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FISCAL IMPACT REPORT

ORIGINAL DATE 02/04/09
 SPONSOR Anderson LAST UPDATED 02/28/09 HB 276
 SHORT TITLE Military Retirement Pay Tax Exemption SB _____
 ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(\$14,300.0)	(\$9,900.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

NMSU report per 2008 SJM 27

Military Officers Association of America (MOAA) – Albuquerque Chapter

Responses Received From

Taxation and Revenue Department (TRD)

Veterans Services Department (VSD)

SUMMARY

Synopsis of Bill

House Bill 276 would allow military retirees or surviving spouses an exemption of 50 percent of retirement or retainer pay that would be includable in net income for purposes of calculating personal income tax liability. The exemption would be effective for tax year 2009 and beyond.

FISCAL IMPLICATIONS

TRD:

As of 2007, there were 19,260 retired military personnel living in New Mexico and receiving \$448 million in retirement benefits. The average retirement benefit was thus \$23,261 per individual. The revenue estimate is derived by increasing the number of military retirees by 1% per year and the average annual benefit by the projected rate of inflation. Because the average household income for retired military personnel residing in New Mexico is approximately \$86,000, it is assumed that military retirement pay at an average marginal tax rate of 4%. The revenue impact in a given year is calculated as the product of the number of retirees, one-half the average annual benefit, and an average

marginal tax rate of 4%. The revenue impact for FY2010 is higher than for other years due to the fact that the full effect of tax year 2009 and half of that for tax year 2010 occurs in FY2010.

NMSU conducted a study that yielded very different and lower results. The central assumption is the rate applied to income for the purposes of calculating income tax. TRD uses a *marginal* tax rate which is the rate that would be applied to the last dollar of adjusted gross income while NMSU uses an *average* rate which is effectively the total tax divided by the adjusted gross income. The marginal rate TRD uses is double the average rate that NMSU uses: this causes the results to be double. TRD has additional taxpayers in the data as well, adding to the fiscal impact.

The FY10 impact is much larger because the effective date is June 19th, 2009, halfway through calendar year 2009. This means that virtually all of the tax year 2009 withholding will occur in FY10 rather than half occurring in FY09 as would normally be the case. In other words, the full year of tax year 2009 and half year of 2010 will show up in FY10, causing the impact to be much higher than a normal year.

SIGNIFICANT ISSUES

TRD:

Individuals with incomes and other circumstances similar to individuals receiving the proposed exemption are likely to view it as unfair, especially when they compete with the retirees for jobs and when the retirees have relatively high incomes.

The measure may encourage military retirees to move to New Mexico. These individuals may possess substantial work skills that could benefit New Mexico economic development efforts. It is sometimes argued that such individuals place lower demands on public spending (education, law enforcement, etc.) than other segments of the population.

The Albuquerque chapter of Military Officers Association of America presented its own analysis of the benefits of exempting retirement pay. In its analysis the group reported that it was in the best interests of the state to attract retirees because they would bring with them federal benefits such as TRI-Care health coverage and retirement income. MOAA suggests that military retirees

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc

could fill vital vacancies in technology, medical and education fields. According to the report, military retirees are better situated to start businesses because of their sustaining retirement income allows more risk-taking, they will receive preferential veterans treatment, and the discipline and training they received in the armed forces directly translate to start up business requirements.

In 2008, Senate Joint Memorial was introduced in the Senate (and amended to be simply a Senate Memorial) that asked NMSU to establish a taskforce to study the economic benefit of providing an exemption to military retirees. The taskforce, made up of representatives from TRD, Economic Development Department, MOAA, veteran's organizations, and military widows, met over the interim and discussed the possible benefit of enacting an exemption.

NMSU reports that New Mexico has a fairly high share of veterans already. Citing data from the Department of Defense, the study reports veterans as a percent of population for NM is 1.08 percent, much higher than the average of 0.66 percent. Further, the states with no income tax have lower shares and states with exemptions have lower shares except for Alabama and Hawaii.

NF/svb