



Tax-Friendly States for Retirees

If you're retired, or about to retire, you may be thinking about relocating to a state that has low tax rates, or that provides special tax benefits to retirees. Here's a survey that may jump-start your search for a tax-friendly state in which to spend your golden years.

Income taxes generally

State income taxes typically account for a large percentage of the total taxes you pay. So, you may consider yourself lucky if you live in one of the seven no-income-tax states--Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming (New Hampshire and Tennessee impose income tax only on interest and dividends). If you're considering a state that does impose an income tax, you'll want to know how it treats Social Security and pensions in particular.

State income tax and Social Security

Social Security income is completely exempt from tax in 27 of the states with an income tax (as well as the District of Columbia): Alabama, Arizona, Arkansas, California, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Virginia, and Wisconsin. Missouri and Iowa partially tax benefits, but will fully exempt benefits beginning in 2012 and 2014, respectively.

Two states (Connecticut and Kansas) don't tax Social Security benefits if your other income is less than a specified dollar amount (\$50,000 or \$60,000 in CT, \$50,000 in KS). Three states (Colorado, Utah, and West Virginia) provide a general retirement income exclusion that takes Social Security benefits into account. Most of the remaining states tax Social Security benefits to the same extent they're taxed for federal income tax purposes.

State income tax and pensions

Of the states with an income tax, 36 fully or partially exempt pension income--only California, Indiana, Nebraska, Rhode Island, and Vermont do not. But the exemptions vary considerably by state. Some states exempt public pensions from taxation but tax private pensions, or exempt public pensions earned in that state, but not public pensions earned in another state.

Some states exempt employer retirement benefits, but not IRA income. Some states exempt a specific dollar amount of retirement income, but only if you've reached a certain age or have income within certain limits. In some states, military pensions are partially or fully exempt, while in others they're fully taxable. Some states exempt defined benefit pension payments, but tax 401(k) benefits. Make sure you understand how your particular type of retirement income is treated.

Keep in mind that federal law prohibits states from taxing certain retirement income (chiefly pension income) unless you're a resident of, or domiciled in, that state. For example, if you receive a pension from your former California employer, but you now reside in Florida, California can't tax your retirement income.

Other considerations

Remember that states impose many other kinds of taxes (for example, sales, real estate, and gift and estate taxes). Some states offer tax breaks to seniors, like property tax reductions, or additional exemptions, standard deductions, or credits based on age.

For an accurate comparison among the states, you'll need to consider your total tax burden. A number of web sites dedicated to providing information to retirees can help you in this daunting task.

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