FISCAL IMPACT REPORT

BILL NUMBER: House Bill 221

SHORT TITLE: Armed Forces Retirement Pay Tax Exemption

SPONSOR: Block/Lord/Martinez, A/Henry/Mason

LAST UPDATE: **ORIGINAL DATE:** 2/2/2026 **ANALYST:** Gray

REVENUE*
(dollars in thousands)

Type	FY26	FY27	FY28	FY29	FY30	Recurring or Nonrecurring	Fund Affected
PIT	($3,000.0)	($6,200.0)	($6,500.0)	($6,800.0)	($7,100.0)	Recurring	General Fund

Parentheses indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

Conflicts with Senate Bill 116

Sources of Information

LFC Files

Because of the short timeframe between the introduction of this bill and its first hearing, LFC has yet to receive analysis from state, education, or judicial agencies. This analysis could be updated if that analysis is received.

SUMMARY

Synopsis of House Bill 221

House Bill 221 (HB221) increases the personal income tax exemption for armed forces retirees and surviving spouses from $30 thousand per year to 100 percent of the taxpayer's income retirement income.

The provisions of this bill apply to tax years beginning 2026.

FISCAL IMPLICATIONS

HB221 is expected to reduce recurring general fund revenue by $3 million in FY26 and $6.2 million in FY27.

LFC has serious concerns about the substantial 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 action be postponed until the implications can be more fully studied.

This analysis estimated costs using the *Statistical Report on the Military Retirement System* from FFY2022, which provides the number of retirees in New Mexico and the average amount of retiree income for military retirees and survivors as of September 2022. Using this data, this analysis modeled the distribution of retiree income for retired armed service members. Modeling included factors such as reserve status, disability status, and the distribution of income between retirees who served as enlisted service members or as an officer in the armed services. The number of taxpayers with military retiree income above $30 thousand was implied from that simulation. This analysis assumes the state will receive a modest influx of military retirees, increasing that population by 25 percent. Lastly, the amount estimated was grown by S&P Global November 2025 estimates of nationwide wage and salary disbursements.

SIGNIFICANT ISSUES

Horizontal equity is a core tenet of tax policy that holds that taxpayers with similar income and circumstances should be treated similarly under the tax code. This provision erodes that principle by favoring some taxpayers with the same income because the source of their income is from military retirement benefits. Policymakers may tolerate or approve of such a horizontal disparity if they believe the benefits of providing a tax benefit for military retirees outweigh the costs of a less horizontally equitable overall tax code.

There is no cliff effect for military retirees in the current tax code because all beneficiaries with military retiree income can currently claim an exemption. The amount of military retirement income above $30 thousand is subject to state income tax at the state marginal rate. The benefit contemplated by HB221 would only benefit retirees with income above $30 thousand per year. On average, officers who serve for longer periods earn more than the $30 thousand exemption. According to the *Statistical Report on the Military Retirement System,* in New Mexico retired officers receive $51 thousand annually in retirement benefits, on average, while retired enlisted members receive $25 thousand annually in retirement benefits, on average.

Policymakers may consider many factors when deciding whether to exempt all military retirement income, including providing financial relief for that population, recognizing taxpayers' military service, and trying to attract military retirees to the state. The provisions of HB221 may have a limited impact on attracting military retirees to the state in part because this exemption is just one among a tapestry of tax policies that may make New Mexico attractive or unattractive for a retiree. For example, New Mexico's property taxes are among the lowest in the nation, but the state has a relatively high sales tax.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB221 conflicts with Senate Bill 116 (SB116), which also removes the exemption cap in Section 7-2-5.13 NMSA 1978. However, SB116 also expands the benefit to include all uniformed service members, adding retired members of the New Mexico Army National Guard, New Mexico Army National Guard, Air National Guard, military reserves, and the United States Public Health Service Commissioned Corps. Because of this, there are irreconcilable differences between the changes contemplated in HB221 and SB116.

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✗	This bill has not been vetted by an interim tax committee.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	✗	This bill does not have a clearly stated purpose, long-term goals, or measurable annual targets
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✗	This bill does not require annual reporting.
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. Public analysis Expiration date	✗	This bill does not have an expiration date.
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. Fulfills stated purpose Passes "but for" test	?	It is unclear whether this bill is effective and efficient, in part because the bill lacks targets.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

BG/dw/sgs