

BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 24, 2025

Bill: SB-285

Sponsor: Senators James G. Townsend, Nicholas A. Paul, Anthony L. Thornton, Jay C. Block, and Pat Boone

Short Title: Exempt Tips From Income Tax

Description: This bill creates a new exemption from net income for residents who receive tips as compensation for services rendered by the resident or as part of wages earned by the resident.

Effective Date: Not specified; 90 days following adjournment (June 20, 2025). Applicable to tax years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2025	FY2026	FY2027	FY2028	FY2029		
--	(\$5,600- \$11,200)	(\$5,900- \$11,800)	(\$6,200- \$12,300)	(\$6,400- \$12,700)	R	General Fund

* In thousands of dollars. Parentheses () indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (Tax & Rev) does not have information regarding tip income separate from other wage or salary income, as tip income is commingled with other wages and compensation in cell 1 on each individual’s W-2 form. Therefore, Tax & Rev used data from the state of Montana to estimate the average amount of tip income per taxpayer. The state of Montana has exempted tipped income from state income tax up until 2024, and therefore provides the best available proxy for the breakdown between different forms of income. According to the Montana Department of Revenue, tipped workers saved in income tax, on average, approximately \$279 per taxpayer in 2021¹. Tax & Rev then calculated the average amount of tip income per taxpayer by applying Montana’s tax year 2021 effective income tax rate and adjusted the tip income for wage inflation using the University of New Mexico’s Bureau of Business and Economic Research (BBER) January 2025 forecast. This resulted in an average tip income of \$7,352 per taxpayer in tax year 2023. Tax & Rev is assuming that tip workers in New Mexico have comparable annual tip income as those workers in Montana.

Tax & Rev then applied the 2023 effective tax rate for New Mexico residents of 2.8% to estimate the average tax savings for an individual with tip income at \$206 per taxpayer². The Yale Budget Lab estimates that approximately 2.2% of workers in the western United States work in jobs that regularly receive tips³. Tax & Rev assumes each worker will file one tax return. Using this percentage, Tax & Rev estimates that approximately 24,200 taxpayers would have tipped income annually. Finally, Tax & Rev calculated the fiscal impact by multiplying the average tax savings by the number of eligible taxpayers.

Tax & Rev recognizes that this estimate may omit many workers that receive tips as contractors (such as

¹ <https://mtrevenue.gov/dor-publications/biennial-reports/>

² For more information on the effective tax rate, see 2024 Tax Expenditure Report at, <https://www.tax.newmexico.gov/forms-publications/>

³ <https://budgetlab.yale.edu/news/240624/no-tax-tips-act-background-tipped-workers>

rideshares), the number of which is unavailable at this time. Therefore, Tax & Rev doubled the percent of workers that receive tip income to 4.4% and provided a range for the fiscal impact.

Policy Issues: Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 16 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 states 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. By basing this exemption on a profession, taxpayers in similar economic circumstances are no longer treated equally.

Generally, tips may consist of the following payments: a cash tip received directly from a customer, a monetary amount rendered through an electronic payment, a non-cash tip (such as a ticket or coupon of monetary value), or amounts received from other employees through tip pools, tip splitting, or other tip-sharing agreements⁴. Some tipped workers are subject to a tipped minimum wage depending on the state. The federal tipped minimum wage is \$2.13 per hour (\$7.25 per hour for non-tipped) and the minimum tipped wage for New Mexico is \$3.00 per hour (\$12 per hour for non-tipped)⁵. Employers are responsible for ensuring each tipped worker receives at least the tipped minimum wage, called the tip credit, and employers must cover the difference if the worker earns under the minimum tipped wage. If a worker earns more than \$20 a month in tips, the worker generally must report it to the employer who is then required to withhold federal payroll taxes under the Federal Insurance Contributions Act (FICA).

The Tax Policy Center estimates that the exclusion of tip income from federal taxes would result in approximately 2% of US households receiving a tax cut. For households with an adjusted gross income (AGI) under \$75,000, about 1.5% of U.S. households would benefit. Households earning between \$63,000 and \$113,000 would see the greatest benefit in terms of an increase of after-tax income, at a 2.8% increase⁶.

Tipped workers generally have a lower income. The median weekly wage for tipped occupations in 2023 was \$538, versus \$1,000 for non-tipped workers⁷. This means that the average tipped workers had a lower federal income tax burden as the federal income tax structure is progressive. 37 percent of tipped workers had incomes low enough that they faced no federal income tax in 2022. For non-tipped occupations, this was 16 percent⁸. The poverty rate for tipped workers is significantly higher in the Midwest and the South of the United States compared to non-tipped workers (see graphic on next page).

Workers that rely on tipped income are susceptible to inherent variability in receiving this tipped income. Pay can vary depending on the day, week, or season. Tipping can be influenced by a customer’s personal preferences, cultural norms, social conventions, or geographic location. Thus, tipping is not necessarily based on an economic activity or directly dependent on the worker’s performance. Also, workers in the accommodation and food service industry, which has a high concentration of tipped workers, are offered paid leave (sick, holiday, and vacation leave), health insurance, and retirement benefits at rates far below

⁴ <https://www.kiplinger.com/taxes/are-tips-taxable>

⁵ https://www.epi.org/minimum-wage-tracker/#/tip_wage/New%20Mexico

⁶ <https://taxpolicycenter.org/model-estimates/options-change-taxation-tips-september-2024/t24-0069-options-change-taxation-tips>

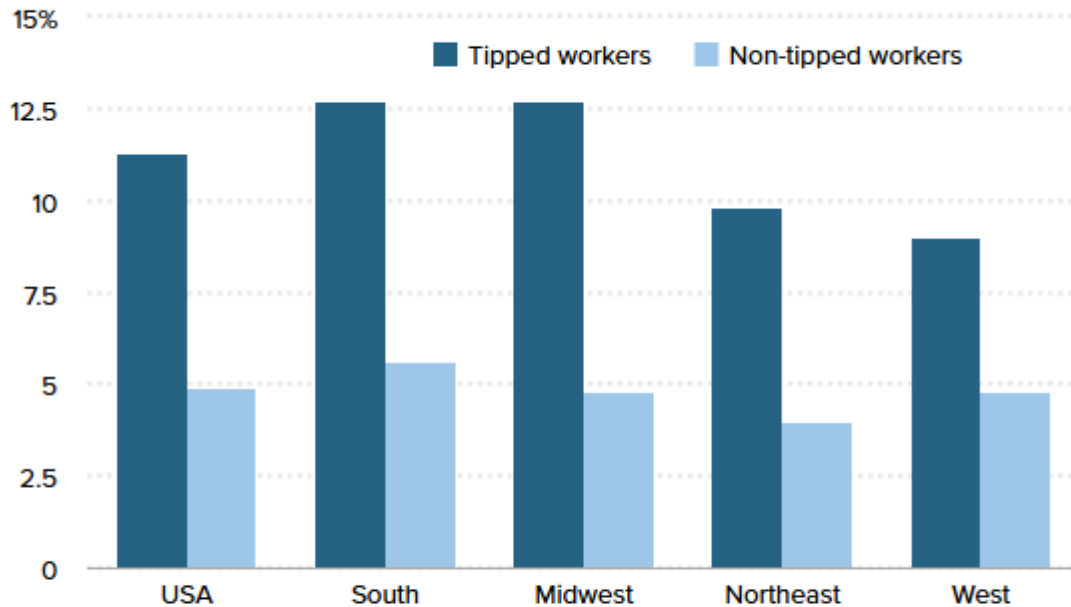
⁷ <https://budgetlab.yale.edu/news/240624/no-tax-tips-act-background-tipped-workers>

⁸ Ibid.

those of private-sector workers⁹.

Legally, if a tipped worker does not earn the tipped minimum wage, the employer is required to cover the tip credit. In practice, this requirement is difficult to enforce, and evidence suggests this¹⁰. This can result in potential wage theft.

Poverty rates for tipped and non-tipped workers in the U.S. and Census Regions, 2017–2019 and 2021–2022



Note: The South is tied with the Midwest for the tipped worker poverty rate. Analysis includes only employed workers.

Source: Economic Policy Institute analysis of U.S. Census American Community Survey data for the years 2017 through 2019 and 2021–2022. The year 2020 was excluded due to concerns about data quality in the 2020 American Community Survey amid the COVID-19 pandemic.

In New Mexico, common tipped occupations include:

Occupation	Number of NM Workers	Average Annual Income ¹¹	Average NM Tax Liability ¹²
Bartender	2,830	\$28,580	\$954
Waiter or waitress	12,760	\$30,350	\$1030
Hairdresser, hair stylist, or cosmetologist	1,540	\$27,380	\$902
Manicurist or pedicurist	140	\$45,280	\$1,719
Courier or messenger	300	\$35,330	\$1,252
Bellhop or baggage porter	60	\$33,430	\$1,162

⁹ <https://www.epi.org/publication/waiting-for-change-tipped-minimum-wage/>

¹⁰ Ibid.

¹¹ Bureau of Labor Statistics, Occupational Employment and Wage Statistics (OEWS); 2023 annual median wage and employment

¹² Under tax year 2025 tax brackets, single filing status

Tax & Rev cannot predict behavioral changes that this bill may incentivize. If employees were to be reclassified as tipped employees, this bill’s overall cost could be substantially higher. For example, if high-income workers were able to shift their earnings into tips, state revenue losses could increase. Additionally, Tax & Rev is unable to estimate the impact of contract workers who receive tips which may increase the fiscal impact.

Technical Issues: This bill does not define “tip” income. As stated in the policy section, there are multiple types of tips. Commissions or bonuses could be considered “tips” because they are discretionary and often based on services. This language should be clarified to provide taxpayers and the Department sufficient guidance in implementing. Without that, Tax & Rev and taxpayers may experience a high number of protests and subsequent litigation around these issues.

Other Issues: The proposed bill to exempt tips from income tax presents challenges for Tax & Rev in verifying the accuracy of the exemption claims. Tips are included in the total wages reported on both the W-2 and IRS Form 1040, making it difficult to distinguish between tip income and regular wages. Since tips are not separately stated on either the W-2 form or Form 1040, it becomes challenging to accurately verify the dollar amount of tips received by taxpayers. This lack of separate reporting can lead to potential misuse of the exemption, as taxpayers who do not actually receive tips may falsely claim the exemption. The proposed exemption is therefore susceptible to tax fraud and evasion.

The absence of a clear and verifiable method to track and substantiate tip income opens the door for taxpayers to exploit the exemption. To prevent exploitation of the exemption, it is recommended to implement a certification requirement. This would involve requiring taxpayers to obtain a certification of their tip income from the employer. However, this places a burden on the taxpayer, the employer, and Tax & Rev.

Administrative & Compliance Impact: Tax & Rev will update forms, instructions and publications and make information system changes. Staff training to administer the exemption will take place. This implementation will be included in the annual tax year changes.

This bill will have a low impact on Tax & Rev’s Information Technology Division (ITD) requiring approximately 220 hours or about 1.5 months for an estimated staff workload cost of \$14,661.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2025	FY2026	FY2027	3 Year Total Cost		
--	\$14.6	--	\$14.6	NR	ITD – Staff workload

* In thousands of dollars. Parentheses () indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).