INCOMELAB

Guide to State Taxes in Retirement

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STATE INCOME TAX IN RETIREMENT

The state where you retire can have a big impact on your net retirement income and, therefore, your standard of living in retirement. But understanding that impact goes far beyond looking at top marginal tax brackets. States often have special provisions specifically designed to lower the tax burden on retirees. In this guide, we'll review some of these provisions and discuss some planning opportunities related to state tax policies. At the end of this guide you will find a helpful summary of relevant tax policies in all 50 states and the District of Columbia.[1]

The Power of Zero

Seven states have zero income tax at the state level. Another two states tax only certain types of investment income (like interest and dividends), but not other income (like wages and retirement income). Clearly, all else being equal, these states are the most tax-friendly to all taxpayers, retirees included.

- **No state income tax:** Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming
- **Only certain investment income is taxed:** New Hampshire, Tennessee

But, for retirees, the list of states that offer the chances of zero state income taxation is much longer. Depending on the make-up of your retirement income picture, you might be looking at low or no state income tax even if you don't live in the above nine tax havens.

States that do not tax Social Security Income

Alabama	Illinois	Nebraska
Arizona	Indiana	New Jersey
Arkansas	Kansas	New York
California	Kentucky	Ohio
Distrcit of Columbia	Massachusetts	Oklahoma
Delaware	Maryland	Oregon
Georgia	Maine	Pennsylvania
Hawaii	Michigan	South Carolina
Iowa	Mississippi	Virgina
Idaho	North Carolina	Wisconsin

In addition, Colorado, Connecticut, Minnesota, Missouri, North Dakota, Rhode Island and Vermont allow exclusion of at least some Social Security income in many cases. In some cases these exclusions phase out above certain income levels.

Social Security

For most retirees, Social Security income is at the core of retirement income. Luckily, not only is Social Security income never 100% taxable at the Federal level, it is often completely or partially exempt from state income tax as well. Twenty-nine states and the District of Columbia completely exclude Social Security income from taxation. This list includes some of the states with the highest marginal tax rates, like New York and California.

Pension & Retirement Plan Income

Three states – Hawaii, Illinois, and Pennsylvania – also exclude pension and qualified retirement plan income from taxation. You'll notice that these states are also on the above list of Social Security-friendly states. That means that for many retirees, these three states may have no taxation at all in retirement.

[1] All tax commentary is intended for general education. For information on your situation, please consult a tax professional. All information discussed here is based on the 2019 tax year. State tax policies are subject to change.

But even if you don't plan on retiring in one of these states, you may have access to some level of additional exclusions for retirement income from pensions and other qualified plans. The following 16 states exclude this sort of retirement income up to a limit. In some states, these exclusions are subject to income-based phase-outs.

State:	Pension/Retirement Plan Income Exclusion:
Arkansas	$6000 per person
Colorado	$20,000 per person age 55-64, $24,000 per person age 65+[2]
Connecticut	Exclude 14% of taxable retirement plan distributions from taxation if income is below threshold
Delaware	$12,500/person age 60+, $2,000/person under age 60
Georgia	$35,000 per person age 62-64, $65,000 per person age 65+
Iowa	$6000 single/$12,000 joint excluded from income of taxpayers age 55+
Kentucky	$31,110 per person age 65+
Maryland	$31,000 per person age 65+ (reduced for excl. Social Security)
Maine	$10,000 per person age 65+ (reduced for excl. Social Security)
Michigan	Age-based (No exclusion if born after January 1953)
Missouri	$6000 per person (subject to income-based phase-outs)
Montana	$4030 per person (subject to income-based phase-outs)
New York	$20,000/person age 59.5+
Oklahoma	$10,000 per person
Rhode Island	$15,000/person at or above full retirement age, subject to income-based phase-outs[3]
South Carolina	$3000 per person up to age 64, $10,000 per person age 65+

In some cases, these "retirement income" exclusions can apply to rental income and investment income from non-retirement accounts (Delaware and Georgia) and even to earned income (Georgia, up to $4,000/person). Some states also exclude from taxation income from certain specific pensions, such as military or government pensions or the state's teacher pensions.

Age-Based Exemptions, Deductions, and Credits

Beyond tax exemptions specifically tied to Social Security, pensions and qualified retirement plans, 24 states also have tax exemptions, deductions, and credits that apply only to people age 65 or older. These tax relief measures have the same effect as the Social Security and pension/qualified plan exclusions above but have the advantage of applying to any type of income, including wages and investment income.

It is important to understand the difference between exemptions/deductions and tax credits. Exemptions and deductions reduce the amount of income subject to taxation, while credits reduce the amount of tax owed dollar for dollar. Note that in many cases these exemptions, deductions, and credits are in addition to other deductions, exemptions, or credits that apply for all taxpayers.

State:	Age 65+ Exemptions/ Deductions/Credits:
Arizona	$2100 per person deduction
Arkansas	$26 per person credit
California	$122 per person credit age 65+, subject to income-based phase-out
District of Columbia	$1650 (single) / $1300 (joint) per person deduction
Delaware	$110/person credit, $2500/person deduction and $2000 single/$4000 joint additional deduction for age 60+ if below an income threshold
Georgia	$1300 per person deduction
Hawaii	$1144 per person exemption
Iowa	$20 per person credit and $1650 (single) / $1300 (joint) per person deduction
Idaho	$1650 (single) / $1300 (joint) per person deduction
Illinois	$1000 per person exemption
Indiana	$1500 or $1000 per person exemption, based on income level
Kansas	$850 (single) / $700 (joint) per person

[2] Exclusion applies to combined Social Security and pension/retirement plan income.
[3] Distributions from IRAs are not excluded.

State:	Age 65+ Exemptions/ Deductions/Credits:
Massachusetts	$700 per person exemption
Maryland	$1000 per person exemption
Maine	$4200 per person exemption
Michigan	$1650 (single) / $1300 (joint) per person deduction
Minnesota	$1650 (single) / $1300 (joint) per person deduction
Mississippi	$1500 per person exemption
Nebraska	$1600 (single) / $1300 (joint) per person deduction
New Jersey	$1000 per person exemption
New Mexico	$8000 per person exemption, subject to income-based phased out
South Carolina	$15,000 per person deduction, reduced for other retirement income exclusions
Virginia	$800 per person exclusion ($12,000 age 90+, subject to income-based phased out)
West Virginia	$8000 per person for low-income households

Special Treatment of Investment Income

Though not specifically targeted at retirees, six states offer lower taxation of certain types of investment income. For those who have taxable investments as part of their retirement income plan, these tax breaks can also help to lower the state income tax burden and increase net retirement income.

State:	Investment Tax Break:
Arizona	25% of long-term capital gain excluded from taxation[4]
North Dakota	40% of long-term capital gains and qualified dividends excluded from taxation
New Mexico	Greater of 100% of long-term capital gains (capped at $1000) or 40% of capital gains excluded from taxation
South Carolina	44% of long-term capital gains excluded from taxation
Vermont	$5000 capital gains excluded from taxation
Wisconsin	30% of long-term capital gains excluded from taxation

Look Beyond the Marginal Rate

It is easy to focus on a state's marginal tax rates – in particular, the top marginal tax rate – as a way to measure how high the tax burden will be in a state. But this is a crude and even misleading way to evaluate state income tax. Because of the exclusions and exemptions above, this is even more true for retirees than it is for those in their working years. To exemplify this effect, we estimated state income taxation for two families, one with total gross-of-tax income of $75,000 per year and the other with $150,000 in income per year, split among income types as shown below.[5]

Income Type:	Household A:	Household B:
Total	$75,000	$150,000
Social Security	$36,000	$48,000
Pension/Qualified Plan Income	$39,000	$51,000
Investment Income	$0	$51,000

The states with the highest marginal tax rates are California (13.3%), DC (8.95%), Hawaii (11%), Iowa (8.53%), Minnesota (9.85%), New Jersey (10.75%), New York (8.82%), Oregon (9.9%), and Vermont (8.75%). With only this information, you might expect that our example families paid the most state income tax in those states. But this is far from true.

[4] For assets purchased after 2011.
[5] We assume that Social Security and pension/qualified plan income is evenly split between spouses.

Household A

For Household A, the results of this test may be surprising. For this family, in addition to the nine no-tax or investment-income-tax-only states, 14 states had an estimated $0 state tax bill. On this list are California, Hawaii and New York, three of the states commonly thought of as high-tax states.

Additional States with a $0 tax bill for Household A:	
California	Maryland
Colorado	Maine
Delaware	Michigan
Georgia	New York
Hawaii	Pennsylvania
Illinois	Rhode Island
Kentucky	South Carolina

In another 11 locations (AZ, CT, DC, IA, ID, ND, NE, NJ, OH, OK, VT), this family's effective rate would have been below 1%. (And in Oklahoma they would have paid just $33, or 0.04% in taxes.)

The states where this family would have paid the highest tax were Utah (3.6% effective rate) and West Virginia (3.1% effective rate)– neither of which are commonly highlighted as a high-tax state.

Household B

Because of its higher total income and its investment income, the number of zero-tax states for Household B is smaller. We estimate $0 in state taxes in the seven zero-tax states and Georgia. But this family's tax burden in many states is still lower than one might expect. Fifteen states had effective rates below 2%. On this list we once again find California and New York.

States with a less-than-2% effective tax rate for Household B:	
Arizona	New Jersey
California	New York
Delaware	North Dakota
Hawaii	Ohio
Illinois	Pennsylvania
Kentucky	South Carolina
Michigan	Tennessee
New Hampshire	

Retiree-Friendly States

The tax burden in any given state will depend on a family's total tax picture. But these two example households show that some states with high top marginal rates can actually be quite tax-friendly to retirees.

Some states, like Georgia, Hawaii, Illinois and Pennsylvania, often masquerade as zero-tax states for some retirees. Typically, the more a household depends on Social Security and qualified retirement plans and pensions, the higher the likelihood that they will come close to paying no state income tax.

Spousal Planning

Thirteen states apply retirement income exemptions on a per-spouse basis, not as a combined exemption for the household. That means that, in order to access up to double the per-person exclusion, each spouse needs to have their own retirement income.

Thirteen states that apply retirement income exemptions on a per-spouse basis:	
Arkansas	Missouri
Colorado	Montana
Delaware	New York
Georgia	Oklahoma
Kentucky	Rhode Island
Maryland	South Carolina
Maine	

For example, in Georgia, spouses who are both age 65+ could exclude a combined $130,000 in retirement income. However, each spouse can only exclude up to $65,000 of their own retirement income. So, if income is evenly split, the full combined exclusion is available. If, on the other hand, one spouse has, for example $140,000 in income and the other spouse has none, only $65,000 could be excluded from state taxation.

Scenario A – Exclusion not maximized

	Jim:	**Jill:**
Retirement Income:	$140,000	$0
Excluded from Georgia Taxation:	$65,000	$65,000
Net Of Exclusion:	**$75,000**	**$0**

Scenario B – Exclusion maximized

	Jim:	**Jill:**
Retirement Income:	$75,000	$65,000
Excluded from Georgia Taxation:	$65,000	$65,000
Net Of Exclusion:	**$10,000**	**$0**

In these states, a couple whose retirement income is more evenly distributed between spouses will end up with a lower state income tax bill than couples whose retirement income is mostly attributable to one spouse. This means that, as much as possible, each spouse should fill up their "exclusion bucket" before taking additional retirement withdrawals.

This income splitting is easiest to do if both spouses have assets in retirement plans. Unfortunately, by the time a couple reaches retirement, it may be too late to set the family up for a better state tax situation. So, planning to optimize for state taxes needs to begin early, with total annual contributions split between spouses rather than concentrated with one spouse.

State Tax Summary

State:	Deductions and Exemptions:	Investment Income:	Social Security:	Pensions and Other Retirement Income:
Alabama			Not Taxed	
Alaska	No State Income Tax			
Arizona	Additional $2,100 deduction per person age 65+	25% of long-term capital gains exempt from taxation[1]	Not Taxed	
Arkansas	Additional tax credit of $26/ person age 65+		Not Taxed	$6000/person excluded
California	Additional tax credit of $122/ person age 65+, subject to reduction based on income level		Not Taxed	
Colorado			$20,000 (age 55-64) / $24,000 (age 65+) per person in combined Social Security and other retirement income excluded from taxation	
Connecticut			Excluded in full if income is below $75,000 (single)/ $100,000 (joint). Exclusion is reduced above this threshold.	14% excluded from taxation if income is below $75,000 (single) / $100,000 (joint)[2]
Delaware	Additional tax credit of $110/ person, deduction of $2,500/ person age 65+, and additional deduction of $2000 (single)/$4000 (joint) joint for age 60+ if below an income threshold		Not Taxed	$12,500 (age 60+)/$2000 (age <60) per person excluded[3]
District of Columbia	Additional $1,650 (single) / $1,300 (joint) per person deduction age 65+		Not Taxed	
Florida	No State Income Tax			
Georgia	Additional deduction of $1300/person age 65+		Not Taxed	$35,000 (age 62-64) / $65,000 (age 65+) per person excluded[4]
Hawaii	Additional exemption of $1144/person age 65+		Not Taxed	
Idaho	Additional deduction of $1650 (single) / $1300 (joint) per person age 65+		Not Taxed	
Illinois	Additional exemption of $1000/person age 65+		Not Taxed	
Indiana	Additional exemption of $1500 (below income thresholds) or $1000 (above income thresholds) per person age 65+		Not Taxed	

State:	Deductions and Exemptions:	Investment Income:	Social Security:	Pensions and Other Retirement Income:
Iowa	Additional tax credit of $20 and deduction of $1650 (single) / $1300 (joint) per person age 65+		Not Taxed	Retirement income of taxpayers age 55+ exempt up to $6000 single/$12,000 joint
Kansas	Additional exemption of $850 (single) / $700 (joint) per person age 65+		Not Taxed	
Kentucky			Not Taxed	$31,110/person excluded
Louisiana				
Maine	Additional exemption of $4200/person age 65+		Not Taxed	$10,000/person excluded[5]
Maryland	Additional exemption of $1000/person age 65+		Not Taxed	$31,000/person excluded from taxation[5]
Massachusetts	Additional exemption of $700/person age 65+	Long-term capital gains taxed at higher rate than other income	Not Taxed	
Michigan	Additional deduction of $1650 (single) / $1300 (joint) per person age 65+		Not Taxed	If born before 1953, tiered exemption of certain retirement income[6]
Minnesota	Additional $1650 (single) / $1300 (joint) per-person deduction age 65+		$4020 (single) / $5150 (joint) excluded from taxation, subject to income thresholds	Exclude up to $9,600 (single) / $12,000 (joint), reduced based on non-taxable Social Security income and certain income thresholds
Mississippi	Additional exemption of $1500/person age 65+		Not Taxed	
Missouri			Exempt from taxation if income is below $85,000 (single) / $100,000 (joint). Exemption phased out above theshold.	Up to $6000/person excluded from taxation, subject to income-based reductions[7]
Montana				$4300/person exempt from taxation, reduced based on income level
Nebraska	Additional deduction of $1600 (single) / $1300 (joint) per person age 65+		Not Taxed	
Nevada	No State Income Tax			
New Hampshire		Interest and dividend income is taxed	No State Income Tax	
New Jersey	Additional exemption of $1000/person age 65+		Not Taxed	
New Mexico	Exemption of $8000/person age 65+, phased out at certain income levels[8]	Greater of 100% of capital gains up to $1000 or 40% of capital gains are excluded from taxation		
New York			Not Taxed	$20,000/person excluded from taxation (age 59.5+)
North Carolina			Not Taxed	

State:	Deductions and Exemptions:	Investment Income:	Social Security:	Pensions and Other Retirement Income:
North Dakota		40% of long-term capital gains and qualified dividends are excluded from taxation	Excluded if income is below $50,000 (single) / $100,000 (joint)	
Ohio			Not Taxed	
Oklahoma			Not Taxed	$10,000/person excluded from taxation
Oregon			Not Taxed	Credit available when income below a threshhold
Pennsylvania			Not Taxed	
Rhode Island			Excluded age 65+ when below income threshholds	$15,000 excluded per person at or above full retirement age[2]
South Carolina	Additional deduction of $15,000/person age 65+, reduced for other retirement exclusions	44% of long-term capital gains excluded	Not Taxed	$3000 (up to age 64) / $10,000 (age 65+) per person excluded
South Dakota	No State Income Tax			
Tennessee		Only interest and dividends are taxed, but taxpayers age 65+ below certain income thresholds are exempt	No State Income Tax	
Texas	No State Income Tax			
Utah			Offset by $450 credit per person age 67+, phased out above income thresholds	
Vermont		$5000 capital gains excluded	Excluded from taxation up to income thresholds	
Virginia	Additional exemption of $800/ person age 65+ and additional deduction of $12,000/person age 90+ up to an income threshold		Not Taxed	
Washington	No State Income Tax			
West Virginia	Additional exemption of $8000/person age 65+ for low-income households			
Wisconsin		30% of long-term capital gains excluded from taxation	Not Taxed	
Wyoming	No State Income Tax			

[1] If assets were purchased after 2011.
[2] Does not apply to IRA income.
[3] Delaware includes non-qualified investment income in its definition of excludable "retirement income".
[4] Most kinds of income, including non-qualified investment income and up to $4000/person in earned income, are included in excludable "retirement income" in Georgia.
[5] Exclusion amount is reduced dollar-for-dollar by amount of total Social Security income that is excluded from taxation.
[6] Born before 1946: $52,208 (single) / $105,615 (joint) in combined public and private pensions excluded from taxation. Born 1946-Jan 1953: $20,000 (single) / $40,000 (joint) standard deduction.
[7] Higher exclusions apply to public pensions and retirement plans
[8] 100% exemption from taxation for those age 100+

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