

**Board of Directors**

## NEWS RELEASE

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# STATE TAX PREFERENCES FOR SENIORS WILL GROW MORE COSTLY AS BOOMERS RETIRE

## Study Outlines Ways to Target Tax Relief to Seniors in Need

The special tax preferences most states provide to seniors — often irrespective of income — will place growing strains on state budgets as the population ages, according to a new report from the Center on Budget and Policy Priorities. The report recommends that states reexamine these tax preferences — whose cost could double as a share of the budget in many states over the next few decades — and target tax relief for seniors on those with limited income.

Better targeting of senior tax preferences would enable states to assist those who need it while also putting state budgets in a better position to deal with other expenses related to the aging of the population, such as the growing cost of Medicaid (which pays for most of the nation's long-term care) and growing pension and health-care costs for retired state employees.

“Being elderly isn't the same thing as being poor. States should consider whether their tax policies reflect that fact,” said Elizabeth McNichol, a senior fellow at the Center and the report's lead author. (See attached table for a summary of state policies.)

Commenting on the report, AARP Director of Policy and Strategy John Rother said that “Tax relief is warranted for people who confront difficulties in meeting living expenses, but it is difficult to justify preferential treatment on age grounds alone or on the basis of receiving pension income.”

The report examined age-based tax preferences in each of the 50 states and found that:

- 28 of the 42 states with an income tax exempt all Social Security income from taxation;
- 33 of these 42 states fully or partially exempt pension income from taxation;
- 38 of these 42 states offer special income-tax exemptions, standard deductions, or credits based on age; and
- 26 states provide special property-tax exemptions or credits for the elderly.

Currently, the cost of these tax preferences exceeds 3 percent of the state's general fund budget in one-third of the 22 states for which cost data are available: **Illinois, Kentucky, Michigan, Mississippi, New York, North Carolina, and Pennsylvania.**

By 2030, when an estimated one in five Americans will be over the age of 65, the cost of tax preferences for seniors will nearly double as a share of the budget in most of the states for which data are available. Three-fifths of those states will spend more than 3 percent of their budget on these tax preferences, and Kentucky, Mississippi, North Carolina, and Pennsylvania will spend more than 7 percent — as much as the average state now spends on prisons and other corrections programs.

### **Many Needy Seniors Do Not Benefit from Existing Tax Preferences**

Supporters of tax preferences for seniors argue that they are needed because seniors must live on fixed incomes while their costs, especially for health care and housing, continue to grow. However, many of these tax preferences date from an era when elderly poverty was much more common than it is today. Since 1970, the number of Americans over the age of 65 who have below-poverty incomes has fallen from one in four to less than one in ten.

Moreover, many needy seniors do not benefit from these tax preferences. Low-income households are already exempt from income taxes in many states, for example, so low-income individuals who are elderly gain nothing from tax exemptions aimed at seniors.

At the same time, a large share of the dollars states spend on senior tax preferences go to higher-income seniors who have the means to pay taxes. These tax preferences are worth more to higher-income households because they have more income that would otherwise be fully taxed and because, in many states, they face higher marginal tax rates than low-income households do.

### **What States Can Do**

“Once large numbers of baby boomers start retiring and begin to benefit from these tax breaks, they’ll become not just more expensive, but also more difficult politically to modify,” said McNichol. “Now’s the time for states to make reforms in this area.” States can:

- **Tax a portion of Social Security benefits for people whose income exceeds a specified amount, as the federal government does.** A dozen states have already taken this step.
- **Phase out tax exemptions for pension income above a specified income level.** Under a law Virginia passed in 2004, for example, the state’s tax exemption for pension income phases out for people making more than \$50,000 (for single filers) or \$75,000 (for joint filers).
- **Target property-tax relief on less-affluent households.** For example, 34 states offer circuit breakers, which limit the percentage of a household’s income that the household can be expected to pay in property tax. Most circuit breaker programs are available only to households with income below a specified level. Thus, they are better targeted on those in need than homestead exemptions, which exempt a specified amount (or percentage) of a house’s value from property taxes.
- **Raise the eligibility age for age-based tax credits and exemptions.** People over age 75 are more likely to be poor than people aged 65 to 75, so raising the eligibility age to 75 would help target tax breaks on the seniors who are least able to pay.

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INCOME TAX PREFERENCES FOR SENIORS					
	Private Pension Exemption	Government Pension Exemption	Exempt all Social Security Income	Additional Personal Exemption or Higher Standard Deduction	Other Tax Preference
Alabama	Full	Full	X		
Alaska	NA	NA	NA	NA	NA
Arizona		Partial	X	X	
Arkansas	Partial	Partial	X		X
California			X		X
Colorado	Partial	Partial		X	
Connecticut					
Delaware	Partial	Partial	X	X	X
District of Columbia		Partial	X	X	
Florida	NA	NA	NA	NA	NA
Georgia	Partial	Partial	X	X	
Hawaii	Full	Full	X	X	
Idaho		Partial	X	X	X
Illinois	Full	Full	X	X	
Indiana		Partial	X	X	X
Iowa	Partial	Partial			X
Kansas		Full		X	
Kentucky	Partial	Partial	X		X
Louisiana	Partial	Full	X	X	
Maine	Partial	Partial	X	X	
Maryland	Partial	Partial	X	X	
Massachusetts		Full	X	X	
Michigan	Partial	Full	X	X	X
Minnesota				X	X
Mississippi	Full	Full	X	X	
Missouri	Partial	Partial		X	
Montana	Partial	Partial		X	
Nebraska				X	
Nevada	NA	NA	NA	NA	NA
New Hampshire	NA	NA	NA	NA	NA
New Jersey	Partial	Partial	X	X	X
New Mexico				X	X
New York	Partial	Full	X		
North Carolina	Partial	Partial	X	X	
North Dakota		Partial		X	
Ohio	Partial	Partial	X		X
Oklahoma	Partial	Partial	X	X	
Oregon	Partial	Partial	X	X	
Pennsylvania	Full	Full	X		
Rhode Island				X	
South Carolina	Partial	Partial	X	X	X
South Dakota	NA	NA	NA	NA	NA
Tennessee	NA	NA	NA	NA	NA
Texas	NA	NA	NA	NA	NA
Utah	Partial	Partial		X	
Vermont				X	
Virginia			X	X	X
Washington	NA	NA	NA	NA	NA
West Virginia		Partial			X
Wisconsin		Limited	X (starting in 2008)	X	
Wyoming	NA	NA	NA	NA	NA

Notes: For more detail, see tables 2, 3 and 4 in the full report. NA is shown for states with no broad-based income tax.