F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 3/4/19
SPONSOR Campos **LAST UPDATED** **HB**

SHORT TITLE Federal Retirement Benefit Tax Exemption **SB** 602

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	($5,200.0)	($5,700.0)	($6,100.0)	($6,600.0)	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 602 adds a new section to the Income Tax Act providing an exemption from state income taxation for federal retirement benefits under the Federal Employees' Retirement System Act (FERS) of 1986.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019). There is no delayed repeal date but LFC recommends adding one.

FISCAL IMPLICATIONS

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.

TRD has prepared an estimate of the general fund impact of this bill.

Estimated Revenue Impact*					Recurring Nonrecurring	Fund(s) Affected
FY2019	FY2020	FY2021	FY2022	FY2023		
$0	($24,200)	($24,500)	($24,700)	($25,000)	Recurring	General Fund

Using data reported by the Congressional Research Service[1] for federal fiscal year 2016, the estimated impact is based on the number of New Mexico federal annuitants and the national average monthly annuity for retirees under the Federal Employees' Retirement System (FERS). The annuity amount is adjusted annually with a Cost of Living Adjustment (COLA) based on the Consumer Price Index for Urban Wage Earners and Clerical Workers. The annuity amount for the forecast period was adjusted by the average COLA increase in the last eight years. Based on the Congressional Research Service report, there are trends that have both increased and decreased the number of federal government retirees. This impact analysis has assumed a flat number of New Mexico retirees from 2016 of around 29,000. Of the 29,000, based on national figures, 94 percent are assumed to be receiving benefits through FERS. The aggregate estimated annuity income for these retirees was then multiplied by the current average New Mexico personal income tax rate.

LFC staff, on the other hand, found a site[2] that described the difference between the FERS system and the earlier Civil Service Retirement System (CSRS). This site indicated that 72 percent of current annuitants (as of FFY2016) were receiving annuities under the CSRS system and 28 percent under the FERS system. The average monthly annuity nationwide was $1,714. LFC assumed a 4 percent marginal tax rate, which was approximately what TRD used for the average tax rate. It should be noted that federal retirees have substantially higher average income than is represented by the FERS annuity alone. It is more appropriate to assume that federal retirees have an income profile similar to that of all pension recipients. This the methodology used by LFC for an appropriate tax rate. Also, LFC staff assumed that there would be an increasing percentage of retirees receiving FERS annuities and used 2.5 percent annual COLA + new entrants. The LFC analysis resulted in impacts roughly 1/4th that of TRD. This lower estimate was reported in the revenue table on page one of this review.

SIGNIFICANT ISSUES

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 be held for future consideration. In particular, this proposed exemption is not accompanied by any goals, rationale or milestones. It is difficult to determine if the purpose of this exemption is to stimulate more pensioners to relocate to New Mexico. Compare this bill to a similar proposal in SB-330 to allow a proportional deduction for federal military retirement pensions. In that bill, the stated goal was to provide incentives for retired military veterans to stay in New Mexico and fill high-tech jobs with trained workers. Military retirees tend to retire in their 40s and have 20 or more years to establish a second or third career. The average age of a FERS retiree is 61.3 years.

TRD notes as follows:

> There are several levels of discriminatory tax policies introduced by this exemption. One level is between different populations of federal civilian employees and retirees. In federal fiscal year 2016, 94 percent of current civilian federal employees were enrolled in

---

[1] Congressional Research Service, Report 98-972, *Federal Employees' Retirement System: Summary of Recent Trends*, February 2, 2018.

[2] https://www.everycrsreport.com/reports/98-972.html

FERS and 6 percent were enrolled under the Civil Service Retirement System (CSRS). This exemption excludes New Mexico federal employees receiving annuities under CSRS. Another level of discrimination is between state or local government retirees and federal retirees. These discriminatory properties may violate the United States constitutional law of intergovernmental immunity. Intergovernmental immunity is summarized as preventing the federal government and individual state governments from intruding on each other's sovereignty. Sovereignty in regards to taxation was recently highlighted in the Supreme Court's ruling in *Dawson v. Steager* (arguments heard on December 3, 2018), where the court ruled against West Virginia in its exempting state retirement benefits without equal treatment of federal retirement benefits. The court cited it was a violation of precedence under the US Supreme Court ruling in *Davis v. Michigan Department of Treasury (1989)* where states' policies must treat federal civil service benefits the same as state and local government retirement benefits. The reverse would also be assumed, treating state and local government retirement benefits the same as federal civil service benefits.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since 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 bill does not establish a measureable purpose so that TRD would be unable to assess whether the exemption is effective.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Note the phased deduction of SB-330, as discussed above.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES

The following is an extract of significant facts from the report at
https://www.everycrsreport.com/reports/98-972.html.

This report describes recent trends in the characteristics of annuitants and current employees covered by the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS) as well as the financial status of the Civil Service Retirement and Disability Fund (CSRDF).

- In FY2016, 94 percent of current civilian federal employees were enrolled in FERS, which covers employees hired since 1984. Six percent were enrolled in CSRS, which covers only employees hired before 1984.
- In FY2016, more than 2.6 million people received civil service annuity payments, including 2,077,804 employee annuitants and 533,884 survivor annuitants. Of these individuals, 72 percent received annuities earned under CSRS.
- About one-third of all federal employee annuitants and survivor annuitants reside in five states: California, Texas, Florida, Maryland, and Virginia.

- The average civilian federal employee who retired in FY2016 was 61.3 years old and had completed 25.6 years of federal service.
- The average monthly annuity payment to workers who retired under CSRS in FY2016 was $4,755. Workers who retired under FERS received an average monthly annuity of $1,714. Employees retiring under FERS had a shorter average length of service than those under CSRS. FERS annuities are supplemented by Social Security benefits and the Thrift Savings Plan (TSP).
- From FY1970 to FY1985, the number of people receiving federal civil service annuities rose from fewer than 1 million to nearly 2 million, an increase of 105 percent. Between FY1985 and FY2016, the number of civil service annuitants rose by 680,000, an increase of about 35 percent.

ALTERNATIVES

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

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **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.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **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.
5. **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.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LG/sb