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FISCAL IMPACT REPORT

SPONSOR Foley ORIGINAL DATE 2/3/07
LAST UPDATED _____ HB 497
SHORT TITLE Military Retirement Pay Tax Exemption SB _____
ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
(\$5,910.0)	(\$23,640.0)	(\$19,700.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to HB207, HB368, H541, S43, S492, S493

SOURCES OF INFORMATION

LFC Files
Military.com

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House bill 497 exempts military retirement pay from the personal income tax for any resident of NM who served in the US armed forces or the surviving spouse who is a resident of a person who served in the US armed forces.

The effective date is January 1, 2007.

FISCAL IMPLICATIONS

The annual impact for exempting the retirement income of retired members of the armed forces is expected to reduce personal income tax revenues by \$19.7 million. Due to the timing of the effective date, 30 percent of the reduction in tax year 2007 accrues to FY07, or \$5.9 million. The other 70 percent plus 50 percent of tax year 2008 accrues to FY08 which totals \$23.6 million. In future years, the tax year impact is distributed evenly between the fiscal years.

The fiscal impact is based on 22,000 retired armed forces in New Mexico with a total of \$460 million in pension income. The assumed effective income tax rate is 4.3 percent based on TRD analysis. The analysis includes both residents and non-residents because of legal issues raised by TRD.

SIGNIFICANT ISSUES

TRD points out that excluding nonresidents treats them differently for similar income and therefore may raise constitutional issues.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The following table shows all of the bills currently under consideration:

207 H Cote	ARMED FORCES INCOME TAX EXEMPTION
368 H Sandoval	ARMED SERVICE RETIREE INCOME TAX EXEMPTION
497 H Foley	MILITARY RETIREMENT PAY TAX EXEMPTION
541 H Anderson	ARMED FORCES INCOME TAX EXEMPTION
43 S Robinson	MILITARY PENSION INCOME TAX EXEMPTION
492 S Carraro	ARMED SERVICES INCOME TAX EXEMPTION
493 S Carraro	MILITARY PENSION INCOME TAX EXEMPTION

OTHER SUBSTANTIVE ISSUES

TRD:

The measure would encourage military retirees to move to New Mexico. It is possible that this group of individuals possesses substantial work skills that would benefit New Mexico economic development efforts. It is sometimes argued that this group places relatively modest demands on infrastructure (education, law enforcement, etc.) than other segments of the population.

Individuals with incomes and other circumstances similar to people receiving the proposed exemption are likely to view it as unfair, especially when they compete with the retirees for jobs, and when the retirees are individuals with relatively high incomes. According to information on the “military.com” website (<http://usmilitary.about.com/>), military retirement pay can be over \$9,000 monthly for high-ranking officers retiring in 2004.

The fiscal impact shown above does not reflect estimates of the potential “feedback” effects of the proposals on the size of the New Mexico economy. Such effects might arise, for example, if tax reductions increase investment or attract new workers to the state. At present, the department does not have reliable means of estimating the magnitude of these effects and their potential impact on state revenues.

By reducing state tax obligations, the proposed measure would tend to increase federal tax liability because state tax obligations are deductible against federal liability. Hence the net taxpayer benefit would be less than the \$880 per claimant mentioned above. The \$600 in state tax savings would, for example, be reduced to \$704 ($\$880 \times .8$) for a taxpayer in the 20% federal tax bracket.

ADDITIONAL INFORMATION FROM TRD:

Present law treatment of military retirement income

Federal tax treatment of military retirement benefits:

Military pension income is treated as taxable income for federal income tax purposes. An exclusion is provided for survivor annuity payments. Veterans’ benefits are excluded from income tax.

New Mexico Statutes:

New Mexico statutes follow federal law in the treatment of military retirement income.

Persons over 65 years of age are allowed an exemption from taxable income of \$8,000 per person. This exemption is reduced for taxpayers with adjusted gross income of more than \$15,000 (\$30,000 married) so that no exemption is available if adjusted gross income is more than \$25,500 (\$51,000 married).

Other states’ tax treatment of military retirement income:

Most states with a personal income tax allow some form of exclusion for retirement income, defined as government pension payments, social security, railroad retirement, private pension plans and public or private deferred compensation plans. Two purposes are cited for these provisions: to protect the income of retired persons and to encourage retired persons to re-locate or to remain in the state.

The U.S. Supreme Court has ruled that states may not discriminate against federal civil service or military pensions by providing better treatment of state pensions than is provided for federal pensions. However, there is no federal impediment to a state providing better treatment for public pensions than is provided for private pensions.

The following table summarizes the treatment of military pensions by the 42 states that have a broad-based personal income tax. Of the 42 states, all but seven provide some form of exclusion for military pensions. In most cases, this relief is also provided for federal civilian pensions, state and local government pensions and for social security income. Only two states (Connecticut and New Jersey) provide relief that is targeted uniquely at military pensions.

Description:	Number of States with Provision:	Notes:
Full exclusion	12	AB, HI, IL, KS, LA, MA, MI, MS, NJ, NY, PA, WI
Capped dollar amount	7	AZ, AR, KY, ME, NC, ND, WV
Capped amount and age threshold	10	CO, DE, DC, GA, ID, IN, IA, MD, SC, VA
Percentage of military pension	1	CT
Amount subject to income level	3	MO, MT, OK
No specific exclusion<1>	7	MN, CA, NE, NM, RI, UT, VT
Tax credits	2	OH, OR
Total	42	