Iowa Fiscal Partnership backgrounder
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RETIREMENT TAX BREAKS

The Policy Issues for Iowa

HF2045 as passed by the Iowa House would: (1) expand Iowa's current exemption of Social Security benefits from Iowa income tax to 100 percent for everyone regardless of income; (2) expand to 100 percent Iowa's current exclusion of pension income, already set at $6,000 for individuals or $12,000 for married couples filing jointly; and (3) eliminate all income tax for seniors (over age 65) making $36,000 or less ($48,000 if married). This would cost $227 million when fully phased in,[1] and rise thereafter.

WHO WOULD BENEFIT FROM HF2045?

- Over 65 percent of the benefits of HF2045 would flow to higher-income seniors.[2]
- Over two-thirds of Iowa Social Security recipients are fully exempt from any state income tax on Social Security benefits under current law. (A 2001 Iowa Department of Revenue and Finance report showed that 69 percent paid no tax on Social Security income.)
- The 31 percent who do pay some income tax on Social Security benefits only pay tax on half of those benefits or less. (There is no double taxation.) 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 Department 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 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).[3]
- Under HF2045, a working person under 65 who receives $55,000 in wages would find all of his or her income subject to tax and would pay about $2,600 in Iowa income tax. But a senior receiving that amount as $15,000 in Social Security and $40,000 from a private pension would pay no tax at all.

DO SENIORS LEAVE IN SIGNIFICANT NUMBERS?

- ***Most seniors stay put.*** Only about 0.7 percent of Iowa residents age 65 and older left Iowa for another state during each year between 1995 and 2000. About 39 percent of those went to a Sunbelt state: Arizona, Florida, Texas, California or Nevada. Another 34 percent went to one of Iowa's neighboring states. In addition, 45 percent of seniors, all with low incomes, already pay no Iowa income tax[4] – yet those seniors are prevalent among those leaving Iowa.
- ***Many seniors move into Iowa.*** While 15,770 seniors left the state during this five-year period, 10,843 migrated into Iowa from another state. The net out-migration from Iowa amounted to under 5,000, or just 1.1 percent of the population of persons age 65 or older.

Table 1. Top 14 Destinations Iowans Age 65 and Older Migrating to Another State 1995-2000

Arizona	2,068
Texas	1,571
Florida	1,363
Illinois	1,188
Minnesota	1,133
Missouri	1,072
California	948
Colorado	781
Nebraska	742
Arkansas	504
Wisconsin	499
South Dakota	446
Kansas	285
Nevada	279
New Mexico	237
All other states	2,654
Total moving	15,770
Total Iowans 65/Older	435,401

Source: 2000 Census

DO TAXES MATTER?

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 sizable pension income. (Social Security benefits are capped, and even the wealthiest retirees already receive 50 percent tax exempt.) Among those with large pensions, other considerations will still be decisive for many, if not most.

- Of the 15,770 seniors who left Iowa between 1995 and 2000, 36 percent went to one of the 13 states that don't tax Social Security and pension income, and 27 percent went to one of the 13 states that tax a larger share of such income than Iowa. The rest went to states where the tax benefit is small to nonexistent.
- 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 percent of elderly Iowans left the state, but higher percentages left South Dakota (4.0 percent) and Illinois (4.8 percent). Illinois seniors migrated to Texas and Florida at a much higher rate than Iowa seniors (1.2 percent vs. 0.7 percent).
- 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 percent) and fewer seniors left Wisconsin (3.3 percent) than left Iowa. The percent of seniors leaving for Texas, Florida, South Dakota and Illinois was the same in Iowa and Minnesota (1.0 percent) and slightly higher in Wisconsin (1.2 percent).
- 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 PROBLEM? WHAT ARE THE TRADEOFFS?

- 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 alternative state priorities that could be funded with $227 million annually. Those options include expanding state health-care programs, or fully replenishing the Senior Living Trust Fund. Taking $227 million out of annual revenues could mean higher taxes, sooner or later, for other Iowans – or more unbalanced budgets that borrow from one-time funds.

WHAT ARE THE LONG-TERM FISCAL IMPLICATIONS OF HF2045?

- Iowa's population will continue to age, and new sources of tax-favored pension income will become more prominent.[5] 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 percent of the state budget in 2005, but 6 percent by 2025.[3]

1 Legislative Services Agency, State of Iowa, Fiscal Notes on HF2045 dated Feb. 7, 2006, Jan. 31, 2006, and Jan. 30, 2006.
2 See "Untaxing Seniors: A 'Solution' in Search of a Problem." Peter S. Fisher, Iowa Fiscal Partnership, Feb. 22, 2006. Available at <http://www.iowafiscal.org>.
3 See "Iowa's Personal Income Tax: Reform for Iowans at Any Age" Charles Bruner and Mike Crawford, Iowa Fiscal Partnership, April 2005. Available at <http://www.iowafiscal.org/documents/050419-ifp-tax.pdf>.
4 Iowa Department of Revenue.
5 Legislative Services Agency, State of Iowa, Fiscal Note on HF2045 dated Feb. 7, 2006.

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