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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 2/11/15  
**LAST UPDATED** 3/10/15     **HB** 229

**SPONSOR** Trujillo, C.

**SHORT TITLE** Combat Veteran Income Tax Deduction     **SB** \_\_\_\_\_

**ANALYST** Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
\$0.0	(\$44,000)	(\$45,400)	(\$46,500)	(\$47,700)	Recurring	General Fund

(Parenthesis ( ) indicate revenue decreases)

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>		**	**			

(Parenthesis ( ) indicate expenditure decreases)

[\*\* ]The bill does not establish procedures for combat veterans to prove their service in a combat zone. TRD would have to piggyback on VA healthcare eligibility or some other means to allow combat veterans to submit documentation with their annual tax returns. The bill makes no provision to allow these combat veterans access to this money during the course of the year as lower amounts of wage withholding. Resolving these issues will require substantial administrative effort.

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Veteran's Services Department (VSD)  
 Taxation and Revenue Department (TRD)  
 Department of Finance and Administration (DFA)

### SUMMARY

#### Synopsis of Bill

House Bill 229 provides for a total income tax deduction for combat veterans. The bill requires the veteran to report this deduction separately in a manner required by TRD, sets out a definition of a combat veteran as a veteran who has served on active duty in a theater of combat operations under orders of the President of the United States and has been discharged under other than dishonorable conditions. The income tax exemption persists for the rest of the combat veteran's life

in New Mexico and, presumably, includes all income for whatever source. The bill requires accountability such that TRD must deliver an annual report to the Revenue Stabilization and Tax Policy Committee regarding the utilization and cost of this exemption.

**FISCAL IMPLICATIONS**

TRD has provided the following estimate:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2015	FY2016	FY2017	FY2018	FY2019		
0	(56,520.0)	(57,650.0)	(58,800.0)	(59,980.0)	Recurring	General Fund

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

The Taxation and Revenue Department (TRD) used New Mexico’s Veteran Population Facts and figures 2015. According to the report, there are a total of 127,876 combat veterans ranging from World War II era to post 9/11. TRD is assuming that this population will grow at a rate of 2 percent given the mortality rates and addition of new combat veterans. According to information obtained from the Department of Defense, the average annual salary nationwide for veterans is about \$26,000. The taxable amount was obtained by multiplying the population by the average salary and applying the tax rates to obtain the deduction. TRD assumed a tax rate of 1.7%.

However, VSD has a somewhat different perspective:

“...according to figures provided by the US Department of Veterans Affairs, as of September 30, 2013, New Mexico was home to 128,960 veterans who had served during a designated war or conflict. The Department of Defense does not track each combat action badge or ribbon, therefore it is difficult to quantify how many New Mexico veterans have actual combat service.”

However, the definition of “combat veteran” includes anyone who served on active duty in a theater of combat operations. The individual does not have to prove that he or she received a combat infantry badge, a combat activity badge or combat medical badge, only that the person served in the theater of operations.

Thus, the TRD estimate may be too large because the analysis assumes that 100 percent of the veterans who served in wartime (see appendix chart) are combat veterans. On the other hand, TRD’s estimate is too small since all income of combat veterans, including, perhaps, income of a spouse (New Mexico is a community property state), would be exempt. The \$26,000 average salary is only for wage income of the veteran and would not include other sources of income or income of a spouse.

DFA also provided fiscal analysis, as follows:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2015	FY2016	FY2017	FY2018	FY2019		
0	(27,729.0)	(-29,141.0)			Recurring	General Fund

“The estimate uses veteran counts reported by the Department of Workforce Solution, and applies to these the share of those who served in combat or a warzone reported by the U.S. Census Bureau’s Current Population Survey. The veteran population is grown by 1.5 percent annually, which is the average veteran population growth rate as reported by the Arrowhead Center at New Mexico State University. The urban consumer price index,

from the U.S. Bureau of Economic Analysis and forecasted by Moody's Analytics, is used to grow New Mexico veteran median income as reported by the 2013 American Community Survey from the U.S. Census Bureau.

“Using the IRS’s Statistics of Income data, New Mexico per capita taxable income is calculated as a share of personal income, and total tax liability is calculated using New Mexico personal income tax tables. The total fiscal impact is calculated by multiplying the per capita tax liability by the estimated population of veterans.”

Finally, LFC staff have estimated the fiscal impact using a third methodology:

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
0.0	(\$47,800.0)	(\$49,300.0)	(\$51,000.0)	(\$52,900.0)	Recurring	General Fund

Note: because of the lack of data on the number of veterans who served during times of conflict that would qualify as combat veterans, this estimate should be considered as “order-of-magnitude.” See “Fiscal Implications” below.

“Assuming 25 percent of veterans who served during times of conflict would qualify as combat veterans and further assuming that the distribution of the 32,000 qualifying combat veterans mirrors the aggregate filing population of total state residents, we can model that 23,000 combat veterans have some taxable income and the average tax per return for returns with taxable income (for TY 2012) is \$1,900. The resulting 2012 tax year impact of \$44 million can be allocated and ratioed up using the February revenue estimate to yield the fiscal impacts shown in the table.”

“This amount is somewhat less than reported by TRD, but relies on an unverifiable assumption that 25 percent of New Mexico’s resident veterans who served during times of conflict are simultaneously combat veterans per the definition. A diligent search of the internet did not disclose any compelling estimate of this proportion.<sup>1</sup> However, if TRD’s estimate is correct in this regard, then the fiscal impact will be four times that included in the table. As noted under the table, this estimate should be considered as an order-of-magnitude calculation.

The amount reported in the table on page 1 is a simple linear average of the three estimates.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

**SIGNIFICANT ISSUES**

This bill provides for a full *exemption* of all income from whatever source reported by a combat veteran as defined. This exemption is annual for the rest of the combat veteran’s residency in the State. This exemption may include wage and other separately earned (or unearned) income earned by a spouse, since New Mexico is a community property state. TRD and DFA have analyzed the bill assuming that spousal income would not be exempt unless the spouse was also a combat veteran. However, in many aspects of tax law, the historical fact that New Mexico is a community property state is important.

In history, from the initial enactment in 1913, many married New Mexico taxpayers could undo the marriage tax penalty by splitting income of the couple and filing as two single persons. This

<sup>1</sup> <https://www.hrc.army.mil/TAGD/Awards%20and%20Decorations%20Statistics%20by%20Conflict>

implicit income averaging tactic used by Wisconsin, Washington, Texas, New Mexico, Nevada, Louisiana, Idaho, California and Arizona taxpayers eventually led to the federal married filing joint status that featured explicit income averaging.

LFC staff recommend that this uncertainty in the scope of the income to exempted be clarified.

Of note, combat pay itself is not taxed at the federal or state level.

The federal definition of combat operations (for purposes of tax-exempt combat pay) requires that the combat occur in an area designated by a Presidential Executive Order. Even if the language in this bill is amended to utilize the federal tax definition of “combat zone,” it may still be difficult to identify some combat veterans from earlier wars. For example, combat zone for the Vietnam War, for purposes of identifying the “combat theater” for exclusion of combat pay from taxation, is defined as follows:

Executive Order 11216--Designation of Vietnam and waters adjacent thereto as a combat zone for the purposes of section 112 of the Internal Revenue Code of 1954

Pursuant to the authority vested in me by section 112 of the Internal Revenue Code of 1954, I hereby designate, for the purposes of that section, as an area in which Armed Forces of the United States are and have been engaged in combat:

Vietnam, including the waters adjacent thereto within the following-described limits: From a point on the East Coast of Vietnam at the juncture of Vietnam with China south-eastward to 21° N Lat., 108° 15' E Long.; thence southward to 18° N Lat., 108° 15' E Long.; thence southeastward to 17° 30' N Lat., 111° E Long.; thence southward to 11° N Lat., 111° E Long.; thence southwestward to 7° N Lat., 105° E Long.; thence westward to 7° N Lat., 103° E Long.; thence northward to 9° 30' N Lat., 103° E Long.; thence north-eastward to 10° 15' N Lat., 104° 27' E Long.; thence northward to a point on the West Coast of Vietnam at the juncture of Vietnam with Cambodia.

The date of the commencing of combatant activities in such area is hereby designated as January 1, 1964.

Because “combat zones” are not wars, there are numerous executive orders over time establishing brief combat initiatives that will qualify individuals for this deduction.

There is no effective date of the act – assume 90 days after adjournment or June 19, 2015. The provisions of the bill are applicable for tax years beginning January 1, 2015.

#### **ADMINISTRATIVE AND COMPLIANCE IMPACTS:**

TRD reports a moderate IT impact (300 hours) – Requires changes to Gentax and Taxpayer Access Point personal income tax document rules and configuration. Additional reports need to be developed to list the taxpayers and deduction amounts. Modifying forms and instructions and publications related personal income tax could be completed at no cost, as this is part of the annual renewal of the program.

Ensuring the completeness of the reports to the legislative committee will be difficult to enforce, because the combat veteran would be required to file a return when no tax is due. However, this requirement would conflict with the basic filing requirement in Federal and State income tax

law.

## **PERFORMANCE IMPLICATIONS**

The bill does not clearly state what a veteran would need to provide as proof of service in a conflict zone.

The LFC tax policy of accountability is met since TRD is required in the bill 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.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

TRD notes that SB 316 that will provide a deduction for 100 percent of all military retirement/pension income for all armed service veterans.

## **TECHNICAL ISSUES:**

TRD points out that Subsection A should begin with, "A taxpayer who files an individual New Mexico tax return" at the beginning of the subsection.

The issue of whether spousal income is exempt or not should be clarified. New Mexico is a community property state and this fact is important for some aspects of tax law.

## **OTHER SUBSTANTIVE ISSUES**

Quantifying combat service or combat duty can be difficult, for instance, there were many sailors who were in "hostile waters" during the Vietnam Conflict who served in support operations of the hostilities who were not awarded a Vietnam Combat or Service Ribbon. Many of these veterans who should have been considered "combat" veterans never have been recognized as such even though they did not receive a combat badge, medal, or ribbon.

([http://www.va.gov/vhapublications/ViewPublication.asp?pub\\_ID=1758](http://www.va.gov/vhapublications/ViewPublication.asp?pub_ID=1758))

The following evidence or documentation may be accepted as an individual veteran's proof of combat service, these include: NOTE: Only one is required.

- a) Notations on the DD 214 of service in a designated theater of combat operations;
- b) Receipt of the Afghanistan Campaign Medal, Iraq Campaign Medal, Armed Forces Expeditionary Medal; Kosovo Campaign Medal; Global War on Terrorism Expeditionary Medal (does not include Global War on Terrorism Service Medal); Southwest Asia Campaign Medal; Air Force Combat Action Medal (AFCAM) or other DoD authorized combat related medal; and
- c) Proof of receipt of Hostile Fire or Imminent Danger Pay (commonly referred to as "combat pay") or combat tax exemption after November 11, 1998.

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