BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 31, 2024

Bill: HB-264 **Sponsor:** Representative Harry Garcia

Short Title: Military Retirement Pay Tax Exemption Sunset

Description: This bill amends Section 7-2-5.13 NMSA 1978 to remove the sunset date of tax year 2026 for the Personal Income Tax (PIT) exemption for armed forces retirement pay.

Effective Date: Not specified; 90 days following adjournment (May 15, 2024).

Taxation and Revenue Department Analyst: Lucinda Sydow and Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
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* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: By making permanent the $30,000 military retirement exemption for an armed forces retiree that is currently scheduled to sunset after tax year 2026, the bill will reduce General Fund revenue by a recurring $12.1 million starting in fiscal year 2028. The revenue decrease for FY2028 is currently factored into the December 2023 Consensus Revenue Estimating Group (CREG) forecast. Therefore, while the fiscal impact notes a loss in general fund revenue above, this loss is already considered in the CREG's December 2023 projections for FY2028. The December 2023 CREG forecast made adjustments to this estimate based on tax year 2022 returns reported in the 2023 Tax Expenditure Report[1]. The impact will increase 1% annually based on the average retirement exemption impact to tax liability.

To the extent the legislation causes more military retirees to move to New Mexico and military retiree population growth is positive versus flat or negative, the fiscal impact will be larger. The revenue impact does not take into account any potential positive impact, such as increased gross receipts tax revenue, that may result from growth in the military retiree population.

Policy Issues: Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25% 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.

Excluding types of retirement income from the tax base is seen as eroding horizontal equity in state income taxes. By excluding income based on retirement status and profession, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not

[1] See https://www.tax.newmexico.gov/forms-publications/

available to younger taxpayers at the same level of income. New Mexico also provides PIT exemptions to low-income individuals that are 65 years and older or blind.

Removing the sunset date reduces future tax burden, but with only one year of utilization, the full impact of the current exemption is unclear. This exemption does not include a sunset date. Tax and Rev supports sunset dates for policymakers to review the impact of a deduction or other tax incentive before extending it, if a sufficient timeframe is allotted for tax incentives to be measured.

There are many reasons why states may exempt some income for retirees, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. The consideration of such exclusions and eroding horizontal equity must be placed in context of the federal and state tax structure in its entirety. This is critical when encouraging military retirees to reside in New Mexico using an armed forces retirement exemption.

Eight states currently do not tax income, including Texas, Nevada and Wyoming. 11 states partially tax military retirement. For retirees, the decision of a place of residence is not evaluated in a vacuum. For example, Texas does not tax any income. 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. 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.

Technical Issues: None.

Other Issues: None.

Administrative & Compliance Impact: None.

Related Bills: Similar bills: SB-85 (2022 Regular Legislative Session); SB-277 and SB-259 (2021 Regular Legislative Session); SB-56 and SB-125 (2024)