

New Mexico's Taxation of Social Security Benefits

New Mexico's income tax piggybacks on the federal. In particular, New Mexico "base income" starts with federal adjusted gross income. So we first have to look how the Internal Revenue Code (IRC) handles Social Security benefits. Keep in mind that the federal income tax system can be described as "progressive".

Note: The following paints a high-level picture. Federal law, especially statutes that have been around as long as those concerning Social Security and income taxation, tend to have multiple refinements and exceptions. Rather than muddy the presentation, we'll stick to the main points.

Social Security system outline: In the very broadest terms, eligible wages of employees are taxed (currently at 12.4%). Half the tax is paid by the employee [IRC §3101] and half by the employer [IRC §3111]. The tax proceeds go to a fund which is invested in obligations of the US government. Upon the employee's retirement, monthly benefits are paid to the retiree in an amount somewhat related to the amount of the taxes paid in.

(1) Federal income tax treatment

(a) Social Security taxes (FICA)

(i) Tax withheld from employee: The employee is not granted a deduction from federal income tax for withheld Social Security taxes. Effectively then, the employee pays income tax on the Social Security "contribution".

(ii) Tax paid by employer: Employers are granted a deduction for Social Security taxes, just like for other payroll expenses.

(b) Social Security (and Tier 1 Railroad Retirement) benefits. The basic scheme [IRC §86] is that half of the benefit must be included in "gross income" (the federal starting point for calculating taxable income).

(i) *Low income exception:* If the taxpayer's adjusted gross income including half of Social Security benefits totals less than \$32,000 for married couples filing jointly or \$25,000 for single filers, **NONE** of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax.

Examples:

(a) Married couple whose only income consists of Social Security pensions. The pension amounts total \$30,000 per year. No federal income tax due.

(b) Single person with a Social Security benefit of \$18,000 annually also with \$15,000 in other income. \$15,000 plus \$9,000 equals \$24,000, which is under \$25,000. The benefits are not includable in income and are not taxed.

(ii) *High income exception*: This applies to taxpayers whose adjusted gross income, including half of received Social Security benefits, exceeds \$44,000 for married persons filing jointly or \$34,000 for single persons. The amount of benefits includable in income can grow to up to 85% of the benefits received—one of the tax's progressive features. See IRC §86(a)(2).

Example (c): A married couple receives \$36,000 in Social Security benefits and \$100,000 in other gross income items. The sum of the other gross income amounts (\$100,000) plus one-half of the Social Security benefits (\$18,000) exceeds the adjusted base amount (\$44,000), which could result in inclusion of \$30,600 of Social Security benefits in gross income.

Whether a federal income tax is due depends on the taxpayer's exemptions and deductions in arriving at income subject to federal tax.

(2) New Mexico income tax treatment. As mentioned above, New Mexico follows the federal Code. Accordingly, New Mexico grants no deduction for Social Security taxes paid in. To the extent that Social Security benefits are included in the taxpayer's federal adjusted gross income, the included portion of Social Security benefits will be subject to New Mexico income tax as well. How much tax would be due depends on the taxpayer's total taxable income and other state provisions.

(a) As noted in examples (a) and (b) above, no Social Security benefits would be included in New Mexico base income or taxable income. No New Mexico income tax would be due. The taxpayer's benefits included in federal adjusted gross income in example (c) would be subject to tax in New Mexico.

(b) New Mexico currently has no income tax provisions specifically addressing Social Security taxes or benefits. A number of other provisions do address taxpayers aged 65 or older:

(i) Section **7-2-5.2** grants an exemption of \$8,000 for individuals who are aged 65 or older or who are blind with adjusted gross incomes of up to \$30,000 for married taxpayers filing jointly (and lesser exemption amounts for AGI up to \$51,000) or up to \$18,000 for singles (and lesser exemption amounts for AGI up to \$28,500).

(ii) Section **7-2-5.7** exempts all income of taxpayers aged 100 or older.

(iii) Section **7-2-5.8** grants an exemption equal to \$2,500 times the taxpayer's number of federal exemptions for taxpayers with AGI up to \$30,000 for married taxpayers filing jointly (and lesser amounts up to AGI of \$55,000) or up to \$20,000 for single taxpayers (and lesser amounts for AGI up to \$36,667).

(iv) Sections **7-2-5.9** (exemption of up to \$3,000) and **7-2-18.13** (credit of up to \$2,800) provide for unreimbursed medical expenses of taxpayers 65 or older.

(v) Section **7-2-14**, low income comprehensive tax rebate grants an extra exemption for purposes of calculating the credit amount for being 65 or older.

(vi) Section **7-2-18** grants an income tax credit for portions of property tax on residences owned by persons 65 or older.

(c) Per \$1,000 of included Social Security benefits, the New Mexico income tax due will vary depending on the taxpayer's filing status and tax bracket. If taxed, the tax would run from \$17 to \$59 (assuming DFA will certify that FY2020 revenues will not exceed FY2019's by five percent).

(3) So how much are we talking about?

The Social Security Administration reported OASDI **monthly** payments to NM beneficiaries as follows:

<u>Calendar Year</u>	<u>No. of Beneficiaries</u>	...	<u>...Benefits (\$Millions)...</u>	
			<u>All</u>	<u>Retirees Only</u>
2017	427,426	3	6,061	4,310

Source: <https://www.ssa.gov/policy/docs/statcomps/supplement/2018/5j.html#hLogo>

\$6.1 billion is a fair piece of change. Given what we have discussed about taxability, how much is actually subject to tax? (See Table 1 for a distribution of benefit payments by size of benefit.)

According to the IRS, a little under one-third (\$1.9 billion) was subject to tax state-wide for 2017. See Table 2. About 86% of the taxable Social Security benefits were received by taxpayers with *at least* \$50,000 in adjusted gross income. Nearly all of benefits received by persons with less than \$25,000 AGI were excluded from AGI.

(4) What other states do.

(a) 12 states (other than NM) tax Social Security benefits in some manner: Colorado*, Connecticut*, Kansas*, Minnesota, Missouri*, Montana, Nebraska*, North Dakota, Rhode Island*, Utah, Vermont* and West Virginia.

* Exemption may be allowed, depending on taxpayer's income level.

(b) 37 states and the District of Columbia either do not impose an income tax or exempt Social Security benefits.

(5) **Cost of granting a New Mexico exemption.** Although producing a precise estimate is TRD's domain, a ballpark figure can be derived from data provided by the IRS for tax year 2017 and using a guesstimate of the average New Mexico tax rate faced by New Mexico recipients of taxable Social Security benefits.

As noted, taxable Social Security benefits in New Mexico for tax year 2017 were about \$1.9 billion. New Mexico tax rates range from 1.7% to 5.9%. Assuming an average tax

rate of 4%, which might be low since the majority of taxable benefits appear to accrue to taxpayers in the top two brackets, the annual cost of exempting these benefits looks like it would be in the \$76 million range.

Table 1, Excerpts from Table 5.J6

State or area	Number	Percentage distribution by dollar amount of benefit											Monthly benefit (dollars)	
		Total	Less than 600.00	600.00–799.90	800.00–999.90	1,000.00–1,199.90	1,200.00–1,399.90	1,400.00–1,599.90	1,600.00–1,799.90	1,800.00–1,999.90	2,000.00–2,199.90	2,200.00 or more	Average	Median
All areas	42,446,992	100.0	7.7	8.7	11.8	11.2	11.3	12.3	12.3	8.7	6.2	9.9	1,404.15	1,388.00
New Mexico	286,641	100.0	9.2	10.6	13.1	12.8	12.0	11.4	10.4	7.1	5.3	8.1	1,323.16	1,269.00

Percentage distribution of retired workers, by monthly benefit amount and state or other area, December 2017

Source: Social Security Administration, Office of Retirement and Disability Policy, Annual Statistical Supplement, 2018; <https://www.ssa.gov/policy/docs/statcomps/supplement/2018/5j.html#table5.j6>

Table 2, Excerpts from—

Table 2. Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2017

[Money amounts are in thousands of dollars]

Item	All returns	Size of adjusted gross income									
		Under \$1 [1]	\$1 under \$10,000	\$10,000 under \$25,000	\$25,000 under \$50,000	\$50,000 under \$75,000	\$75,000 under \$100,000	\$100,000 under \$200,000	\$200,000 under \$500,000	\$500,000 under \$1,000,000	\$1,000,000 or more
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
NEW MEXICO											
Number of returns	922,350	15,270	145,830	222,140	228,410	117,780	72,250	94,580	22,300	2,700	1,090
Number of single returns	440,670	9,520	114,550	128,770	107,030	44,550	18,140	14,570	2,930	410	200
Number of joint returns	311,560	4,740	13,700	32,990	60,670	54,590	47,480	75,640	18,710	2,200	850
Number of head of household returns	159,060	700	16,500	58,070	56,910	16,670	5,850	3,740	520	60	30
Number of exemptions	1,784,580	22,530	169,150	392,610	460,840	257,040	173,590	242,630	56,690	6,850	2,660
Number of dependent exemptions	593,540	3,000	41,720	147,020	172,410	84,700	53,880	72,420	15,700	1,950	720
Number of elderly returns [4]	254,890	8,550	38,200	45,490	50,700	37,120	25,920	36,630	10,370	1,340	580
Adjusted gross income (AGI) [5]	49,150,042	-997,787	710,320	3,829,246	8,201,853	7,232,959	6,254,027	12,673,939	6,195,021	1,801,225	3,249,239
Total income: [6] [7] Number	917,470	10,400	145,820	222,140	228,410	117,780	72,250	94,580	22,300	2,700	1,090
Amount	49,800,237	-966,232	728,523	3,876,058	8,285,164	7,310,920	6,317,264	12,820,622	6,302,044	1,840,713	3,285,161
Taxable individual retirement distributions: Number	81,400	980	5,260	10,530	14,260	13,430	11,170	19,140	5,820	590	230
Amount	1,491,051	12,261	19,987	77,344	140,042	179,244	194,265	520,105	287,017	42,087	18,699
Pensions and annuities in AGI: Number	192,420	1,520	13,320	30,940	42,180	33,460	24,860	36,680	8,550	670	260
Amount	5,531,427	20,784	64,534	372,516	847,915	955,310	888,222	1,720,818	587,335	52,480	21,513
Taxable social security benefits: Number	133,890	20	310	14,030	37,020	28,560	19,930	26,300	6,600	780	340
Amount	1,884,673	128	1,192	24,154	239,178	416,427	386,171	610,795	175,009	21,800	9,819
Taxable income: Number	678,110	0	10,450	139,090	218,890	117,120	72,070	94,450	22,270	2,700	1,090
Amount	33,631,550	0	18,490	866,512	4,087,327	4,689,397	4,433,616	9,779,376	5,202,259	1,605,314	2,949,259

From IRS website, SOI Tax Stats – Historic Table 2, New Mexico, 2017

Appendix A

2019 Federal Poverty Guidelines Chart

HHS issues poverty guidelines for each household size. For example, the poverty level for a household of four is an annual income of \$25,750. To get the poverty level for larger families, add \$4,420 for each additional person in the household. For smaller families, subtract \$4,420 per person. Guidelines for Alaska and Hawaii are higher since it's more expensive to live there. The chart below calculates it for you.

Number of People in Household	48 States & DC
One	\$12,490
Two	\$16,910
Three	\$21,330
Four	\$25,750
Five	\$30,170
Six	\$34,590
Seven	\$39,010
Eight	\$43,430
For nine or more, add this amount for each additional person	\$4,420

Source: <https://www.thebalance.com/federal-poverty-level-definition-guidelines-chart-3305843>

US Income Statistics

US HOUSEHOLD INCOME BY AGE OF HOUSEHOLDER (2017)

Age Group	Est # of HH	Est Median income
15 to 24 years	4,334,161	31,867
25 to 44 years	38,660,668	65,879
45 to 64 years	46,375,863	72,443
65 years and over	30,692,126	43,735

US HOUSEHOLD INCOME BY AGE OF HOUSEHOLDER (2018)

15 to 24 years	4,423,535	33,389
25 to 44 years	39,170,027	68,817
45 to 64 years	46,083,717	75,289
65 years and over	31,842,901	44,992

Source: Census Bureau,
<https://data.census.gov/cedsci/table?q=Income%20%28Households,%20Families,%20Individuals%29&table=S1903&tid=ACSST1Y2018.S1903&t=Income%20%28Households,%20Families,%20Individuals%29&lastDisplayedRow=19>

New Mexico Income Statistics

The following data are the most current income statistics for New Mexico from the US Census Bureau, are in 2017 inflation adjusted dollars and are from the American Community Survey 2017 5-year estimates.

- Median Household Income: \$46,718.
- Average Household Income: \$64,625.
- Per Capita Income: \$25,257.
- 3.4% of Households in New Mexico are High Income Households that make over \$200,000 a year.

Median Household Income in **New Mexico** by Age of Householder

	New Mexico
Householder under 25 years	\$26,158
Householder 25 to 44 years	\$48,852
Householder 45 to 64 years	\$54,948
Householder 65 years and over	\$39,073

Appendix B

Excerpts from the Internal Revenue Code [26 USC]

§86. Social security and tier 1 railroad retirement benefits

(a) In general

(1) In general

Except as provided in paragraph (2), gross income for the taxable year of any taxpayer described in subsection (b) (notwithstanding section 207 of the Social Security Act) includes social security benefits in an amount equal to the lesser of-

- (A) one-half of the social security benefits received during the taxable year, or
- (B) one-half of the excess described in subsection (b)(1).

(2) Additional amount

In the case of a taxpayer with respect to whom the amount determined under subsection (b)(1)(A) exceeds the adjusted base amount, the amount included in gross income under this section shall be equal to the lesser of-

- (A) the sum of-
 - (i) 85 percent of such excess, plus
 - (ii) the lesser of the amount determined under paragraph (1) or an amount equal to one-half of the difference between the adjusted base amount and the base amount of the taxpayer, or

- (B) 85 percent of the social security benefits received during the taxable year.

(b) Taxpayers to whom subsection (a) applies

(1) In general

A taxpayer is described in this subsection if-

- (A) the sum of-
 - (i) the modified adjusted gross income of the taxpayer for the taxable year, plus
 - (ii) one-half of the social security benefits received during the taxable year, exceeds

- (B) the base amount.

(2) Modified adjusted gross income

For purposes of this subsection, the term "modified adjusted gross income" means adjusted gross income-

- (A) determined without regard to this section and sections 135, 137, 221, 222, 911, 931, and 933, and
- (B) increased by the amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax.

(c) Base amount and adjusted base amount

For purposes of this section-

(1) Base amount

The term "base amount" means-

- (A) except as otherwise provided in this paragraph, \$25,000,
- (B) \$32,000 in the case of a joint return, and
- (C) zero in the case of a taxpayer who-

(i) is married as of the close of the taxable year (within the meaning of section 7703) but does not file a joint return for such year, and

(ii) does not live apart from his spouse at all times during the taxable year.

(2) Adjusted base amount

The term "adjusted base amount" means-

(A) except as otherwise provided in this paragraph, \$34,000,

(B) \$44,000 in the case of a joint return, and

(C) zero in the case of a taxpayer described in paragraph (1)(C).

(d) Social security benefit

(1) In general

For purposes of this section, the term "social security benefit" means any amount received by the taxpayer by reason of entitlement to-

(A) a monthly benefit under title II of the Social Security Act, or

(B) a tier 1 railroad retirement benefit.

(2) Adjustment for repayments during year

(A) In general

For purposes of this section, the amount of social security benefits received during any taxable year shall be reduced by any repayment made by the taxpayer during the taxable year of a social security benefit previously received by the taxpayer (whether or not such benefit was received during the taxable year).

(B) Denial of deduction

If (but for this subparagraph) any portion of the repayments referred to in subparagraph (A) would have been allowable as a deduction for the taxable year under section 165, such portion shall be allowable as a deduction only to the extent it exceeds the social security benefits received by the taxpayer during the taxable year (and not repaid during such taxable year).

(3) Workmen's compensation benefits substituted for social security benefits

For purposes of this section, if, by reason of section 224 of the Social Security Act (or by reason of section 3(a)(1) of the Railroad Retirement Act of 1974), any social security benefit is reduced by reason of the receipt of a benefit under a workmen's compensation act, the term "social security benefit" includes that portion of such benefit received under the workmen's compensation act which equals such reduction.

(4) Tier 1 railroad retirement benefit

For purposes of paragraph (1), the term "tier 1 railroad retirement benefit" means-

(A) the amount of the annuity under the Railroad Retirement Act of 1974 equal to the amount of the benefit to which the taxpayer would have been entitled under the Social Security Act if all of the service after December 31, 1936, of the employee (on whose employment record the annuity is being paid) had been included in the term "employment" as defined in the Social Security Act, and

(B) a monthly annuity amount under section 3(f)(3) of the Railroad Retirement Act of 1974.

(5) Effect of early delivery of benefit checks

For purposes of subsection (a), in any case where section 708 of the Social Security Act causes social security benefit checks to be delivered before the end of the calendar month for which they are issued, the benefits involved shall be deemed to have been received in the succeeding calendar month.

(e) Limitation on amount included where taxpayer receives lump-sum payment

(1) Limitation

If-

(A) any portion of a lump-sum payment of social security benefits received during the taxable year is attributable to prior taxable years, and

(B) the taxpayer makes an election under this subsection for the taxable year,

then the amount included in gross income under this section for the taxable year by reason of the receipt of such portion shall not exceed the sum of the increases in gross income under this chapter for prior taxable years which would result solely from taking into account such portion in the taxable years to which it is attributable.

(2) Special rules

(A) Year to which benefit attributable

For purposes of this subsection, a social security benefit is attributable to a taxable year if the generally applicable payment date for such benefit occurred during such taxable year.

(B) Election

An election under this subsection shall be made at such time and in such manner as the Secretary shall by regulations prescribe. Such election, once made, may be revoked only with the consent of the Secretary.

(f) Treatment as pension or annuity for certain purposes

For purposes of-

(1) section 22(c)(3)(A) (relating to reduction for amounts received as pension or annuity),

(2) section 32(c)(2) (defining earned income),

(3) section 219(f)(1) (defining compensation), and

(4) section 911(b)(1) (defining foreign earned income),

any social security benefit shall be treated as an amount received as a pension or annuity.

The following six sections are referenced in IRC §86(b)(2). For the first 5, a very brief snippet is presented just to give a flavor of what each section is about.

§135. Income from United States savings bonds used to pay higher education tuition and fees

(a) General rule

In the case of an individual who pays qualified higher education expenses during the taxable year, no amount shall be includible in gross income by reason of the redemption during such year of any qualified United States savings bond.

§137. Adoption assistance programs

(a) Exclusion

(1) In general

Gross income of an employee does not include amounts paid or expenses incurred by the employer for qualified adoption expenses in connection with the adoption of a child by an employee if such amounts are furnished pursuant to an adoption assistance program.

221. Interest on education loans

(a) Allowance of deduction

In the case of an individual, there shall be allowed as a deduction for the taxable year an amount equal to the interest paid by the taxpayer during the taxable year on any qualified education loan.

§222. Qualified tuition and related expenses

(a) Allowance of deduction

In the case of an individual, there shall be allowed as a deduction an amount equal to the qualified tuition and related expenses paid by the taxpayer during the taxable year.

§911. Citizens or residents of the United States living abroad

(a) Exclusion from gross income

At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year-

- (1) the foreign earned income of such individual, and
- (2) the housing cost amount of such individual.

§931. Income from sources within Guam, American Samoa, or the Northern Mariana Islands

(a) General rule

In the case of an individual who is a bona fide resident of a specified possession during the entire taxable year, gross income shall not include-

- (1) income derived from sources within any specified possession, and
- (2) income effectively connected with the conduct of a trade or business by such individual within any specified possession.

§933. Income from sources within Puerto Rico

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Resident of Puerto Rico for entire taxable year

In the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, income derived from sources within Puerto Rico (except amounts received for services performed as an employee of the United States or any agency thereof); but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Taxable year of change of residence from Puerto Rico

In the case of an individual citizen of the United States who has been a bona fide resident of Puerto Rico for a period of at least 2 years before the date on which he changes his residence from Puerto Rico, income derived from sources therein (except amounts received for services performed as an employee of the United States or any agency thereof) which is attributable to that part of such period of Puerto Rican residence before such date; but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction for personal exemptions under section 151), or any credit, properly allocable to or chargeable against amounts excluded from gross income under this paragraph.