Expanding Iowa's Exemptions for Retirement Income: The Policy Issues

HF2045 would expand Iowa's current exemption of Social Security benefits from Iowa income tax to 100% for everyone. Iowa law also allows taxpayers to exclude $6,000 in pension income, or $12,000 for married couples filing jointly. The bill would exempt 100% of pension income. A fiscal note of March 2005 estimated a cost when fully phased in of $225 million, rising thereafter.

Who Would Benefit From HF2045?

- Over 2/3 of Iowa Social Security recipients are fully exempt from any state income tax on Social Security benefits under current law. (According to a 2001 Iowa Dept. of Revenue and Finance report, 69% paid no tax on Social Security income.)
- For the 31% who do pay some income tax on Social Security benefits, they pay tax on 50% of those benefits at most, and the average tax payment on those benefits *among those paying some tax* was $418. Among those earning between $100,000 and $200,000, the average tax on Social Security income was $843. (2001 Iowa Dept. of Revenue and Finance report.)

Do Seniors Pay More than their Share Now?

- Because Iowa income tax law already favors seniors significantly, the full exemption of retirement income would worsen the inequities in the Iowa income tax. Working individuals and couples pay substantially more in taxes than retired individuals or couples with the same amount of income (but from pensions and Social Security). (See "Iowa's Personal Income Tax: Reform for Iowans at Any Age" by Charles Bruner and Mike Crawford, Iowa Fiscal Partnership, April 2005. Available at http://www.iowafiscal.org/documents/050419-ifp-tax.pdf)

Is There Evidence that Seniors Are Leaving Iowa in Significant Numbers because of Taxes?

- Most seniors stay put. Over the 5 years 1995-2000, only about 0.7% of Iowa residents age 65 and older left Iowa for another state each year. Of those, 80% went to the 13 states shown in the table below. Of those migrating to one of these states, just 36% (914 per year) went to the four states with no taxes on retirement income (Texas, Florida, Illinois & South Dakota). The majority went to the remaining nine states, with taxes on retirement income similar to or higher than Iowa's.

Interstate migration of those 65 & older from and to Iowa, 1995-2000
Average annual number who moved for top 13 destination states

	Outmigration				
	Number moving to destination state	Percent of those leaving	Percent of 1995 Iowa elderly population	In-Migration From:	Net Migration
Arizona	414	13%	0.09%	138	(276)
Texas	314	10%	0.07%	104	(210)
Florida	273	9%	0.06%	135	(138)
Illinois	238	8%	0.05%	241	4
Minnesota	227	7%	0.05%	151	(75)
Missouri	214	7%	0.05%	155	(59)
California	190	6%	0.04%	189	(0)
Colorado	156	5%	0.04%	70	(87)
Nebraska	148	5%	0.03%	168	19
Arkansas	101	3%	0.02%	56	(45)
Wisconsin	100	3%	0.02%	139	39
South Dakota	89	3%	0.02%	42	(47)
Kansas	57	2%	0.01%	28	(29)
Subtotal	2,520	80%	0.57%	1,616	(904)
All other states	625	20%	0.14%	553	(72)
Total	3,145	100%	0.72%	2,169	(976)

Source: US Census 2000 data

- Younger people (age 20 to 64) move at three times the rate as seniors (age 65 and older), and they move to pretty much the same places as the elderly. During the five-year period 1995-2000, a total of 10.9% of the younger age group left Iowa for another state, compared to 3.6% of those 65 and older. The top 12 destination states for those under 65 were all among the top 13 states for the elderly.

- For the majority of Iowa seniors, the amount of tax savings involved is too small (or nonexistent) to outweigh other considerations such as climate, amenities, health services, or proximity to children and grandchildren. Substantial tax savings are limited to those with sizeable pension income. (Social security benefits are capped, and even the wealthiest retirees already receive 50% tax exempt.) Among those with large pensions, other considerations will still be the decisive ones for many, if not most.

- If income taxes were a major factor causing people to leave for other states, we should expect greater rates of migration out of Iowa than out of South Dakota (which has no income tax) or Illinois (which has no tax on retirement income). In fact, between 1995 and 2000, 3.6% of elderly Iowans left the state, but *higher* percentages left South Dakota (4.0%) and Illinois (4.8%). Illinois seniors migrated to Texas and Florida at a much higher rate than Iowa seniors (1.2% vs. 0.7%), while South Dakota seniors migrated to those two states at a slightly lower rate (0.5%).

- If income taxes were a major factor causing people to leave for other states, we would also expect more seniors leaving the higher tax states of Minnesota or Wisconsin than leaving Iowa. In fact, about the same percent of seniors left Minnesota (3.5%) and *fewer* seniors left Wisconsin (3.3%) than left Iowa. The percent of seniors leaving for Texas, Florida, South Dakota, and Illinois was the same in Iowa and Minnesota (1.0%) and slightly higher in Wisconsin (1.2%).

- Despite Illinois' exemption of all retirement income, more seniors migrated from Illinois to Iowa than from Iowa to Illinois. Despite Iowa's lower taxes, more seniors migrated from Iowa to Minnesota (1,133) than from Minnesota to Iowa (757).

Is this a $225 million Problem? What Programs will Not be Funded, or Whose Taxes will be Higher, Because of HF2045?

- A tax expenditure should be judged by the same criteria as a direct expenditure. Is it fair? Does it accomplish its objectives? Is it sustainable? This should prompt consideration of the alternative state priorities that could be funded with $225 million annually, but will not be funded if that sum is devoted to tax relief for higher income seniors. Those foregone priorities could be an expansion of state health care programs, or tax reductions for the low-income elderly through greater funding of the circuit-breaker program, or full replenishment of the senior living trust fund. Or the bill may simply mean higher taxes, sooner or later, on other Iowans. The consequences could be a return to un-balanced budgets that require borrowing from one-time funds.

What are the Long-term Fiscal Implications of HF2045?

- As the Fiscal Note of March 2, 2005 indicates, Iowa's population will continue to age, and new sources of tax-favored pension income will become more prominent. Thus the cost of this exemption will continue to rise. It will rise faster than the rest of the budget, because pension income will rise as a share of overall income. The proposed exemptions would amount to 4% of the state budget in 2005, but 6% by 2025. (See IFP report cited above.)

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