

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current and previously issued FIRs are available on the NM Legislative Website (www.nmlegis.gov).

FISCAL IMPACT REPORT

ORIGINAL DATE 2/7/22

SPONSOR Moores LAST UPDATED _____ HB _____

SHORT TITLE Exempt Police Officers from Income Tax SB 184

ANALYST Faubion

REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|-------------------|--------------|--------------|--------------|--------------|---------------------------|---------------|
| FY22 | FY23 | FY24 | FY25 | FY26 | | |
| -- | (\$29,000.0) | (\$29,000.0) | (\$30,000.0) | (\$31,000.0) | Recurring | General Fund |

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| FY22 | FY23 | FY24 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|------|-------|------|-------------------|---------------------------|---------------|
| -- | \$5.2 | -- | \$5.2 | Nonrecurring | TRD/ITD |

Parenthesis () indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Public Safety (DPS)
 State Personnel Office (SPO)
 Taxation and Revenue Department (TRD)
 General Services Department (GSD)

SUMMARY

Synopsis of Bill

Senate Bill 184 (SB184) adds a new section to the Income Tax Act to exempt from state income tax the salary paid for active duty service of a federal, state, or local police officer.

There is no effective date of this bill. It is assumed that the effective date is 90 days following adjournment of the Legislature. The provision in the bill are applicable to taxable years beginning on or after January 1, 2022.

FISCAL IMPLICATIONS

To estimate the fiscal impact of the proposed legislation, the Taxation and Revenue Department (TRD) used information on average wages and employment estimates in the protective services industry, as classified under the Standard Occupational Classification (SOC) system, from the Occupational Employment and Wage Statistics (OEWS) for New Mexico, made available by the Bureau of Labor Statistics¹. Based on 2020 employment data, it was assumed that about 11,000 taxpayers will qualify as either a federal, state, or local police officer to benefit from the proposed personal income tax (PIT) exemption. The average wage for the qualified officers in 2020 ranged from about \$40 thousand for correctional officers and jailers to over \$87 thousand for first-line supervisors of police and detectives. The fiscal impact is grown using the IHS Markit's latest forecast for the consumer price index.

TRD will make information system changes and update forms and publications. These changes will be incorporated into annual tax year implementation and cost \$5.2 thousand in workload costs for the Information Technology Division (ITD).

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.

This bill creates or 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 committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

SIGNIFICANT ISSUES

TRD notes the following tax policy issues:

PIT revenue represents a 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 42 states along with the District of Columbia that 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, means taxes where the average tax rate increases as the taxable amount increases. Thus, an exemption of income from taxation as proposed in this legislation would erode horizontal equity in the state

¹ https://www.bls.gov/oes/current/oes_nm.htm#33-0000

personal income taxes. By basing the credit on profession and type of work performed, taxpayers in similar economic circumstances are no longer treated equally. Thus, two taxpayers who earn the same salary may have different tax liability given their choice of profession.

Tax policy principles do not necessarily favor singling out certain professions for income tax exemption. Many other taxpayers provide an essential public service, and a case could be made for exempting their income as well. Furthermore, the proposed tax exemption would narrow the base with respect to the income tax; providing an exemption to one or more favored group of taxpayers will cause taxes to be raised on the narrowed base to fund the same level of government expenditures.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since TRD is not 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.

TECHNICAL ISSUES

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

OTHER SUBSTANTIVE ISSUES

The Department of Public Safety notes that exempting commissioned law enforcement officers from state income tax would be an additional recruiting and retention incentive for the New Mexico State Police.

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 | ? | |
| Targeted | | |
| Clearly stated purpose | ✘ | |
| Long-term goals | ✘ | |
| Measurable targets | ✘ | |
| Transparent | ? | |
| Accountable | | |
| Public analysis | ? | |
| Expiration date | ✘ | |
| Effective | | |
| Fulfills stated purpose | ? | |
| Passes “but for” test | ? | |
| Efficient | ✘ | |
| Key: ✓ Met ✘ Not Met ? Unclear | | |