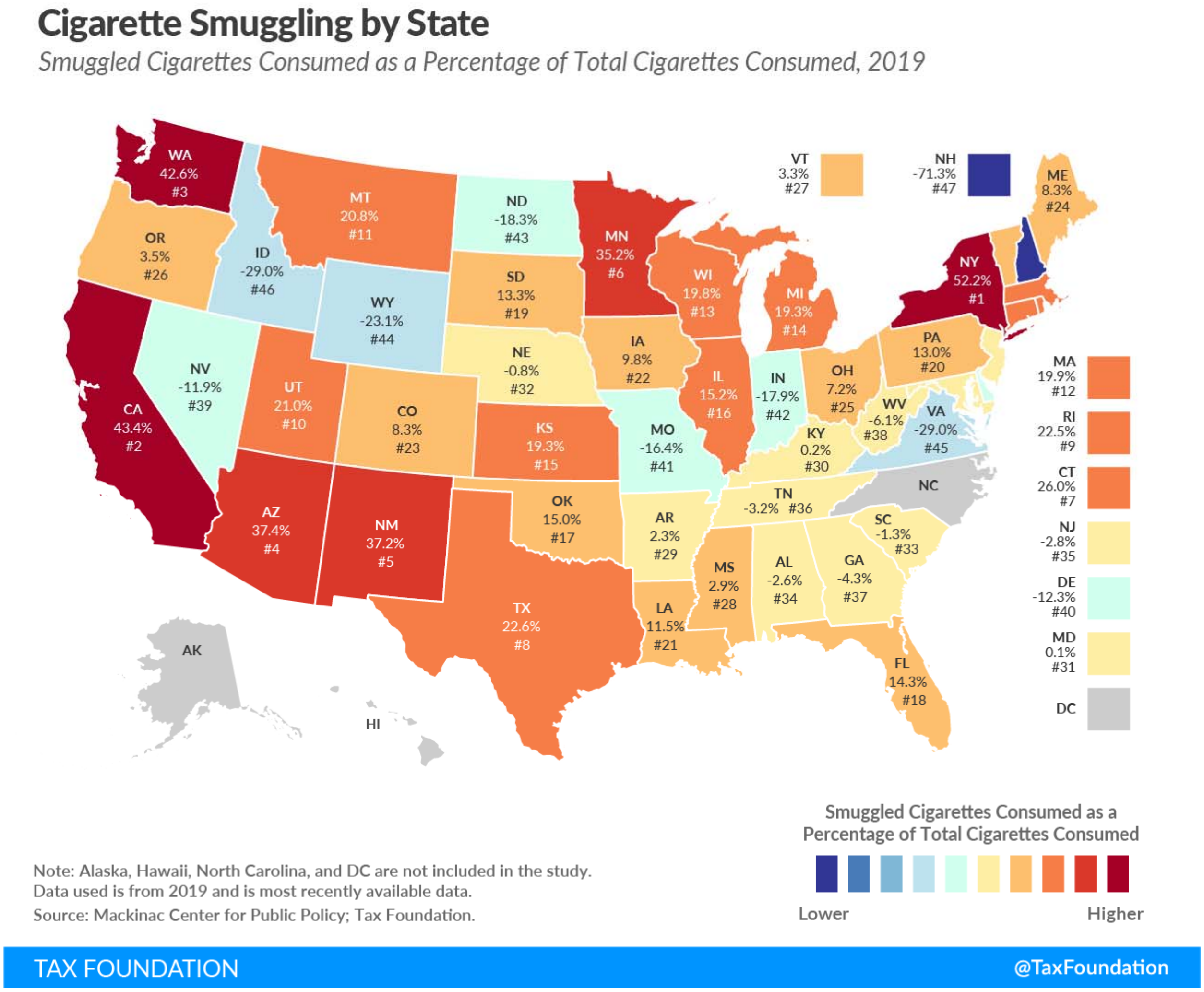
STATE EXCISE TAX RATES ON CIGARETTES

(January 1, 2021)

STATE	TAX RATE (¢ per pack)	RANK	STATE	TAX RATE (¢ per pack)	RANK
Alabama (a)	67.5	41	Nebraska	64	42
Alaska	200	18	Nevada	180	25
Arizona	200	18	New Hampshire	178	26
Arkansas	115	36	New Jersey	270	13
California	287	12	New Mexico	200	18
Colorado	194	24	New York (a)	435	2
Connecticut	435	2	North Carolina	45	48
Delaware	210	16	North Dakota	44	49
Florida (b)	133.9	33	Ohio	160	29
Georgia	37	50	Oklahoma	203	17
Hawaii	320	7	Oregon	333	6
Idaho	57	46	Pennsylvania	260	14
Illinois (a)	298	11	Rhode Island	425	4
Indiana	99.5	39	South Carolina	57	46
Iowa	136	32	South Dakota	153	30
Kansas	129	34	Tennessee (a) (c)	62	43
Kentucky	110	37	Texas	141	31
Louisiana	108	38	Utah	170	27
Maine	200	18	Vermont	308	8
Maryland	200	18	Virginia (a)	60	44
Massachusetts	351	5	Washington	302.5	10
Michigan	200	18	West Virginia	120	35
Minnesota (d)	304	9	Wisconsin	252	15
Mississippi	68	40	Wyoming	60	44
Missouri (a)	17	51			
Montana	170	27	Dist. of Columbia (e)	450	1
			U. S. Median	178	

Source: Compiled by FTA from state sources.

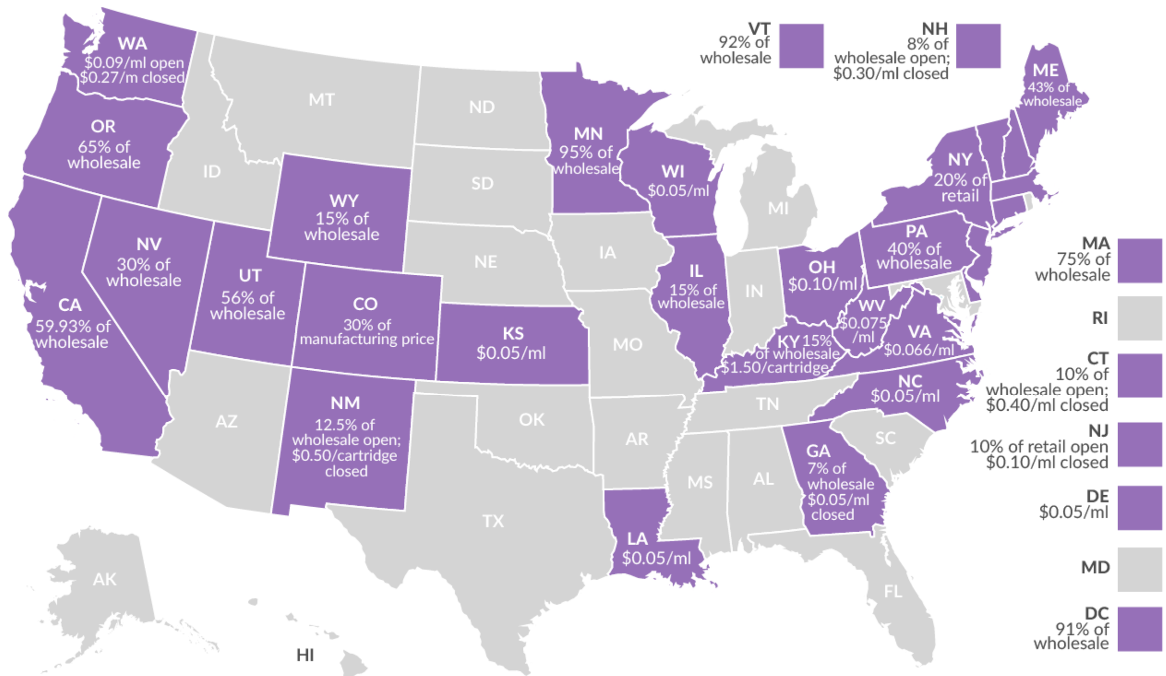
ATTACHMENT B



ATTACHMENT C

How High are Vapor Taxes in Your State?

State Vapor Products Excise Tax Rates, January 1, 2021



Note: Several states levy general sales taxes in addition to the excise tax. Those are not included on the map.

Open: An open tank allows the consumer to refill the liquid and allows more freedom in voltage and nicotine levels.

Closed: Normally sold as pods or cartridges. Closed systems typically have higher nicotine levels to allow for consumption of the desired amount of nicotine in shorter sessions.

Source: State Statutes & Bloomberg Tax

Has a Statewide Vapor Excise Tax

No Vapor Excise Tax

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ATTACHMENT D

State Taxation of Social Security Benefits	
Colorado	For beneficiaries younger than 65, up to $20,000 of Social Security benefits can be excluded, along with other retirement income. Those 65 and older can exclude benefits and other retirement income up to $24,000. Starting with the 2022 tax year, residents will be able to deduct all federally taxable Social Security benefits from their state income, part of a tax-code overhaul that Colorado lawmakers enacted in June 2021.
Connecticut	Social Security is exempt for individual taxpayers with federal adjusted gross income of less than $75,000 and for married taxpayers filing jointly with federal AGI of less than $100,000.
Kansas	Social Security benefits are exempt from Kansas income tax for residents with a federal adjusted gross income of $75,000 or less.
Minnesota	Social Security income is taxable, but a graduated system of Social Security subtractions apply if someone's provisional income is below $81,180 for a single filer or $103,930 for joint filers.
Missouri	Social Security benefits are not taxed for single taxpayers with adjusted gross income of less than $85,000 and married couples with AGI of less than $100,000. Taxpayers who exceed those income limits may qualify for a partial exemption on their benefits.
Montana	Social Security benefits are taxable. The taxable amount may be different from the federally taxable amount because Montana taxes some types of income that the federal government does not, and vice versa.
Nebraska	A taxpayer may subtract Social Security income included in federal adjusted gross income if a taxpayer's federal adjusted gross income is less than or equal to $58,000 for married couples filing jointly, or $43,000 for all other filers. Nebraska is phasing out taxation of benefits starting in the 2021 tax year when beneficiaries saw a 5 percent cut in taxes on their Social Security. The reduction will grow in steps to 50 percent by 2025, at which point state lawmakers will vote on whether to eliminate the tax on benefits altogether by 2030.
New Mexico	Benefits are taxed to the same extent as on the federal tax return. But Social Security income can be included as part of an overall retirement-income exemption of up to $8,000 per person, subject to income restrictions.
Rhode Island	Rhode Island doesn't tax Social Security benefits for single filers with up to $81,900 in adjusted gross income and joint filers with up to $102,400 in AGI.
Utah	Social Security benefits are taxed, but the state uses tax credits to eliminate liability for beneficiaries with less than $30,000 (single filers) or $50,000 (joint filers), with credits phasing out at 2.5 cents for each dollar above these thresholds.
Vermont	Vermont provides a graduated system of Social Security exemptions which kick in if a taxpayer's income is below $34,000 (single filer) or $44,000 (filing jointly)
West Virginia	West Virginia passed a law in 2019 to begin phasing out taxes on Social Security for those with incomes not exceeding $50,000 (single filers) or $100,000 (married filing jointly). Beginning in tax year 2020, the state exempted 35 percent of benefits for qualifying taxpayers. As of 2021, that amount increased to 65 percent, and in 2022, the benefits will be completely exempt for those taxpayers.

Sources: Tax Foundation, 2021 and AARP, 2022

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