FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Armstrong/Brown	**ORIGINAL DATE**	2/6/24
SHORT TITLE	Social Security Income Tax Exemption Cap	**BILL NUMBER**	House Bill 248
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT	-	($27,000.0)	($27,000.0)	($28,000.0)	($29,000.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	-	$12.2	-	$12.2	Nonrecurring	General Fund
Total	**-**	**$12.2**	**-**	**$12.2**	Nonrecurring	**General Fund**

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Conflicts with House Bill 249

Sources of Information

LFC Files

<u>Agency Analysis Received From</u>
Office of the Attorney General (NMAG)
Taxation and Revenue Department (TRD)

<u>Agency Analysis was Solicited but Not Received From</u>
Aging and Long-Term Services Department (ALTSD)

SUMMARY

Synopsis of House Bill 248

House Bill 248 removes the income cap on social security income that is exempt from income tax.

The provisions in this bill apply to taxable years beginning on or after January 1, 2024.

FISCAL IMPLICATIONS

Currently, social security income is exempt from state income tax for individuals with income of less than $75 thousand for married filers filing separately, $150 thousand for heads of household, surviving spouses, and married filers filing jointly, and $100 thousand for single filers. This bill removes the income caps and exempts all social security income from state income tax.

To estimate the impact of removing the income cap on the social security exemption, TRD notes the following methodology:

> The exemption of some social security from income tax was enacted for tax year 2022 and approximately 127,400 taxpayers have claimed the exemption with a total tax relief of $76.5 million. The current maximum adjusted gross income (AGI) is applicable to low- and middle-income taxpayers – for individuals the cap is $100 thousand, for married joint filers it is $150 thousand, and for married filing separately it is $75 thousand -- and the average tax savings per taxpayer is $601. By removing the maximum AGI limits in New Mexico, this bill allows higher-income social security earners to claim the exemption.
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> The Internal Revenue Service's (IRS) Statistics of Income tabulates the number of social security recipients of taxable income and the amount of social security income by AGI brackets. TRD calculated the weighted average annual social security income and number of taxpayers with AGIs over $150 thousand by AGI ranges. TRD then estimated the tax due using the effective tax rate for tax year 2022 and assumes taxpayers will claim this amount against personal income taxes. TRD grew the number of higher-income eligible taxpayers by the average growth rate from 2019 to 2020 of the number of New Mexico recipients of taxable social security income at 2.3 percent.

Fiscal Impact:

Social Security Income Exemption	**Tax Year (Calendar)**	2022
	Claims	119,367
	Expenditure (thousands)	$71,762
	Fiscal Year	2023
	Claims	118,904
	Expenditure (thousands)	$71,480

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

SIGNIFICANT ISSUES

In similar bill proposed during the 2023 legislative session, the Aging and Long-Term Services Department notes this additional exemption overwhelmingly benefits higher income seniors and the loss in revenue may negatively impact programs for lower-income New Mexicans that are funded by this tax though the general fund.

In current statute, there is a "cliff effect" at the income caps where those with incomes just under the cap do not pay income tax on their social security income, while those with incomes just over the cap do pay income tax on their social security income. This erodes horizontal equity at those income levels near the exemption caps as those with similar incomes are not treated equally.

TRD notes the following policy issues:

> Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 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 statues 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.
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> Removing the current cap and exempting all social security income will principally benefit high-income individuals who do not depend solely on social security benefits for their income, and who have other sources of income as well.
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> With the adoption of this bill, New Mexico would join most of the states that do not tax social security benefits at all. Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on age, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not available to younger taxpayers at the same level of income.
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> There are many other reasons why states may exempt some income for those over 65, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. As far as attracting more retirees to the state is concerned, exempting social security from income taxation may not necessarily help in achieving that goal. For example, Texas does not tax any income, social security or otherwise, at all. Yet, the state features as one of the least tax friendly states for retirees in the country because of its high property and sales taxes[3]. Notably, New Mexico's property taxes are amongst the lowest in the nation. It is, therefore, necessary to take a holistic look at New Mexico's tax code, and attempts should be made to make the tax structure more simple, broad based, and equitable, without being punitive to any segment of the population.
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> Reducing a taxpayer's New Mexico taxable income may result in a taxpayer's income bracket falling. As this bill applies to higher-income taxpayers, there may be a secondary effect of more pronounced reduction in overall aggregate personal income taxes.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met because TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the exemption and other information to determine whether the exemption is meeting its purpose. The exemption is published in the Tax Expenditure Report.

ADMINISTRATIVE IMPLICATIONS

TRD will make information system changes and update forms, instructions, and publications annually. This bill will have a low impact on the Information Technology Division (ITD), approximately 220 hours or about one month for an estimated staff workload cost of $12,210. The implementation will be included in the annual tax year changes.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill conflicts with House Bill 249 which indexes the social security income caps to inflation.

OTHER SUBSTANTIVE ISSUES

At the federal level, if a taxpayer's adjusted gross income (AGI) including half of social security benefits totals less than $32 thousand for married couples filing jointly or $25 thousand for single filers, none of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax or state income tax. For AGI including half of social security benefits that exceeds $44 thousand for married joint and $34 thousand for single, then 50 percent to 85 percent of social security income is taxable at the federal level.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
Vetted: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.	✗	This bill was not vetted through an interim committee.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	✗	There are no stated purpose, goals, or targets.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	?	There is no required annual reporting, but the expenditure is reported in the Tax Expenditure Report.
Accountable: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date. Public analysis Expiration date	 ? ?	There is no expiration date and only minimal reporting.
Effective: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure. Fulfills stated purpose Passes "but for" test	 ? ?	There are no stated goals or targets by which to measure effectiveness or efficacy.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

JF/ne/al