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COMPARING STATE INCOME TAX PREFERENCES FOR THE ELDERLY IN THE SOUTHEAST

Over the past 20 years, states have altered their income tax codes to give preferential treatment to seniors. Most of these statutory changes have fallen within three areas: the treatment of social security income, the treatment of retirement income, especially that coming from pensions, and the inclusion of age-specific deductions, exemptions, and credits. This Policy Brief looks at the current state of these tax preferences in the Southeast for those states that impose a major income tax.[1] It also estimates the dollar value of these preferences.

The 2004 Tax Laws

We use the *State Handbook of Economic, Demographic and Fiscal Indicators 2006* (Baer, 2006), published by the AARP, to compile information on the tax codes for each of the Southeastern states for 2004. Table 1 summarizes the major ways that Georgia and a set of comparison states have adjusted their income tax codes to create preferences for the elderly. Georgia has the second highest additional elderly deduction of $1,300 per person, which trails only Mississippi's $1,500. Overall, 6 states offer an additional exemption, 2 states offer an additional tax credit, and only two states, Alabama and West Virginia, offer no additional tax credit or exemption based on age.

Georgia is generally more generous with exempting public pension income than private pension income. Three states (Alabama, Louisiana and Mississippi) fully exempt public pension income, whereas the remaining seven states offer amounts between $4,000 and $38,775. For private pensions, West Virginia does not exempt any income, nor does Alabama unless the income comes from a defined benefit plan, in which case it exempts all the income. Mississippi exempts all private pension income, and the remaining states exempt amounts between $2,000 and $38,775.

Rather than make a distinction between private and public pensions, Georgia, along with South Carolina and Virginia, apply their exemptions to "retirement income" broadly defined. Georgia is the most generous of states using this definition; it exempted $15,000 of retirement income per elderly individual in 2004.[2] Georgia has two additional unique features.

[1] Florida has no personal income tax and Tennessee taxes only interest and dividend income.

[2] Note that this amount increased to $25,000 per individual for 2006, $30,000 per individual for 2007 and is scheduled to increase to $35,000 for 2008 under current law.

First is that this exemption holds for anyone 62 and over, as opposed to the normal age of 65. By contrast, both Virginia and South Carolina reduce the amount exempted for the 62-65 age group.

Second, Georgia allows for $4,000 in earned income to count towards the retirement income exemption. It appears as though no other state in the Southeast allows for such a provision.

Finally, in addition to pension income exemptions, Georgia, along with every Southeastern state, fully exempts all social security income. West Virginia makes this exemption means-tested, but they are the lone exception.

What do we make of all these different preferences? Georgia is consistently in the top tier of Southeastern states for all the various categories. But what does this mean dollar-wise? To find out, we created a summary measure that incorporates all these differences.

Calculating the Elderly Bonus

To calculate the state income tax benefit afforded the elderly, we constructed profiles of elderly and non-elderly households following Conway and Rork (2007). We extracted data from the 2002 March Current Population Survey for elderly (aged 65 and over) and non-elderly (age 25-55) married households. For each group, we further divided the group into four income quartiles. For each quartile, we calculate the median income and the composition of that income into its major components -- social security benefits, pension income, dividend and interest income, earnings, other income and unemployment benefits.

However, for a crisp comparison, we want to keep the income levels the same between elderly and non-elderly households. Thus, all our high-income households are assumed to have the income from the top elderly income quartile, whereas our low-income households are assumed to have the income level corresponding to the bottom elderly quartile. We then use the CPS to allow the composition of income between elderly and non-elderly households to differ. By keeping the income level constant, we can isolate the effects of *composition* of income plus any extra benefits given simply on the basis of age.

Once these profiles are created, we use the TAXSIM model at the National Bureau of Economic Research to estimate the state income tax liabilities each type of household would face, given its state of residence. We adjust our profiles for inflation to bring them up to 2004 levels, so that they correspond to the 2004 tax laws.

Table 2 shows the breakdown of income by source for elderly and non-elderly households in the highest and lowest quartiles. For our low-income elderly, 86 percent of their income comes from social security, and another 10 percent comes from pension and dividend income. For the high-income elderly, their income is evenly distributed between wages, social security, pensions and dividends, which combined account for approximately 93 percent of income. The main source of income for the non-elderly, regardless of income-level, is wage income, accounting for over 92 percent of all income for low-income and over 94 percent for high-income non-elderly.

The results generated by TAXSIM are reported in Table 3. The elderly tax liability is the estimated tax bill created by TAXSIM for our elderly household. The non-elderly tax liability is the same exercise for our non-elderly household. The *elderly tax savings* is the difference between the estimated tax liabilities for elderly and non-elderly households of the same income level who live in the same state. The estimated elderly tax savings as a percentage of household income is the *elderly tax bonus*. This measures the percentage savings the elderly receives in their tax bill compared to non-elderly with similar income. Doing so has the additional benefit of allowing for easy comparison across income levels.

Note that the low-income elderly have no income tax liability in any state in the Southeast. Moreover, the low-income elderly would receive an estimated $40 from Arkansas in the form of a tax rebate. On the other hand, the low-income non-elderly would have no tax liability in only 3 states. The largest difference between elderly and non-elderly is in Kentucky, where the elderly household would pay an estimated $489 less in income taxes than the non-elderly, a tax savings of approximately 3 percent of income. Georgia ranks sixth in the Southeast, with an estimated elderly bonus of $197, representing a tax savings for the elderly of 1.2 percent compared to the non-elderly.

Not surprisingly, the tax liability for high-income elderly, as compared to low-income elderly, is higher in 9 states, with South Carolina imposing zero tax liability. In Georgia, our hypothetical high-income elderly household pays only $445 in state income tax, which amounts to 0.56 percent of their $78,395 in income. By contrast, the non-elderly household would pay $2,385 in income tax, or a little over 3 percent of their income. Thus, the elderly tax savings in Georgia amounts to an estimated $1,938, or just under 2.5 percent of income.

Overall, this places Georgia fourth in the Southeast in terms of elderly tax liability, but when we compare the elderly and non-

TABLE 1: STATE EXEMPTIONS AND CREDITS FOR AN ELDERLY TAXPAYER IN TAX YEAR 2004 FOR GEORGIA AND ITS COMPARISON STATES

State	Extra Personal Exemption, Deduction or Credit for Elderly	Public Pension Exemption	Private Pension Exemption	Social Security Exemption
Alabama	none	full	full or zero [g]	full
Arkansas	$20-$40 credit [a]	$6,000	$6,000	full
GEORGIA	$1,300	$15,000 [b]	$15,000 [b]	full
Kentucky	$40 credit	$38,775-full [c]	$38,775	full
Louisiana	$1,000	full	$6,000	full
Mississippi	$1,500	full	full	full
North Carolina	$750	$4,000-full [d]	$2,000 [h]	full
South Carolina	$1,200	$10,000 [e]	$10,000 [e]	full
Virginia	$900	$12,000 [f]	$12,000 [f]	full
West Virginia	none	$2,000	none	if income < $25,000 [i]

[a]: If resident does not claim the retirement income deduction, they get additional $80 credit, otherwise they get additional $40 credit.
[b]: In Georgia, any individual over the age of 62 can exempt $15000 in retirement income, including $4000 in earned income.
[c]: In Kentucky, public pensions are fully exempt if employee worked before January 1, 1998. For workers employed afterwards, the exemption is at least $38775 per person, although the final amount depends on time served.
[d]: In North Carolina, public pensions are fully exempt if employee worked five years as of August 12, 1989. Otherwise, the exemption is limited to $4000 per person.
[e]: In South Carolina, an individual under the age of 65 is allowed to exempt $3000 of retirement income from taxation. For individuals over the age of 65, this amount becomes $10000.
[f]: In Virginia, an individual between the ages of 62 and 64 can exempt $6000 in retirement income. For individuals 65 and over, this amount increases to $12000 per individual.
[g]: If pension is a defined benefit plan, all income is exempt. Otherwise, there is no exemption.
[h]: In North Carolina, no more than $4000 per individual in total pension (private and public) income is exempt.
[i]: This is provisional income, as defined in West Virginia. The amount is $32,000 if filing jointly.

TABLE 2: 2004 INCOME BREAKDOWNS OF THE MARRIED ELDERLY AND MARRIED NON-ELDERLY

	Low Income Households				High Income Households			
Income Source	Elderly		Non-Elderly		Elderly		Non-Elderly	
Wages	$319	[1.9%]	$15,197	[92.4%]	$20,526	[26.2%]	$73,842	[94.2%]
Dividends & Interest	$618	[3.7%]	$113	[0.7%]	$18,309	[23.4%]	$2,746	[3.5%]
Pension Income	$887	[5.3%]	$85	[0.5%]	$17,990	[22.9%]	$369	[0.5%]
Social Security	$14,360	[86.3%]	$419	[2.5%]	$16,619	[21.2%]	$50	[0.1%]
Unemployment	$134	[0.8%]	$346	[2.1%]	$1,153	[1.5%]	$242	[0.3%]
Other Income	$322	[1.9%]	$479	[2.9%]	$3,797	[4.8%]	$1,120	[1.4%]
Total Income	$16,640		$16,440		$78,395		$78,395	

TABLE 3: CALCULATED 2004 ELDERLY TAX SAVINGS AND TAX BONUS, BY STATE

	Low Income Households				High Income Households			
State	Elderly Tax Liability	Non-Elderly Tax Liability	Elderly Tax Savings	Elderly Tax Bonus	Elderly Tax Liability	Non-Elderly Tax Liability	Elderly Tax Savings	Elderly Tax Bonus
Alabama	0	389	389	2.337	1685	1877	192	0.245
Arkansas	-40	0	40	0.240	2185	2895	710	0.905
GEORGIA	0	197	197	1.184	445	2385	1938	2.471
Kentucky	0	489	489	2.941	1095	2873	1778	2.268
Louisiana	0	135	135	0.810	959	2593	1634	2.084
Mississippi	0	0	0	0.000	391	1891	1501	1.914
North Carolina	0	285	285	1.710	1443	3068	1626	2.074
South Carolina	0	0	0	0.000	0	2823	2823	3.601
Virginia	0	327	327	1.966	142	2633	2491	3.177
West Virginia	0	370	370	2.222	2782	3636	854	1.089

elderly tax liability, Georgia rises to third with their 2.5 percent elderly tax bonus for high income elderly households. Only South Carolina and Virginia have higher elderly tax bonuses.

Conclusion

Every state in the Southeast has at least one tax preference that benefits the elderly. These preferences, however, tend to benefit wealthier elderly more so than poor elderly. Georgia has a consistently high elderly tax bonus regardless of income levels, although the wealthy elderly appear to benefit more from current regulations, suggesting that the preferential treatment of the elderly in the Georgia tax code does not treat all elderly the same. Georgia might want to consider the potential inequities in the design of the current tax code, not only between young and old, but also between rich elderly and poor elderly.

References

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