

BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 11, 2024

Bill: SB-114, as amended by STBTC

Sponsor: Senator Bill Tallman

Short Title: Public Employee Retirement Income Tax

Description: This bill provides for a personal income tax exemption for public employee retirement income that was from a pension or other retirement benefit from state or local government employment, and that were exempt from social security tax and for which the individual receiving the wages will not receive social security benefits.

The *Senate Tax, Business and Transportation Committee* amendment adds the federal government to the list of eligible employers from whom wages could have been received in the definition of “certain public employee retirement income.”

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

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	(\$10,000)	(\$9,600)	(\$9,300)	(\$9,000)	R	General Fund

* In thousands of dollars. Parentheses () indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (Tax & Rev) estimated the number of state and local government workers that are not covered by social security (non-covered) using data from the Congressional Research Service’s analysis of social security coverage of state and local government employees¹, and estimated that 9.6% of New Mexico public employees are not covered by social security.

The number of New Mexico taxpayers that receive public employee retirement income attributable to wages earned in another state’s pension system is not available. Therefore, it is assumed that the tax base in this analysis includes taxpayers that receive public employee retirement income attributable to wages earned in New Mexico. Tax & Rev also assumes this includes all recipients of public employee retirement income attributable to wages such as child, survivor, disabled, and volunteer firefighter (VFF) recipients.

The Census Bureau’s Annual Survey of Public Pensions reports the number of beneficiaries of public pensions by state². The number of public pension beneficiaries in New Mexico from 2019 to 2022 grew by 2.7%.

Tax & Rev used data provided by Public Employees Retirement Association (PERA) of New Mexico³ and the New Mexico Educational Retirement Board⁴ (ERB) to estimate the average public pension in New Mexico from FY2018 to FY2022. Both associations cover approximately 94% of the total number of

¹ <https://crsreports.congress.gov>

² www.census.gov/programs-surveys/

³ www.nmpera.org/financial-overview/

⁴ www.erb.nm.gov/annual-reports/

public pension beneficiaries in New Mexico over the same time frame.

Federal workers hired before 1984 were covered by the Civil Service Retirement System (CSRS) which did not contribute to social security. In 1984, federal workers began contributing to social security in the Federal Employees Retirement System (FERS)⁵. As of 2023, 98% of federal workers and 50% of federal retiree income were covered by FERS leaving 50% of retirees eligible for this bill. To estimate the number of federal retirement beneficiaries that do not receive social security, Tax & Rev used the Congressional Research Services' Federal Employees' Retirement System: Summary of Recent Trends from FY2016 to FY2022 to estimate the number and annual income of federal retirees in New Mexico and surviving spouses⁶. The number of federal retirees and spouses that do not receive social security has fallen 10% since FY2016. This is due to fewer federal retirees contributing to CSCR.

Using 2022 New Mexico resident tax returns, Tax & Rev calculated the effective tax rate and the proportion of taxpayers that fall into the income categories and filing status specified in the bill.

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 statutes 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.

This bill is designed to ease the tax burden on low and middle-income individuals who earn non-covered public retirement income. Low and middle-income taxpayers tend to have lower taxable retirement benefits. At the state level, these same taxpayers are eligible for other credits and rebates such as the low-income comprehensive tax rebate (LICTR), leaving them with little or no tax liability under current law.

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. 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 retirees to reside in New Mexico using a non-covered public employee retirement income exemption.

Exempting certain public employee retirement income from taxation may not necessarily be meaningful if the goal of this exemption is to recruit to or retain retirees in New Mexico. First, the number of retirees with non-covered public employee pensions is small. This includes teachers, state and municipal police, and firefighters. Second, some states do not have an income tax or do not tax pension income. Neighboring Texas, for example, does have an income tax but is considered one of the least tax friendly states for retirees because of its high property and sales taxes⁷. 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.

⁵ Benefits Planner: Retirement | Social Security Benefits for Federal Workers | SSA

⁶ <https://www.opm.gov/retirement-center/fers-information/>

⁷ https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

The bill does support horizontal equity, as New Mexico will not tax either retirement income or Social Security income as those two incomes are described in the bill and up to a certain amount of adjusted gross income on a Federal Form 1040. If a taxpayer’s reported income exceeds the limit in Section (B), none of the retirement income or Social Security income of the taxpayer may be exempted from income tax.

Technical Issues: Tax & Rev recommends specifying if all recipients of public employee retirement income attributable to wages are eligible including child, survivor, those disabled, and VFF for clarification.

Other Issues: None.

Administrative & Compliance Impact: Tax & Rev will make information system changes and update forms, instructions, publications. These changes will be included in annual tax year changes.

This bill will have a low impact on Tax & Rev’s Information Technology Department (ITD), approximately 220 hours or about 1 month for an estimated staff workload cost of \$12,210.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2024	FY2025	FY2026	3 Year Total Cost		
--	\$12.2	--	\$12.2	NR	Tax & Rev - ITD

* In thousands of dollars. Parentheses () indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).