FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Brown/Armstrong	**ORIGINAL DATE**	2/8/23
SHORT TITLE	Social Security Income Tax Exemption Cap	**BILL NUMBER**	House Bill 192
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	($36,100.0)	($38,100.0)	($40,200.0)	($48,200.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
		$5.6		$5.6	Nonrecurring	TRD/ITD
Total		**$5.6**		**$5.6**		

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Conflicts with HB193.

Sources of Information
LFC Files

Responses Received From
Aging and Long-Term Services Department (ALTSD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 192

House Bill 192 removes the income cap on social security income that is exempt from income tax.

The provisions in this bill apply to taxable years beginning on or after January 1, 2023.

FISCAL IMPLICATIONS

Currently, social security income is exempt from state income tax for individuals with income of less than $75 thousand for married filers filing separately, $150 thousand for heads of household, surviving spouses, and married filers filing jointly, and $100 thousand for single filers. This bill

removes the income caps and exempts all social security income from state income tax.
To estimate the impact of the proposed legislation of exempting all remaining 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)[1], b) the growth rate of the population 65 years and older in New Mexico relative to the United States[2], and c) the cost-of-living-adjustment (COLA) to Social Security and Supplemental Security Income (SSI) benefits for calendar year 2022[3,4].

The estimate is based on the taxpayer population in IRS data who filed a NM 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[5] 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.

The estimate then removes the current population of social security beneficiaries who are eligible for the social security income exemption up to $75 thousand adjusted gross income (AGI) for married individuals filing separate returns, $100 thousand AGI for single individuals, and $150 thousand AGI for heads of household and married individuals filing joint returns. The current exemption estimate is based on the Consensus Revenue Estimating Group (CREG) December 2022 forecast for Personal Income Tax (PIT).

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 action be postponed until the implications can be more fully studied.
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

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[1] https://www.cbo.gov/publication/57342
[2] Population Projections, United States, 2004 - 2030, by state, age and sex, on CDC WONDER Online Database, Sept. 2005.
[3] https://www.ssa.gov/cola/
[4] 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.
[5] 'R' filers file based on the rate tables. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income.

This proposal will benefit only the top 6 percent of taxpayers when applied to tax year 2021 data. The Aging and Long-Term Services Department notes this additional exemption overwhelmingly benefits higher income seniors and the loss in revenue may negatively impact programs for lower-income New Mexicans that are funded by this tax though the general fund.

TRD notes the following policy issues:

> 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. The 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.
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> New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "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. The new exemption for social security income by levels of AGI breaks the conformity with the federal application at those income levels. This bill would break conformity with federal application of social security at all income levels.
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> Removing the current caps and exempting all social security income will principally benefit high-income individuals who do not depend solely on social security benefits for their income, and who have other sources of income as well.
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> With the adoption of this bill, New Mexico would join most of the states that do not tax social security benefits at all. Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. 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.
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> 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 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[6]. Notably, New Mexico's property taxes are amongst 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 structure more simple, broad based, and equitable, without being punitive to any segment of the population.

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

In current statute, there is a "cliff effect" at the income caps where those with incomes just under the cap do not pay income tax on their social security income, while those with incomes just over the cap do pay income tax on their social security income. This erodes horizontal equity at those income levels near the exemption caps as those with similar incomes are not treated equally.

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.

ADMINISTRATIVE IMPLICATIONS

Updates to forms, instructions and publications will be incorporated into annual tax year implementation. These changes will cost $5,554 in workload costs for TRD's Information Technology Division (ITD).

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 192 conflicts with House Bill 193, which indexes the social security income caps to inflation.

OTHER SUBSTANTIVE ISSUES

At the federal level, if a 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.

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:

> 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).[7]

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

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[7] Potential Fiscal Impacts of a New Mexico Retiree Attraction Campaign, December 2018 https://aces.nmsu.edu/pubs/_circulars/CR691.pdf

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

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	?	The issue has not been discussed at an interim committee recently. The issue was discussed during the 2022 legislative session.
Targeted		No purpose, targets, or goals established.
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
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.
Key: ✓ Met ✘ Not Met ? Unclear		

JF/al/ne/rl