

BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 25, 2024

Bill: SB-125

Sponsor: Senator William F. Burt

Short Title: Armed Forces Retirement Pay Tax Sunset

Description: This bill amends the personal income tax exemption under Section 7-2-5.13 NMSA 1978 for armed forces retirement pay to add a surviving spouse of an armed forces retiree. It also removes the sunset of taxable year 2026 for the exemption, setting the exemption permanently at \$30,000, effective for tax year 2024 and beyond.

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

Taxation and Revenue Department Analyst: Lucinda Sydow & Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	(\$990)	(\$1,000)	(\$1,010)	(\$13,120)	R	General Fund

* 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 Report¹.

The bill expands the population eligible to claim the exemption to surviving spouses of an armed forces retiree. The Statistical Report on the Military Retirement System provides an aggregate number of retirees and survivor beneficiaries by state. As of September 30, 2021, New Mexico had 20,806 reported retirees and 2,812 survivor beneficiaries. Tax & Rev assumes that an additional 2,812 surviving spouses will claim the exemption beginning in tax year 2024 (See Technical Issues). 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 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,

¹ See <https://www.tax.newmexico.gov/forms-publications/>

New Mexico computes its income tax based on the federal definition of taxable income and generally conforms 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 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 also reduces future tax burden, but with only one year of utilization, the full impact of the current exemption is unclear. Tax & Rev supports sunset dates for policymakers to review the impact of tax expenditures before extending them.

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 nearby 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: This bill is missing an applicability date. For administrative purposes, it is important to know what tax year this change should be implemented. Ideally, to allow for proper instruction to the public Tax & Rev would suggest applicability start in taxable year 2024 as the 2023 tax forms have already been released and processing of that tax year will begin January 2024.

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) Conflicts with: SB-56 (2024 Regular Legislative Session).