

State Income Taxes and Older Adults

State governments provide a wide array of tax breaks for their elderly residents. Almost every state levying an income tax now sensibly allows some form of income tax exemption or credit for its over-65 citizens that is unavailable to non-elderly taxpayers. But many states have enacted poorly-targeted, unnecessarily expensive elderly income tax breaks that make state tax systems less sustainable and less fair. This policy brief surveys approaches to elderly income tax relief and suggests options for reforming state tax breaks for seniors.

The Starting Point: Federal Income Tax Breaks for the Elderly

Most states base their income tax on federal rules: the starting point in calculating a given taxpayer's taxable income for state purposes is usually the amount of adjusted gross income reported on federal tax forms. This makes the process of filing and administering state income taxes much simpler for taxpayers and state tax administrators, but also means that states automatically allow a variety of federal tax breaks to reduce state tax collections.

Federal tax law provides two substantial tax breaks to elderly taxpayers:

- A larger standard deduction. An under-65 married couple gets a \$11,600 standard deduction in 2011; an elderly couple receives an extra \$1,150 for each over-65 spouse.
- A partial exemption for Social Security benefits. Seniors with incomes below \$25,000 (\$32,000 for married couples) pay no tax on Social Security benefits.

Most States Offer Additional Elderly Tax Breaks

Virtually every state conforms to at least one of the federal government's elderly tax breaks. All 42 states that levy broad-based income taxes follow the federal exemption for Social Security benefits, with many states exempting them altogether. Ten states allow their seniors to claim the same higher federal standard deduction. But most income tax states go beyond these tax preferences inherited from federal income tax rules to allow special elderly-only tax breaks of their own, including:

- **Pension Benefits:** 36 states allow an exemption for private or public pension benefits. These range from fully exempting all pension benefits or adults above a certain age (3 states) to only exempting very specific benefits such as those for military veterans.
- **Social Security:** 29 states exempt all Social Security benefits from tax. Five states provide an extra exemption for Social Security benefits in addition to the federal tax break. Eight states follow the federal exemption for the benefits.
- **Other Income:** Virginia allows an exemption capped at \$12,000 for all sources of income for adults 65 and older with income below \$50,000 (\$75,000 for married couples). A few states exempt interest, dividends, or capital gains income received by seniors.
- **Extra Personal Exemption:** 21 states allow senior citizens an extra personal exemption or exemption credit—allowing these taxpayers to shelter twice as much of their income from tax as similar non-elderly taxpayers can claim.

Demographic Trends Mean Growing Costs for Elderly Tax Breaks

Poorly targeted tax breaks for the elderly are a costly commitment for many states—and long-term demographic changes threaten to make these tax breaks unaffordable in the long run. Older adults are the fastest growing age demographic in the country. According to the US Census, between 2000 and 2010, the US population of adults 55 and older grew by more than 30 percent while the population of those under 55 grew only by 4 percent. This trend is even more stark

in specific states where the population of older adults has grown by as much as 50 percent in just ten short years (see table on pages 3 and 4).


By 2030, almost 20 percent of the US population will be over 65. Over time, this demographic shift will mean that a shrinking pool of workers will be forced to fund tax breaks for an expanding pool of retirees—heightening the need to target these tax breaks appropriately in order to minimize their cost.

Design Issues for Elderly Income Tax Breaks

The goal of providing income tax relief to elderly taxpayers is a simple, if not costly, one—and lawmakers in virtually every state have taken steps to achieve it. But lawmakers seeking to provide such tax breaks must confront several important design issues that can make the difference between an effective tax-relief device and a poorly-targeted and expensive tax giveaway.

- **What types of income should be eligible for tax breaks?** State income tax exemptions for non-elderly taxpayers typically do not discriminate between wages and other income sources: these exemptions can be used to reduce any source of taxable income. But many state income tax exemptions for elderly taxpayers apply only to particular income sources, such as pension benefits and Social Security benefits, while providing no relief for earned income such as salaries and wages. Special tax breaks for pension benefits shift the cost of funding public services away from retirees and onto working taxpayers—including working seniors.
- **How large a deduction or exemption?** States that provide elderly exemptions usually limit the amount that can be deducted. For example, Arkansas allows seniors to exempt the first \$6,000 of all pension benefits. But other states impose much higher caps on the deduction: a married Maryland couple could deduct as much as \$47,200 in benefits in 2011. And three states (Illinois, Mississippi and Pennsylvania) completely exempt all pension benefits from income tax while fully taxing seniors' wages (Georgia will join this group later this decade). Imposing a low cap on these exemptions helps target the benefits of elderly tax breaks to low-income seniors, and makes these exemptions more affordable.
- **Income limits.** Some states allow elderly exemptions only for low-income seniors. For example, Montana exempts up to \$3,640 of pension income. The exemption is gradually reduced to zero for single taxpayers with incomes over \$32,140 (\$33,960 for joint filers). However, most states extend elderly tax breaks to all income levels. Imposing income limits helps target the benefits of pension and other retiree tax breaks to truly needy seniors.
- **Deduction or credit?** States can provide income tax breaks through deductions and exemptions, which reduce taxable income, or through credits, which provide a dollar-for-dollar reduction in tax liability. Deductions are usually worth much more to upper-income taxpayers, while credits are more valuable for lower-income taxpayers.
- **Refundable or non-refundable credit?** A refundable income tax credit is one that is available even to those who owe little or no income tax. Refundability is important for fixed-income seniors, for whom sales and property taxes are often more burdensome than income taxes. Kansas and Idaho each allow special “grocery tax” credits for seniors that are administered through the income tax, but are designed to offset sales taxes on low-income seniors who may owe no income tax. Refundable credits are the best-targeted, and least expensive, way to achieve income tax relief for fixed-income seniors.

Elderly Tax Breaks: Matching Rhetoric with Reality

Few demographic groups receive more attention from state lawmakers than do fixed-income seniors. There is a virtual consensus among elected officials that retirees should not be “taxed out of their homes.” Yet state income tax breaks for seniors typically reserve the lion’s share of their benefits for better-off elderly taxpayers. These poorly targeted tax breaks shift the cost of funding public services towards non-elderly taxpayers, many of whom are less well-off than the seniors benefiting from the tax breaks. Retooling elderly tax breaks to better target the neediest seniors will help states, in the long run achieve a fairer and more sustainable tax system. 

Older Adult Tax Breaks in the States, 2011

| STATE | Treatment of Social Security | Treatment of Pension Income | 2000-2010 Change in % of Pop 55+ | 2000-2010 Change in % of Pop Under 55 |
|-------|---|--|--|---|
| AL | Exempt | Payments from defined benefit private plans are exempt; most public systems are exempt; military and US Civil service are exempt | +25.2% | +2.4% |
| AK | | No PIT | +75.1% | +4.2% |
| AZ | Exempt | Private Pensions not exempt; for public, military and US Civil Service, \$2,500 per taxpayer is excluded | +44.8% | +19.0% |
| AR | Exempt | First \$6,000 of all pension income exempt | +22.2% | +5.0% |
| CA | Exempt | No exemptions | +33.4% | +4.7% |
| CO | If aged 55-64, up to \$20,000/person of federally taxable benefits excluded; up to \$24,000/person if 65 or older. Maximum amounts are combined limits for pension income and federally taxed social security | \$20,000 per person excluded for ages 55-64; \$24,000 per person excluded for 65 and older | +51.9% | +9.5% |
| CT | Exempt if income is below \$50,000 (\$60,000 MJ/HH); partially taxable if higher income | No exemptions except for Military can exclude 50% of their pensions | +22.0% | -0.1% |
| DE | Exempt | \$2,000 excluded per person for those under 60; \$12,500 excluded for 61 and older | +38.7% | +7.8% |
| DC | Exempt | Private Pensions not exempt; for public, military and US Civil Service, \$3,000 per taxpayer 62 and older is excluded | +10.9% | +3.7% |
| FL | | No PIT | +28.2% | +13.7% |
| GA | Exempt | \$35,000 per person excluded (age 62 and older + disabled) | +45.3% | +12.6% |
| HI | Exempt | Private pensions exempt if employer funded; public, military and US Civil Service are fully exempt | +38.5% | +4.8% |
| ID | Exempt | Private pensions not exempt; Certain police and firemen, US Civil Service, and Military—exclude \$25,392 single; \$38,088 married (65 and older) | +48.0% | +14.6% |
| IL | Exempt | Private exempt if from a qualified employee benefit plan; public, US Civil Service, and Military are fully exempt | +21.3% | -1.3% |
| IN | Exempt | Private and Public are not exempt; US Civil Service and Military can exempt up to \$2,000 less the amount of social security payments | +25.5% | +1.6% |
| IA | Up to 22.5% of benefits are taxable. Starting in 2014, social security will be exempt from taxation. | Up to \$6,000 (\$12,000 MFJ) exempt, if 55 or over or disabled | +19.0% | -0.5% |
| KS | Exempt for taxpayers with federal AGI less than or equal to \$75,000. Otherwise, same as federal | Kansas Public Employee Retirement System and certain other Kansas public systems exempt; Private, US Civil Service, and Military are exempt | +22.7% | +52.6% |
| KY | Exempt | Private pensions can exclude up to \$41,110; Public, US Civil Service and Military are fully exempt if retired before 1998 and partially exempted afterwards | +27.3% | +1.8% |
| LA | Exempt | \$6,000 per person excluded from private pensions; certain benefits from LA retirement system are fully exempt, other benefits are treated the same as private; pensions; US Civil Service and Military pensions are fully exempt | +22.0% | -3.7% |
| ME | Exempt | Up to \$6,000 is exempt, less social security and railroad retirement benefits | +31.5% | -4.5% |
| MD | Exempt | Up to \$23,600/person excluded (65 or over or disabled) | +31.2% | +3.4% |
| MA | Exempt | Private pensions are not exempt; Public, US Civil Service, and Military are exempt | +21.3% | -2.0% |
| MI | Exempt | Private pensions exempt up to \$45,120 single (\$90,240 MFJ); Public, US Civil Service, and Military are fully exempt | +25.5% | -7.5% |
| MN | Taxed- Same as Federal | No exemptions | +31.4% | +1.8% |
| MS | Exempt | Fully exempt | +23.5% | -0.7% |
| MO | Up to 50% of federally taxable benefits are exempt, subject to AGI limit. Starting in 2012, social security will be exempt from taxation. | Private pensions exclude \$6,000 with some exceptions; Public, US Civil Service, and Military exclude the greater of 20% of the pension income or \$6,000. AGI must be less than \$25,000 single (\$32,000 MFJ) (excludes social security benefits) and the benefit is phased out for high income. | +23.7% | +2.2% |
| MT | Separate state calculation of taxable amount | Up to \$3,600/retiree exempt if income is below \$37,000 | +38.6% | +1.1% |
| NE | Taxed- Same as Federal | No exemptions | +23.0% | +2.2% |
| NV | | No PIT | +56.4% | +29.7% |
| NH | | No Broad Based PIT | +38.4% | -1.9% |

| STATE | Treatment of Social Security | Treatment of Pension Income | 2000-2010 Change in % of Pop 55+ | 2000-2010 Change in % of Pop Under 55 |
|-------|------------------------------|--|--|---|
| NJ | Exempt | Private, Public and US Civil Service exclude \$15,000 Single (\$20,000 MFJ); Military fully exempt. Gross income cannot exceed \$100,000 | +19.6% | +0.2% |
| NM | Taxed- Same as Federal | No exemptions | +42.6% | +5.7% |
| NY | Exempt | Up to \$20,000 excluded for private pensions if 59.5 and older; Public, US Civil Service, and Military are fully exempt | +19.0% | -2.6% |
| NC | Exempt | First \$2,000 of private plan is excluded; first \$4,000 of public, US Civil Service and military plans is excluded. Some state retirement plans are fully exempt (Bailey Settlement) | +40.2% | +12.7% |
| ND | Taxed- Same as Federal | Private plans are not exempt; up to \$5,000 less social security benefits excluded from Public, US Civil Service and Private plans | +21.2% | -0.2% |
| OH | Exempt | Offers credit up to \$200 | +22.2% | -4.2% |
| OK | Exempt | Up to \$10,000 per person exempt for private pension plans for persons 65 and older with a low AGI; up to \$10,000 is exempt for public and US Civil Service plans; he greater of 75% or \$10,000 per person exempt for Military plans | +22.6% | +4.7% |
| OR | Exempt | 9% credit if low-income and 62 or over | +40.5% | +4.1% |
| PA | Exempt | Fully exempt | +17.4% | -1.2% |
| RI | Taxed- Same as Federal | No exemptions | +17.0% | -4.6% |
| SC | Exempt | 3,000/person exclusion (under 65); \$10,000/person (65+) | +41.6% | +8.1% |
| SD | No PIT | | +25.8% | +2.6% |
| TN | No Broad Based PIT | | +32.6% | +5.7% |
| TX | No PIT | | +41.6% | +16.1% |
| UT | Taxed- Same as Federal | Deduct up to \$4,800 pension/retirement income per person if under 65; exempt up to \$7,500 of income from any source if 65 or over. Phases out for higher-income taxpayers. | +47.2% | +19.7% |
| VT | Taxed- Same as Federal | No exemptions | +34.7% | -6.3% |
| VA | Exempt | No exemptions except for Military retiree with a Congressional Medal of Honor. VA offers a Age 65 and older deduction for all income capped at \$12,000 per qualifying taxpayers. This benefit is limited to taxpayers with AGI of 50K (Single) or 75K (MFJ). | +35.7% | +7.3% |
| WA | No PIT | | +43.5% | +6.9% |
| WV | Taxed- Same as Federal | Private pension plans not exempt; Public plans are exempt if from certain West Virginia law enforcement and firemen; US Civil Service plans can exclude up to \$2,000; Military can exclude up to \$22,000 retirement systems. Others generally exclude up to \$2,000. | +21.8% | -4.1% |
| WI | Exempt | Private pensions are not exempt; Public and US Civil Service are exempt if members of certain systems before 1964; Military is fully exempt | +27.3% | +0.2% |
| WY | No PIT | | +40.4% | +7.3% |

Sources:

ITEP analysis of 2000 and 2010 US Census demographic data
 Individual state Department of Revenue websites
Individual Income Tax Provisions in the States, Wisconsin Legislative Fiscal Bureau, January 2009.