

July 2004

## Iowa Taxes on Social Security Benefits – The Facts, Part I

Some Iowa legislators are talking about reviving a proposal to eliminate taxes on Social Security benefits for high-income taxpayers. This would affect fewer than 1 in 3 retired households, and no households where Social Security is the primary source of income.

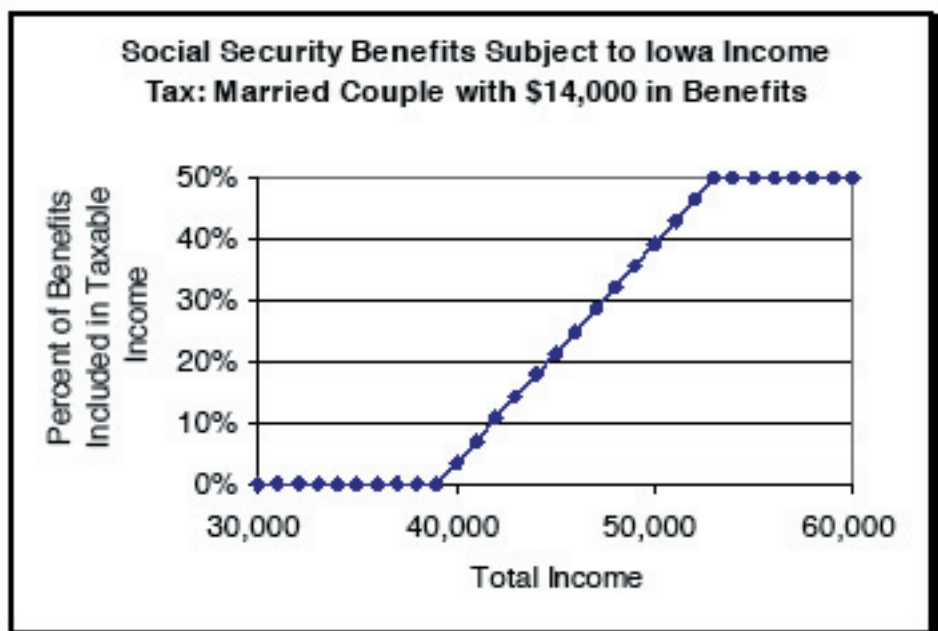
Below are some facts that may be useful to Iowans considering the debate on this issue. This is the most recent information available from the Iowa Department of Revenue.

■ Iowa already exempts the vast majority of Social Security recipients from paying state income taxes on their Social Security benefits. This is because they must reach income thresholds before they are required to include Social Security benefits in their taxable income.

■ The typical tax in Iowa on Social Security benefits is zero. To use an average of \$400 is simply incorrect, and grossly misrepresents the impact of the tax. According to the Iowa Department of Revenue, the average tax among all households *paying the tax* was \$418 in 2001. This average only includes 3 in 10 households that receive Social Security benefits. The other 7 in 10 households do not pay state taxes on their Social Security benefits.

■ There is never any Iowa tax on fully half of Social Security benefits, regardless of income. Even Iowa's highest-income retirees are exempt from tax on half of their benefits. This exemption recognizes that tax already has been paid on the individual's Social Security contribution during working years – but not the employer's contribution.

■ An elderly married couple who receive \$14,000 in Social Security benefits – an average amount – do not pay any tax on Social Security benefits unless they have at least \$25,000 in other income, such as interest, dividends, pensions, IRA distributions, etc. According to an Iowa Department of Revenue report in 2001, only 31 percent of Iowans receiving Social Security benefits paid any income tax at all on those benefits (1998 data, latest available). In addition, 81 percent of the benefit of eliminating the tax would go to retired households earning over \$50,000; 46 percent would go to households with income over \$75,000. None of the benefit of this change would go to about 7 in 10 households receiving Social Security benefits.



■ The tax is small for the few taxpayers affected by this tax. Among households earning between \$100,000 and \$200,000, the average tax paid on Social Security benefits in 2001 was \$843, according to the Iowa Department of Revenue. It doesn't make sense that for families with that income, \$843 would be enough to cause them to leave Iowa.

■ An example of the preference Iowa already gives to low- or moderate-income Social Security recipients would be to look at two families making \$30,000. A single-income family of four who makes \$30,000 and claims a standard deduction owes Iowa taxes of \$1,084. By contrast, a retired couple with \$30,000 in Social Security and pension income owe no Iowa taxes, because their income does not meet the \$32,000 threshold, and Iowa exempts the first \$12,000 of pension income for a married couple.

■ The best estimate of the cost of fully extending the Social Security exemption for the highest-income recipients would be \$100 million a year, according to the Iowa Department of Revenue.

This issue was addressed in the 2001 Iowa Policy Project policy brief, "Expanding the Social Security Benefit Exemption Under the Iowa Income Tax," by Peter S. Fisher. See that report at the Iowa Policy Project website, [www.iowapolicyproject.org](http://www.iowapolicyproject.org) <<http://www.iowapolicyproject.org>>.