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Wealth Insights

Are you considering relocating when you retire? Tax issues to consider.

For those thinking about relocating to a new city or state during their retirement years, there are several important factors to consider prior to making this decision.

For many, being in a warmer climate during the winter months while still maintaining proximity to family and friends is a major priority. For others, living where there is accessibility to quality health care facilities, while being able to enjoy cultural and entertainment options such as museums and concerts in a big city, or outdoor activities such as golf and walks on a beach, is important.

The goal for most is to find that right balance between a region that allows you to maintain your financial security, while not compromising your quality of life.

For just about everybody though, affordability and the cost of living is a major determinant on where to live during the retirement years. Included in that calculation is the cost of housing, medical expenditures and overall daily living expenses. Another key issue is the impact one can expect from future taxes, and the fact that the taxes which seniors are subject to during retirement can vary greatly depending on where one lives.

In a state like Wyoming or Florida, where there are no state income taxes and comparatively low sales and property taxes, retirees can expect to have a smaller overall tax bill. On the other hand, states like Connecticut or Nebraska, where residents are taxed on retirement income and there are relatively high property taxes, the overall state and local tax burden for a senior can often be thousands of dollars higher.

While each individual will need to decide for themselves the key factors, in this white paper I will review some of the tax differences between states that would be wise to consider prior to relocating to another state.

Social Security, Retirement Account and Pension Income

Keep in mind that relocating to a state (and county) that does not tax retiree income - or taxes it only lightly - might make evaluating the differences between state taxes an easier task. Even so, it is important to research the details of the tax structures of each individual state that you may consider relocating to because it is quite possible that states with no or low income taxes might levy higher property, sales or other types of taxes on their residents.

Most states do not tax Social Security income at all. Among the 13 states that tax Social Security income in some way, seven provide some sort of deduction or credit to limit or offset the cost of the tax for retirees. The remaining six states (Minnesota, North Dakota, Nebraska, Rhode Island, Vermont and West Virginia) tax all Social Security income that is taxable at the Federal level.

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Which states don't tax Social Security benefits?

The 37 states that do not tax Social Security benefits include Alabama, Alaska, Arizona, Arkansas California, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Virginia, Washington, Wisconsin, and Wyoming. Washington D.C. also exempts Social Security income from local income taxes .

Source: The Motley Fool

Some states, such as Illinois, exempt nearly all forms of retirement plan income (i.e. Social Security, IRA, 401(k), and pension income) from taxation.

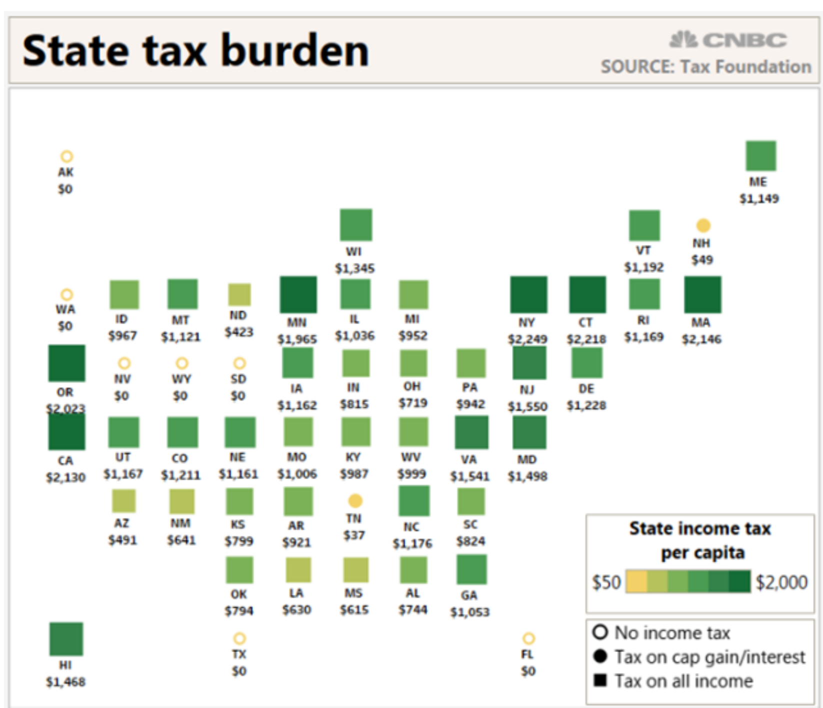
For those planning on relocating to another state and have a desire to continue working, living in a state where there is low or no income tax on earned income compared to living in a high income tax state (such as California, where the top individual income tax rate is 13.3%) might factor into the relocation decision.

There are currently 7 states that do not have a state income tax (i.e. on any forms of income). Those states are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

Tennessee and New Hampshire also do not have a state tax on income from wages, but they do currently impose a tax on investment interest and dividends. These interest and dividend taxes will be eliminated from both states in 2021 and 2022 respectively.

Regarding other forms of retirement income, there are currently 22 states that do not provide any kind of deduction, exemption or credit on withdrawals from a retirement account such as a 401(k) or IRA.

For example, if you were a retiree residing in a state with an effective state income tax rate of 4% and your annual income from your 401(k) distributions was $50,000, you would pay a tax of $2,000 on that retirement account income. This tax wouldn't exist if you lived in a state like Nevada (which has no income tax) or Mississippi (which exempts retirement account income).



Exemptions for pension income are more common, as there are currently only nine states that fully tax income from a government pension, and sixteen that tax income from a private employer pension.

Property Taxes

Homeownership has often been viewed as a good way for retirees to lock in their housing costs for the long run so that they don't have to worry about shifts in the housing or rental market. In some states (and counties), however, high property taxes or escalating property taxes from one year to the next are discouraging retirees from owning a home.

One way many states help retirees limit the burden of property taxes is by offering exemptions. Exemptions (sometimes called homestead exemptions) typically allow seniors to protect part of their home's value from property taxes. They often have income limits, so households earning more than a certain amount are not eligible.

In Illinois, for example, a 65-year old homeowner who has household income under $65,000 can participate in a similar type of program that provides a senior citizen property tax exemption freeze. This program limits the amount of property tax increases from year-to-year for retirees.

Property tax rates and rules differ drastically between states. In Alabama, for example, most homeowners on average spend less than $600 each year on property taxes. Compare that to New Jersey, where the average homeowner spends at least $7,000 annually on property taxes.

It is not surprising to see that when looking at the property tax impact alone, New Jersey with its effective property tax rate of 2.13% (highest in the U.S.) has experienced an outbound flight of residents the past several years (according to the Tax Foundation).

The 2017 Federal Tax overhaul plan, which capped the state and local tax (SALT) deduction at $10,000 per year, has also influenced many retirees who have been paying annual property taxes above that amount to consider moving to a lower property tax state such as Florida and Texas (i.e. away from higher property tax states such as New York, New Jersey and Illinois).

<u>Sales Taxes</u>

Sales taxes are important for retirees to consider as they often are living on a fixed income but spend a significant portion of that income on potentially taxable items. Sales taxes are often overlooked by retirees seeking to relocate since these taxes are paid gradually instead of all at once.

Four states (Oregon, New Hampshire, Montana and Delaware) currently have no state or local sales taxes. Alaska has no state sales tax but does have some local sales taxes. Hawaii has a general excise tax (GET) that is very similar to a sales tax (though at 4.35% it would be the lowest sales tax in the U.S.).

In the remaining states, total state and average local tax rates range from 5.43% to 9.45%. Tennessee has the highest sales tax rates in the U.S. (despite that, as noted earlier, Tennessee is one of the 9 states that is very attractive from an income tax standpoint).

Please note that most states (and counties) with a sales tax do provide some exemptions that seniors can benefit from. The most common exemptions include those on purchases of groceries, prescription drugs and medical equipment. For this reason, when comparing the impact of sales taxes on your overall tax picture, it is important to consider what you will be spending your money on during retirement.

<u>Estate and Inheritance Taxes</u>

Another type of tax that is typically important to retirees, particularly for those who have a desire to pass on their assets to loved ones and heirs, is the estate tax.

The federal estate tax exemption amount (i.e. the limit below which estates are not subject to an estate tax) has steadily increased over the past few years and is now at $11.4 million (2019) per individual. Although this higher threshold amount excludes most estates from being subject to paying estate tax at the Federal level, there are currently 13 states (Connecticut, Hawaii, Illinois, Oregon, Maine, Maryland, Massachusetts, Minnesota, New York, Rhode Island, Vermont, Washington, and the District of Columbia) that have their own estate tax laws that effect many others with smaller estates. In fact, eight of these states have an exemption amount less than $4 million.

Similar to the estate tax, an inheritance tax affects property that is passed on to one's heirs. The tax applies not to the estate itself, but rather to those receiving the property of the estate. For example, if you receive $1,000 in inheritance and are subject to a 10% inheritance tax, you would pay $100 back in taxes.

Six states currently have an inheritance tax (Iowa, Kentucky, Maryland, Nebraska, New Jersey and Pennsylvania). Of these, Maryland is the only state with both an inheritance and an estate tax. Inheritance taxes typically provide exemptions or lower rates for direct family members, while fully taxing non-relatives.

The following chart compares different states and the impact of various taxes on retirees. The states are categorized between "very tax friendly" and "not tax friendly".

Very Tax Friendly	Tax Friendly	Moderately Tax Friendly	Not Tax Friendly
States that either have no state income tax, no tax on retirement income, or a significant tax deduction on retirement income. In addition, states in this category have friendly sales, property, estate and inheritance tax rates.	States that do not tax Social Security income and offer an additional deduction on some or all other forms of retirement income. Generally, states in this category also have relatively friendly sales, property, estate, inheritance and income tax rates.	States that offer smaller deductions on some or all forms of retirement income. The sales, property, estate, inheritance and income tax rates in this category range in friendliness based on the degree of retirement deductions available.	States that offer minimal to no retirement income tax benefits. These states also do not have particularly friendly sales, property, estate and inheritance tax rates.
> Alaska	> Alabama	> Arizona	> California
> Florida	> Arkansas	> District of Columbia	> Connecticut
> Georgia	> Colorado	> Hawaii	> Maine
> Mississippi	> Delaware	> Indiana	> Minnesota
> Nevada	> Idaho	> Iowa	> Nebraska
> South Dakota	> Illinois	> Kansas	> Rhode Island
> Wyoming	> Kentucky	> Maryland	> Vermont
	> Louisiana	> Massachusetts	
	> Michigan	> Missouri	
	> New Hampshire	> Montana	
	> Oklahoma	> New Jersey	
	> Pennsylvania	> New Mexico	
	> South Carolina	> New York	
	> Tennessee	> North Carolina	
	> Texas	> North Dakota	
	> Virginia	> Ohio	
	> Washington	> Oregon	
	> West Virginia	> Utah	
		> Wisconsin	

Source: www.smartasset.com/retirement

It is interesting to note that from an annual survey completed by relocation company United Van Lines in November of 2018, New Mexico surpassed both Florida and Arizona as the new top destination for retirees. With New Mexico falling into one of those states listed above as only "Moderately Tax Friendly", this survey reveals that taxes are not the only reason why retirees are choosing to leave some areas in favor of others.

Summary

This white paper touches on one of the many factors to consider when planning a move to another state entering the retirement years, specifically, some of the tax differences between states. As mentioned earlier, it would be wise for retirees to research these different state tax structures prior to deciding where to relocate.

IMPORTANT DISCLOSURES

Note: Nothing contained herein is offered as tax advice. Please consult qualified professionals with any tax planning needs or tax questions you may have.

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