Tax reform and seniors: Better focusing on the real need

*Over age 65, Iowans already benefit without unneeded, unfair tax breaks*

By Peter Fisher and Charles Bruner

Tax bills in the Iowa Legislature offer substantial new tax breaks for seniors without any demonstration of need or recognition of existing preferences. Seniors have the lowest poverty rate of any age group in Iowa. Furthermore, tax preferences for those age 65 or older already mean that seniors collecting just an average Social Security benefit could pay no tax even with a total income of up to $40,000 for a single person, or up to $69,000 for a couple. Further tax breaks will only serve to benefit the most well-off seniors, who already pay substantially less in taxes than working families with the same income.

Seniors are now the age group least likely to live in poverty and most likely to have substantial wealth, providing very ample revenue for the later years. Iowa’s seniors are half as likely to be in poverty as Iowa’s children, and almost four in ten have current incomes above 400 percent of the federal poverty level ($65,800 for a married couple living alone).

Moreover, Iowa has adopted a number of special provisions benefiting seniors. While the elderly and disabled property tax credit is available only for those with low income, the other tax preferences are not based on ability to pay:

- All Social Security benefits are exempt from tax.
- The first $6,000 in pension benefits per person ($12,000 per married couple) is exempt from tax.
- Those age 65 or older receive an additional $20 personal credit.
- While non-elderly taxpayers are exempt from tax on the first $9,000 of income, for those age 65 or older, the exemption rises to $24,000. For married couples, the threshold is $13,500 for the non-elderly, but $32,000 for seniors.  

The average annual Social Security benefit for retired workers in Iowa was $16,360 as of December 2016. However, the maximum amount possible (for those who earned very high incomes during their working years) is currently a little over $44,000. In most instances, those receiving this maximum also have other pension income and earnings from investments. Assuming at least $6,000 in pension benefits, that means the first $22,360 in income for the average earner and the first $50,360 in income for the highest earner would not be taxed. This compares with working-age adults, who would be taxed on all their earnings.

In short, under current Iowa tax law, seniors get very substantial breaks. The table below shows what a single retiree or a retired couple could earn in Social Security and pension income without paying any Iowa income tax. As illustrated, a single retiree earning the average Social Security benefit could receive as much as $24,050 in pension income, for a total income of $40,410 — over three times the poverty level — and pay no Iowa income tax. A married couple, each with the average Social Security benefit, could have $36,220 in pension income, for a total income of almost $69,000 — over four times the poverty level — and still pay no Iowa income tax.

In contrast, a family of four with both parents working and the same total income $68,940 entirely from wages and salaries would pay over $2,000 in Iowa income taxes. For a retired couple with the maximum Social Security benefit, their combined income could reach $129,900 and still be tax exempt.
Iowa retirees already receive substantial tax breaks under current state law

Maximum Income Iowa Retirees Could Receive Without Paying Any State Income Tax

<table>
<thead>
<tr>
<th></th>
<th>Single Retire</th>
<th>Maried Couple, Both Retired</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Low earner</td>
<td>Average earner</td>
</tr>
<tr>
<td>Social Security</td>
<td>$7,800</td>
<td>$16,360</td>
</tr>
<tr>
<td>Pensions</td>
<td>25,490</td>
<td>24,050</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>$33,290</strong></td>
<td><strong>$40,410</strong></td>
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Calculations are based on current law for the 2017 tax year. Households are assumed to own their homes outright and to claim the standard deduction. They pay annual Medicare Part B and Medicare Supplement Plan F premiums of $3,689 annually, which they deduct on line 18 of the Iowa return.

Income is split evenly between the filer and spouse for couples. The low earner receives monthly Social Security benefits of $650, approximately the 10th percentile of benefits nationally in 2017. The average earner receives $16,360 per year, the average retiree benefit in Iowa in 2016.

The Iowa tax free income levels vary because taxpayers will pay some federal income tax on Social Security benefits, and federal tax is deductible on the Iowa return. Also, low earners may benefit from the high retiree tax free threshold, the alternate tax calculation (married couples) or the income tax reduction (singles).

Both the Governor’s proposal and SF2383 offer additional preferential treatment for seniors without regard to their overall income. The Governor’s proposal increases the standard deduction to $4,000 for an individual and $8,000 for a married couple, and then adds an additional $1,500 for seniors and the blind. The Senate bill, SF2383, doubles the pension income exclusion from $6,000 for an individual and $12,000 for a married couple to $12,000 for an individual and $24,000 for a married couple. The cost of this provision for FY2023 may be in excess of $50 million annually.

Because seniors already receive substantial preferential tax treatment under the Iowa income tax, most are not subject to any tax until their incomes are well above the poverty level. They also pay substantially less than individuals or couples with the same income, but from earnings. Moreover, many of the greatest benefits accrue to very high-income seniors, who have big Social Security checks and pension income in addition to other investment income and earnings.

To follow principles of tax fairness — ability to pay and equal treatment of people in similar economic circumstances — at least some of the current benefits and the exclusion of income from Social Security and pension income from tax should be phased out at high income levels. The Governor’s proposal, and to a greater degree SF2383, goes in the opposite direction.

By that standard, lawmakers would not offer additional tax benefits either through expanding the pension fund exemption or additional deductions solely for the reason of being over 65. Eliminating these additional preferences would also prevent a further reduction of tax revenue that threatens the adequacy of Iowa General Fund revenue, which benefits programs that support all Iowans but especially those that support low-income Iowans at any age.

1 The income used to determine whether this threshold is met is “modified adjusted gross income.”
2 Social Security Administration at https://www.ssa.gov/policy/docs/factsheets/cong_stats/2016/ia.html
3 $44,376 ($3,698 per month) for the highest income earners retiring at age 70 in 2018 (Social Security Administration)
4 Each earns $32,247, two school-age children (no child care expense), $4,445 in employee contributions to health insurance from a job, standard deduction, $5,071 in Federal taxes for 2017 deducted on Iowa return.
5 The revenue estimate for the increase between the original bill and the amendment from $10,000 to $12,000 and $20,000 to $24,000 was over $16 million, with the increase from $6,000 and $12,000 at least 3 times that amount.

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