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## FISCAL IMPACT REPORT

**SPONSOR** Anderson **ORIGINAL DATE** 02/05/14  
**LAST UPDATED** 02/13/14 **HB** 332

**SHORT TITLE** Armed Forces Retainer Pay Tax Credit **SB** \_\_\_\_\_

**ANALYST** Dorbecker

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	(\$21,500.0)	(\$21,500.0)	(\$21,500.0)	(\$21,500.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of Bill

House Bill 332 creates a new section of the Income Tax Act to create the “armed forces retainer pay income tax credit”. The amount of the credit is limited to \$1,000 per taxpayer, and may not be carried forward, refunded or transferred to another taxpayer.

The bill requires taxpayers applying for the credit to provide information to the Taxation and Revenue Department (TRD) concerning the taxpayer’s status as an armed forced retiree. The bill further requires TRD to promulgate rules establishing procedures to certify armed forces retirees for purposes of obtaining the credit.

The bill includes reporting requirements. TRD is required to periodically audit its own records of the credit to ensure the credit’s effective administration. TRD must also compile an annual report that includes the number of taxpayers approved to receive the credit. The bill requires the appropriate legislative committees to review the effectiveness and cost of the tax credit every three years, beginning in 2018.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends. The provisions of this bill apply to taxable years beginning on or after January 1, 2014.

## **FISCAL IMPLICATIONS**

TRD used information from the Statistical Report on the Military Retirement System published by the Department of Defense to estimate the fiscal impact. According to TRD, between 2008 and 2012, the average number of armed forces retirees in New Mexico was about 21,400 with virtually no relative variation in the last couple of years. TRD assumed approximately 21,400 armed forces retirees would qualify for this credit in the next few years.

By applying the maximum \$1,000 credit to this number, TRD estimated the fiscal impact to be a revenue loss of \$21.5 million dollars per year to the general fund. Because \$1,000 dollars is the maximum non-refundable credit proposed by the bill, and because the credit is against the taxpayer's income tax liability, the actual fiscal impact of the bill could end up being smaller than TRD's estimate.

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.

## **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

## **ADMINISTRATIVE IMPLICATIONS**

TRD estimates a moderate impact from the bill as it involves modifying the income tax returns and instructions at no additional cost. The bill also involves changes in the business credit manager of GenTax with a total of 250 hours needed to complete the task. TRD recommends the approval process would be best managed through a pre-approval process to avoid paying interest for instances when the claim is incomplete.

According to TRD, the tracking and reporting will have to be manual, and will require one quarter (¼) FTE to manage. TRD will need to develop rules and procedures in order to approve qualifying retirees for the credit. Coordination with the Department of Veterans affairs and the Department of Defense may be needed to determine necessary documentation to verify proper taxpayer qualifications.

## **TECHNICAL ISSUES**

This bill does not contain a sunset date. LFC recommends adding a sunset date.

## OTHER SUBSTANTIVE ISSUES

TRD reports confidentiality issues may arise from this bill, particularly when reporting to the legislature.

The term “retainer pay” is not defined by the bill. TRD recommends adding language to clarify.

Since this bill is to encourage armed forces retirees to move to New Mexico, TRD also recommends that subsection A should state “and is a New Mexico resident”.

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

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