November 2016

State Tax Preferences for Elderly Taxpayers

State governments provide a wide array of tax breaks for their elderly residents. Almost every state that levies an income tax allows some form of income tax exemption or credit for citizens over age 65 that is unavailable to non-elderly taxpayers. Most states also provide special property tax breaks to the elderly. Unfortunately, too many of these breaks are poorly-targeted, unsustainable, and unfair. This policy brief surveys federal and state approaches to reducing taxes for older adults and suggests options for designing less costly and better targeted tax breaks.

Federal Income Tax Breaks for Elderly Taxpayers

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

- *A partial exemption for Social Security benefits*: No taxpayers with Social Security income pay tax on every dollar of their benefits. Elderly taxpayers with incomes below $25,000 ($32,000 for married couples) are fully exempt from paying taxes on Social Security benefits. Income for this purpose is adjusted gross income plus half of Social Security benefits. For those with incomes between $25,000 and $34,000 ($32,000 and $44,000 for married couples) up to 50 percent of benefits are taxable and for higher incomes up to 85 percent is subject to tax.
- *A larger standard deduction*: All married couples can claim a $12,600 standard deduction in 2016 while elderly taxpayers receive an extra $1,250 for each spouse over 65. Single elderly taxpayers also receive an extra deduction.

Most States Offer Additional Elderly Tax Breaks

Most states that levy income taxes go beyond the tax preferences for the elderly inherited from federal income tax rules and allow special elderly-only tax breaks of their own. Many states also provide property tax breaks available only to homeowners (and in some cases renters) over 65. For a list of tax breaks by state, see the chart at the end of the brief.

- *All Retirement Income*: Three states with a broad-based income tax (Illinois, Mississippi, and Pennsylvania) fully exempt all retirement income from taxation. This includes private and public pensions, Social Security, and annuities.
- *Pension Benefits*: 36 states with an income tax allow some exemption for private or public pension benefits. These range from fully exempting all pension benefits for adults above a certain age to exempting only a portion of benefits or the benefits earned by specific types of workers, such as military veterans.
- *Social Security*: 32 states with an income tax exempt all Social Security benefits from tax. Five states tax some Social Security benefits, but provide an exemption that is more generous than what is available at the federal level. Six states tax Social Security benefits using the same exemption rules as the federal government.
- *Other Income*: Virginia, for example, allows an exemption capped at $12,000 for all sources of income for adults 65 and older with annual 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 and Standard Deduction*: 20 states allow senior citizens an additional personal exemption or exemption credit, allowing these taxpayers to shelter twice as much of their income from tax as non-elderly taxpayers. Seven states allow their senior citizens to claim the higher federal standard deduction.
- *Property Tax Reductions*: 22 of the 30 states that provide a property tax credit limit the credit's availability to senior citizens, or provide a more generous version of the credit to older adults. In some states, the credits are calculated based on the relationship between income and property taxes (a circuit breaker) and in others the credits are simply based on age and income. Many states also offer homestead exemptions, which shelter a certain amount of a home's value from tax, that are larger for senior citizens than for other taxpayers.

Design Issues for Elderly Income Tax Breaks

The goal of reducing taxes for elderly taxpayers is a politically attractive, yet costly, one—and lawmakers in virtually every state have taken steps to achieve it. Providing such tax breaks requires confronting several important design issues that can make the difference between an effective policy and a poorly-targeted and expensive tax giveaway.

First and foremost, there is the question of who should benefit. In many cases, wealthy elderly taxpayers reap the biggest benefits from state income tax breaks designed for older adults. This is especially true in states that fully exempt Social Security or pension income from the tax base. Low- and fixed-income elderly taxpayers are already shielded from owing income taxes on Social Security if states follow the federal rules; if states choose to exempt all Social Security benefits, they spend a lot of money offering a tax break to those who do not need it. In Rhode Island for example, more than half of the benefit of fully exempting Social Security from the state's income tax flows to the richest 20 percent of taxpayers. Exempting all retirement income is even less targeted with two-thirds or more of the break going to the top 20 percent in Rhode Island.

Given the costs of poorly targeted tax breaks, some states allow elderly exemptions only for low-income seniors. For example, Montana exempts up to $3,980 of pension income, and the exemption is gradually reduced to zero for single taxpayers with incomes over $35,180 ($37,170 for joint filers). Most states, however, extend elderly tax breaks to seniors at all income levels. Imposing income limits helps to target the benefits of pension and other retiree tax breaks to truly needy seniors.

Other considerations include:

- *Exemption, 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 provide a more equal benefit to taxpayers with varying levels of income.
- *What types of income should be eligible for tax breaks?* Many state income tax exemptions for elderly taxpayers apply only to particular income sources, such as pension and Social Security benefits, while providing no tax breaks for earned income such as salaries and wages. Special tax breaks for pension benefits shift the cost of funding public services away from older adults who have retired onto working taxpayers—including seniors who remain in the workforce.
- *How large an exemption, deduction, or credit?* States that provide elderly exemptions usually limit the amount that can be deducted. Arkansas, for example, allows seniors to exempt the first $6,000 of all pension benefits. Yet other states allow much higher caps on deductions; a married Maryland couple over 65 could deduct as much as $58,400 in benefits in 2015. And three states (Illinois, Mississippi and Pennsylvania) completely exempt all pension benefits from income tax while fully taxing seniors' wages. Imposing a low cap on exemptions for seniors helps to target the benefits of elderly tax breaks to low-income seniors most in need, and makes these exemptions more affordable for state governments.
- *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 who pay a larger portion of their income in sales and property taxes than in income taxes. Idaho, for example, has a special "grocery tax" credit (available to taxpayers of all ages, but seniors get a higher credit) that is administered through the income tax, and is 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.

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, the population of adults 55 and older grew by more than 30 percent between 2000 and 2010, while the population of those under 55 grew only by 4 percent. This trend is even starker in some states, where the population of older adults has grown by as much as 50 percent in just a decade.

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 to minimize their cost.

Moreover, while poverty has often been associated with advanced age, a 2014 US Census report found that Americans over 65 are less likely to be poor than people in their prime working years, further exacerbating the mismatch between the tax breaks offered and needs within the population. Since the 1990s, the poverty rate for the elderly has been steady at 10 percent, recently decreasing to 8.8 percent in 2014, while the overall share of Americans living in poverty has risen to 13.5 percent. Trends such as rising income inequality and single-parent household formation have eroded the middle class, further weakening the pool of workers that finance tax breaks for the elderly.

INSTITUTE ON TAXATION AND ECONOMIC POLICY

Policy Brief

Elderly Tax Breaks: Matching Rhetoric with Reality

Few demographic groups receive more attention from state lawmakers than fixed-income seniors. There is a virtual consensus among elected officials that retirees should not be "taxed out of their homes," for example. Yet state income tax breaks for elderly taxpayers typically grant the lion's share of their benefits to better-off elderly taxpayers. These poorly targeted tax breaks shift the cost of funding public services towards non-elderly taxpayers, many of whom are worse 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, to achieve a fairer and more sustainable tax system.

See the accompanying chart for a state-by-state overview of tax breaks for elderly taxpayers as well as age demographic trends.

Tax Breaks for Elderly Taxpayers in the States in 2016

State	Treatment of Social Security	Treatment of Pension Income	Other Income Tax Breaks	Property Tax Breaks	Demographic Shift 2000-2010 % Change of Pop 55+	2000-2010 % Change 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		Special Homestead Exemption for 65+	+25.2%	+2.4%
AK		No PIT		Homestead Exemption for 65+	+75.1%	+4.2%
AZ	Exempt	Private Pensions not exempt; for public, military and US Civil Service, $2,500 per taxpayer is excluded	Extra Personal Exemption	Income Based Property Tax Credit for Homeowners and Renters 65+	+44.8%	+19.0%
AR	Exempt	First $6,000 of all pension income exempt	Extra Personal Exemption Credit	Homestead Exemption	+22.2%	+5.0%
CA	Exempt	No Exemptions	Extra Personal Exemption Credit	Income Based Property Tax Credit for Renters 62+; Homestead Exemption	+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. Maximum amounts are combined limits for pension income and federally taxed Social Security	Extra Standard Deduction	Income Based Property Tax Credit for Homeowners and Renters 65+; Homestead Exemption for 65+	+51.9%	+9.5%
CT	Exempt if income is below $50,000 ($60,000 MJ/HH); partially taxable if higher income	Military pensions are fully exempt and teachers have a partial tax exemption, 25% in 2016 and 50% in 2017 and beyond		Income Based Property Tax Credit for Homeowners and Renters 65+; Homestead Exemption for 65+	+22.0%	–0.1%
DE	Exempt	$2,000 excluded per person for those under 60; $12,500 excluded for 61 and older	Extra Personal Exemption Credit	Homestead Exemption	+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	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+10.9%	+3.7%
FL		No PIT		Homestead Exemption	+28.2%	+13.7%
GA	Exempt	$35,000 per person excluded (age 62 and older + disabled)		Homestead Exemption	+45.3%	+12.6%
HI	Exempt	Private pensions exempt if employer funded; public, military and US Civil Service are fully exempt	Extra Personal Exemption	Homestead Exemption	+38.5%	+4.8%
ID	Exempt	Private pensions not exempt; Certain police and firemen, US Civil Service, and Military--exclude $31,956 single; $47,934 married (65 and older) (2015 amounts)	Extra Standard Deduction	Income Based Property Tax Credit for Homeowners 65+; Homestead Exemption	+48.0%	+14.6%

Tax Breaks for Elderly Taxpayers in the States in 2016

					Demographic Shift	
State	Treatment of Social Security	Treatment of Pension Income	Other Income Tax Breaks	Property Tax Breaks	2000-2010 % Change of Pop 55+	2000-2010 % Change of Pop Under 55
IL	Exempt	Private exempt if from a qualified employee benefit plan; public, US Civil Service, and Military are fully exempt	All Retirement Income is exempt; IL also offers an extra personal exemption	Homestead Exemption	+21.3%	−1.3%
IN	Exempt	Private and Public are not exempt; US Civil Service and Military can exempt up to $16,000 ($8,000 in 2015) less the amount of Social Security payments	Extra Personal Exemption	Homestead Exemption	+25.5%	+1.6%
IA	Exempt	Up to $6,000 ($12,000 MFJ) exempt, if 55 or over or disabled; Military pension benefits are fully exempt	Extra Personal Exemption Credit	Income Based Property Tax Credit for Homeowners and Renters 65+; Homestead Exemption	+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		Income Based Property Tax Credit for Homeowners 65+; Homestead Exemption 65+	+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	Extra Personal Exemption Credit	Homestead Exemption 65+	+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	Extra Personal Exemption	Homestead Exemption	+22.0%	−3.7%
ME	Exempt	Up to $10,000 is exempt, less Social Security and railroad retirement benefits; all military pension income is exempted		Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+31.5%	−4.5%
MD	Exempt	Up to $29,200/person excluded (65 and over or disabled)(2015 amount); $10,000 Military pension exemption	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+31.2%	+3.4%
MA	Exempt	Private pensions are not exempt; Public, US Civil Service, and Military are exempt	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+21.3%	−2.0%
MI	Exempt, but optional for some taxpayers starting in 2019	For taxpayers born before 1946, public, US civil service, and military pensions are fully exempt; private pensions can also be exempted up to $49,811 in combined exemptions if single ($99,623 MFJ) (2015 amount)	Taxpayers born 1946-1948 receive $20,000 single ($40,000 MFJ) exemption against all types of income; Taxpayers born 1949-1952 receive $20,000 single ($40,000 MFJ) exemption against retirement income; Taxpayers born 1953 with retirement income not subject to Social Security withholdings receive $15,000 single ($30,000 MFJ) exemption against retirement income; Taxpayers born before 1946 may also deduct dividend/interest/capital gains up to $11,104 for single ($22,207 MFJ) less any deduction for retirement benefits	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+25.5%	−7.5%
MN	Taxed- Same as Federal	No Exemptions	Extra Standard Deduction	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+;Homestead Exemption	+31.4%	+1.8%

Tax Breaks for Elderly Taxpayers in the States in 2016

					Demographic Shift	
State	**Treatment of Social Security**	**Treatment of Pension Income**	**Other Income Tax Breaks**	**Property Tax Breaks**	**2000-2010 % Change of Pop 55+**	**2000-2010 % Change of Pop Under 55**
MS	Exempt	Fully Exempt	All Retirement Income is exempt; MS also offers an extra personal exemption	Homestead Exemption	+23.5%	–0.7%
MO	Exempt	Private pensions exclude $6,000 with some exceptions; Public and US Civil Service 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. 75% of Military pension income is exempt		Property Tax Circuit Breaker Credit for Homeowners and Renters 65+;Homestead Exemption 65 +	+23.7%	+2.2%
MT	Separate state calculation of taxable amount	Up to $4,070 retiree exemption, phased out for every $1 of FAGI for income over $33,910 (inflation adjusted annually)	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+;Homestead Exemption	+38.6%	+1.1%
NE	Fully exempt for married taxpayers with federal AGI of $58,000 or less ($43,000 or less for single taxpayers); Otherwise, same as federal	No Exemptions			+23.0%	+2.2%
NV		No PIT			+56.4%	+29.7%
NH	Exempt	Exempt	Extra Personal Exemption	Income Based Property Tax Credit for Homeowners 65+; Homestead Exemption 65+	+38.4%	–1.9%
NJ	Exempt	Private, Public and US Civil Service exclude $15,000 Single ($20,000 MFJ); Military fully exempt. Gross income cannot exceed $100,000	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners 65+	+19.6%	+0.2%
NM	Taxed- Same as Federal	No Exemptions	Extra Standard Deduction	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+	+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		Small Property Tax Circuit Breaker Credit for Homeowners and Renters 65+; Homestead Exemption	+19.0%	–2.6%
NC	Exempt	No private exclusion. 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	Extra Standard Deduction	Income Based Property Tax Credit for Homeowners and Renters 65+; Homestead Exemption 65+	+21.2%	–0.2%
OH	Exempt	Offers credit up to $200 if income is below $100,000			+22.2%	–4.2%

Tax Breaks for Elderly Taxpayers in the States in 2016

State	Treatment of Social Security	Treatment of Pension Income	Other Income Tax Breaks	Property Tax Breaks	Demographic Shift 2000-2010 % Change of Pop 55+	2000-2010 % Change of Pop Under 55
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	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners 65+; Homestead Exemption	+22.6%	+4.7%
OR	Exempt	9% credit if low-income and 62 or over	Extra Standard Deduction	Property Tax Circuit Breaker Credit for Renters 65+; Homestead Exemption	+40.5%	+4.1%
PA	Exempt	Fully Exempt	All Retirement Income is Exempt	Income Based Property Tax Credit for Homeowners and Renters 65+ (smaller benefit for renters)	+17.4%	−1.2%
RI	Fully exempt for married taxpayers with federal AGI of $100,000 or less ($80,000 or less for single taxpayers); Otherwise, same as federal	No Exemptions		Income Based Property Tax Credit for Homeowners and Renters 65+	+17.0%	−4.6%
SC	Exempt	3,000/person exclusion (under 65); $10,000/person (65+)	Extra Standard Deduction	Homestead Exemption 65+	+41.6%	+8.1%
SD		No PIT		Income Based Property Tax Credit for Homeowners 65+	+25.8%	+2.6%
TN	Exempt	Fully Exempt	Taxpayers over age 65 are exempted from the state's tax on dividend and interest income if their total income from all sources is below $33,000 (single) or $59,000 (MFJ)	Homestead Exemption 65+	+32.6%	+5.7%
TX		No PIT		Homestead Exemption	+41.6%	+16.1%
UT	Taxed- Same as Federal	Credit of $450 per spouse for taxpayers over age 65. Credit of $288 per spouse against retirement income only for taxpayers under age 65. No credit available to taxpayers born after 1952. Begins phasing out at incomes of $25,000 (single) or $32,000 (MFJ).		Income Based Property Tax Credit for Homeowners and Renters 65+; Homestead Exemption	+47.2%	+19.7%
VT	Taxed- Same as Federal	No Exemptions	Extra Standard Deduction	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+	+34.7%	−6.3%
VA	Exempt	No exemptions except for Military retiree with a Congressional Medal of Honor.	Taxpayers over age 65 receive a $12,000 deduction against all types of income. This benefit is limited to taxpayers with AGI under $50,000 (single) or $75,000 (MFJ). Virginia also offers an extra personal exemption.	Homestead Exemption 65+	+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.		Property Tax Circuit Breaker Credit for Homeowners 65+; Homestead Exemption 65+	+21.8%	−4.1%

Tax Breaks for Elderly Taxpayers in the States in 2016

State	Treatment of Social Security	Treatment of Pension Income	Other Income Tax Breaks	Property Tax Breaks	Demographic Shift 2000-2010 % Change of Pop 55+	2000-2010 % Change of Pop Under 55
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	Extra Personal Exemption	Property Tax Circuit Breaker Credit for Homeowners and Renters 65+	+27.3%	+0.2%
WY		No PIT		Income Based Property Tax Credit for Homeowners 65+	+40.4%	+7.3%

Sources:
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