FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Armstrong/Brown	**ORIGINAL DATE**	2/3/24
SHORT TITLE	Social Security Income Indexing	**BILL NUMBER**	House Bill 249
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT	-	-	($1,000.0)	($1,400.0)	($1,700.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	-	$12.2	-	$12.2	Nonrecurring	General Fund
TRD	-	-	$6.7	$6.7	Recurring	General Fund
Total	-	**$12.2**	**$6.7**	**$18.9**	**Recurring/Nonrecurring**	**General Fund**

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

Conflicts with House Bill 248.

Sources of Information

LFC Files

Agency Analysis Received From
Taxation and Revenue Department (TRD)
Attorney General's Office (NMAG)

Agency Analysis was Solicited but Not Received From
Aging and Long-Term Services Department (ALTSD)

SUMMARY

Synopsis of House Bill 249

House Bill 249 annually adjusts the income caps on the income tax exemption for social security income to account for inflation.

The provisions in this bill apply to taxable years beginning on or after January 1, 2024.

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 will annually adjust the income caps by a ratio of the consumer price index, increasing the income levels by the inflation rate, except in instances where the inflation rate would result in a downward revision.

TRD notes the following methodology for estimating the fiscal impact:

> The personal income tax (PIT) exemption for social security income was enacted in 2022. 12 percent of New Mexico tax filers claimed the exemption. Using tax year 2022 taxpayer returns that claimed the social security exemption, the Taxation and Revenue Department (TRD) calculated the amount of the exemption by tax filing status per tax filer.
>
> | Filing Status | 2022 Exemption per Tax Filer |
> |---|---|
> | Single | $453 |
> | Head of Household, Surviving Spouses, and Married Filing Joint | $706 |
> | Married Filing Separate | $432 |
>
> TRD then adjusted the maximum adjusted gross income (AGI) from tax year 2025 to tax year 2027 using the Congressional Budget Office's inflation forecast. See table below for the estimated maximum AGI by filing status. TRD estimated the additional number of tax filers that would qualify for the social security exemption under the adjusted AGI and multiplied this by the amount of exemption per tax filer by filing status.
>
> | Inflation-Adjusted Maximum AGI to Qualify for Social Security Exemption | | | |
> |---|---|---|---|
> | | Married Filing Separate | Head of Household, Surviving Spouses, and Married Filing Joint | Single |
> | Current | $75,000 | $150,000 | $100,000 |
> | Tax Year 2025 | $78,000 | $156,000 | $104,000 |
> | Tax Year 2026 | $79,000 | $159,000 | $106,000 |
> | Tax Year 2027 | $81,000 | $163,000 | $108,000 |

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.

SIGNIFICANT ISSUES

This bill requires the income caps that determine eligibility for the social security exemption to index to inflation, allowing incomes to naturally rise with inflation without "graduating" people off the exemption. Without adjusting the income eligibility for inflation, the exemption will slowly "phase out" as people's incomes rise above the static eligibility income thresholds. Allowing tax expenditures to phase out with inflation acts like a gradual sunset and allows future Legislatures to decide whether the exemption should be continued and at what level. Indexing the income thresholds creates permanence to this exemption, requiring statutory changes to eliminate or reduce the benefit.

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.

TRD notes the following policy issues:

> Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. 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 taxpayers' ability to pay. This bill will continue to affect horizontal equity in state income taxes offering one taxpayer a competitive advantage over another.
>
> Assuming the purpose of the statute is to reduce the tax liability of middle- and low-income taxpayers that receive social security income, adjusting the maximum AGI at the state level for inflation ensures that these taxpayers will continue to qualify for the exemption as federal social security income is adjusted for inflation.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met because 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

TRD will make information system changes and update forms, instructions, and publications annually. This implementation will be included in the annual tax year changes. This bill will have a low impact on TRD Information Technology Division (ITD), approximately 220 hours or over one month and $12,210 of staff workload costs. This will add recurring work in tax year 2026 and beyond, as AGI thresholds may now be updated each year. For subsequent tax years, the impact of ITD recurring work will be about 120 hours per tax year or $6,660 of staff workload costs.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill conflicts with House Bill 248 which removes the income caps for the social security income tax exemption.

TECHNICAL ISSUES

TRD notes the 'consumer price index' referenced in the proposed subsection B, is not defined. TRD suggests using the following definition currently in law for the indexing of the Low-Income Comprehensive Tax Rebate, Section 7-2-14 NMSA 1978. "Consumer price index" means the consumer price index for all urban consumers published by the United States department of labor for the month ending September 30.

TRD notes on page 2, line 13, the formula refers to multiplying each amount of "modified gross income." The amount referenced should be to "adjusted gross income."

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 at the federal level.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✗	This bill has not been vetted.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	✗	No stated purpose, goals, or targets.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	?	No reporting to a committee is required. The exemption is reported on annually in the tax expenditure report.
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. Public analysis Expiration date	?	No expiration date. Some data available in the TER for public analysis.
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. Fulfills stated purpose Passes “but for” test	?	There are no stated goals or targets by which to measure effectiveness or efficiency.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

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