

Full Exclusion of Retirement Income from State Taxation: Evaluating the Impact in Wisconsin

**Prepared for
The Wisconsin Department of Revenue**

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Foreword

This report is the result of collaboration between the Robert M. La Follette School of Public Affairs at the University of Wisconsin–Madison and the Wisconsin Department of Revenue. Our objective is to provide graduate students at La Follette the opportunity to improve their policy analysis skills while contributing to the capacity of the Department of Revenue to evaluate tax policy proposals.

The La Follette School offers a two-year graduate program leading to a master's degree in public affairs. Students study policy analysis and public management, and they can choose to pursue a concentration in a policy focus area. They spend the first year and a half of the program taking courses in which they develop the expertise needed to analyze public policies.

The authors of this report are all in their final semester of their degree program and are enrolled in Public Affairs 869 Workshop in Public Affairs. Although acquiring a set of policy analysis skills is important, there is no substitute for doing policy analysis as a means of learning policy analysis. Public Affairs 869 gives graduate students that opportunity.

This year the workshop students were divided into six teams. Other teams completed projects for the Division of Budget and Management of the City of Milwaukee; the Wisconsin Department of Children and Families and the Wisconsin Department of Health Services; the Department of Public Instruction; and the Wisconsin Legislative Council.

Under Wisconsin law, retirement income receives favorable income tax treatment. Most notably, Social Security benefits are completely excluded from taxation. Legislation has been introduced to expand significantly those preferences. Beyond that, some Wisconsin policymakers are interested exempting *all* retirement income from state taxation. In this report, the five authors conduct a comprehensive analysis of a full exclusion of retirement income from state taxation.

This report would not have been possible without the support and encouragement of John Koskinen, the Administrator of the Division of Research and Policy at the Department of Revenue and the state's Chief Economist. Other people contributed to the success of the report. Their names are in the acknowledgments.

The report also benefited greatly from the support of the staff of the La Follette School. Marjorie Matthews contributed logistic support and Karen Faster, the La Follette School's Publications Director, edited and managed production of the final bound document.

By involving La Follette students in the tough issues confronting state governments, I hope they not only have learned a great deal about doing policy

analysis but have gained an appreciation of the complexities and challenges facing state government in Wisconsin and elsewhere. I also hope that this report will contribute to policy research and analysis at the Department of Revenue.

Andrew Reschovsky
May 2013
Madison, Wisconsin

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We are grateful to John Koskinen and Brad Caruth at the Wisconsin Department of Revenue for generously sharing with us their time, information, and knowledge throughout the course of our research and analysis. We also extend our thanks to Professor Andrew Reschovsky for his thoughtful guidance and enthusiastic support for our work. Finally, we thank Karen Faster, Publications Director, for her exceptional editorial support.

Executive Summary

This report investigates the impacts of a full exclusion of retirement income from Wisconsin state taxation. Four main issues in the debate over taxing retirement income are explored: (1) whether the full exclusion of retirement income would decrease state out-migration and attract new elderly individuals to Wisconsin; (2) the impact of a retirement tax exclusion on the distribution of tax burden across the income distribution and among individuals with similar levels but different sources of income; (3) the projected fiscal cost of implementing a full exclusion of retirement income through 2040; and (4) budgetary options to offset the revenue loss resulting from a full exclusion of retirement income, including increasing the income tax, increasing the state sales tax rate, and cuts in state spending.

Highlights from this report include:

- The public finance literature investigating the relationship between state tax policies and interstate migration choices of older adults point to an emerging consensus that state income tax preferences for older adults have limited to no impact on elderly interstate migration.
- Younger residents out-migrate from Wisconsin in much larger numbers than older adults. Younger out-migrants also account for a larger proportion of lost state income tax revenue due to state out-migration as compared to elderly out-migrants.
- Individuals ages 65 and older in the wealthiest income quintile pay taxes at a rate similar to that of working individuals in the middle-income quintile. Full exclusion of retirement income from state taxation would further increase the differential tax burden between younger and older Wisconsin residents with similar income.
- Because individuals with higher incomes pay taxes at higher marginal rates, the exclusion provides greater savings at higher income levels.
- The tax exclusion provides greater benefits to taxpayers with higher proportions of total income from retirement sources. On average, individuals with higher income also have more income from retirement sources. The full exclusion offers lower-income individuals a larger overall percentage reduction in tax burden, but only if they still have income tax liability after existing elderly tax preferences are applied.
- Had a full retirement income tax exclusion been in place in tax year 2010, this policy would have resulted in \$473 million in foregone Wisconsin state income tax revenue. This represents 8.14 percent of all 2010 state income tax revenue collections.

- Revenue losses resulting from a full retirement income exclusion are projected to grow substantially each year. This growth is driven by two main factors: inflation and the projected growth in the proportion of elderly Wisconsin residents. By 2040, annual revenue losses are projected to surpass \$1.2 billion, representing 10.69 percent of all state income tax revenue for that year. If the policy were to take effect in tax year 2014, the total revenue lost during the 26-year period ending in 2040 is projected at just more than \$24 billion.
- To offset state revenue losses associated with full exclusion of retirement income, we estimate that the State of Wisconsin could institute an across-the-board cut of 3.7 percent to General Fund spending. Alternatively, the State could (1) for remaining taxable income, raise the average tax rate from 4.45 percent to 4.9 percent, which increases income tax liability on remaining taxable income by roughly 10 percent; (2) raise the state sales tax on all currently taxed goods and services from 5 to 5.6 percent; or (3) reduce overall state spending on General Purpose Revenue programs by 3.69 percent or reduce the budget of a single state government program, for example cut K-12 School Aids by 9.3 percent, Correctional Services by 43.8 percent, the UW System by 46.1 percent, or Shared Revenue by 58.3 percent.

Introduction

In recent years, state and federal tax preferences for the elderly have received considerable attention from policymakers. Although Wisconsin already offers some tax preferences for older adults, a number of Wisconsin state policymakers propose further expansion of retirement income tax preferences. In March 2013, companion bills were introduced in the Wisconsin Senate (2013 Wisconsin SB 82) and Assembly (2013 Wisconsin AB 87) to gradually increase the state's retirement income exemption from \$5,000 to \$20,000 and eliminate qualifying age and income restrictions (see Appendix A for full text and fiscal estimate of 2013 Wisconsin SB 82). Similar policies were introduced in both houses during the 2011–12 legislative session (Wisconsin 2011 SB 29 and AB 52). Wisconsin Governor Scott Walker has similarly advocated for the elimination of the state tax on retirement income (Umhoefer 2013). This report considers the impact of offering a full exclusion of retirement income from state taxation in Wisconsin. For the purposes of this report, retirement income includes the following sources: pensions, annuities, and tax-deferred retirement accounts (such as 401(k)s, 403(b)s, and IRAs). This exclusion would not be age-specific. In addition to excluding the retirement income of older adults, it would also exclude income received for early retirements, survivor benefits, and other retirement income received by younger people.

State governments offer a wide array of income tax breaks for older adults. Many states treat the elderly favorably, exempting Social Security income and some or all income from tax-deferred retirement accounts. A number of states also provide substantial standard deductions and age-specific tax credits for older adults. Elderly tax preferences can be costly for a state to maintain, however, especially as the proportion of elderly residents grows. While these rising costs motivated some states with the more generous tax breaks to rethink their policies, others that had less generous elderly tax preferences have recently expanded income tax preferences for older adults (National Conference of State Legislatures 2013).

Wisconsin tax law provides limited income tax breaks for older adults. In 2008, all taxpayers, regardless of income, were allowed to exclude Social Security benefits from state taxation. Military pensions and pensions received by individuals who were members of the Milwaukee City and County retirement funds, the state teachers' retirement fund, and the civil service retirement system prior to 1964 are exempt from taxation. Additionally, taxpayers with incomes less than \$15,000 (\$30,000 for married joint filers) may exclude up to \$5,000 of pension income from state income taxation.

Proponents of offering more generous retirement income tax breaks are concerned that high state taxes are burdensome to retirees and may be pushing these individuals out of Wisconsin. They argue that the state should focus on retaining middle-income and affluent elderly residents who contribute to economic growth by making purchases at Wisconsin businesses, providing in-state capital for business investment and job creation, and supporting state and local governments

through the payment of a variety of other taxes (Bark 2013; Kedzie 2013; Umhoefer 2013).

Opponents offer two general criticisms of expanding tax preferences for older adults. First, they argue that little evidence demonstrates a strong impact of state income tax policies on elderly migration. This lack of evidence suggests that excluding retirement income may not have the desired effect of maintaining and attracting older adults in numbers sufficient to spur state economic development. Second, opponents contend that an equitable tax system is one that treats all forms of income equally. A full exclusion of retirement income requires wage earners to bear a heavier income tax burden for funding government services than individuals with high levels of retirement income. Furthermore, since contributions to retirement accounts are often made on a pre-tax basis, excluding income withdrawals from these accounts means that some income is never subject to taxation. Finally, opponents argue that this policy favors affluent elderly with considerable retirement income, decreasing the amount they contribute to fund public services provided to all older adults. As increasing numbers of baby boomers retire, excluding retirement income from taxation would reduce state income tax revenue in the face of rising demand for state services.

In this report, we explicitly address the implications of fully excluding retirement income from Wisconsin state taxation. Specifically, we attempt to determine: (1) whether fully excluding retirement income would decrease elderly out-migration from Wisconsin and attract new elderly residents to the state; (2) the loss in state income tax revenue projected through 2040 resulting from a full exclusion of retirement income; (3) the impact of the policy on the distribution of tax burden across groups with different levels and sources of income, and (4) the impact of various alternative means by which Wisconsin might offset the revenue loss generated by these tax preferences.

In the first two sections, we detail historical trends and contemporary prevalence of elderly income tax preferences, including a detailed explanation of neighboring states' income tax policies targeting older adults. We then present descriptive statistics related to interstate migration patterns of older adults and provide a literature review of late-life migration interstate migration. Next, we explore the differential tax burden associated with fully excluding retirement income from state taxation, including policy simulations illustrating impacts on individuals at different income levels and with different sources of income. We then estimate the opportunity cost of fully excluding retirement income, including projected revenue impacts of the policy through 2040. Finally, we consider a number of alternative policies Wisconsin may pursue to offset revenue lost due to the retirement income tax exclusion.

Background: Income Tax Treatment of the Elderly

The number of states offering income tax breaks for the elderly has grown substantially during the past 40 years (Conway and Rork 2012, 2008a). Most states provide tax preferences that are at least as generous as the tax preferences offered to the elderly through the federal tax system. Federal law provides a partial exemption of Social Security benefits, a substantial standard deduction for adults older than 65, and a tax credit for the elderly. Some states such as Alabama, Hawaii, and Illinois offer benefits that are significantly more generous than federal treatment. Common income tax preferences for the elderly follow three general frameworks including: (1) extra deductions, exemptions, or tax credits given on the basis of age; (2) the full or partial exemption of Social Security benefits; and (3) the full or partial exemption of pension income. We discuss the historical trends and contemporary prevalence of the three basic types of elderly tax breaks. Appendix B details tax preferences offered by all states in the 2011 tax year.

Extra Deductions, Exemptions, or Tax Credits

The federal government and nearly all states provide older adults with a standard deduction that is more generous than the standard deduction offered to individuals younger than 65. In 1982, taxpayers ages 65 and older received twice the standard federal exemption of \$1,000. The Tax Reform Act of 1986 substituted the federal elderly exemption with a standard deduction that was smaller in value (\$600 for each spouse or \$750 for a single individual). This legislation not only decreased the relative size of the tax preference but limited it to older adults who do not itemize their deductions (Conway and Rork 2008b). After the Tax Reform Act of 1986, many states followed the federal government's lead and reduced the value of elderly-specific exemptions and deductions, although the number of states providing extra deductions, exemptions, and tax credits increased (Conway and Rork 2012, 2008b).

In 2011, the federal government offered elderly taxpayers a larger standard deduction and a tax credit. An older adult filing as single received \$1,450 in addition to the \$7,400 standard deduction for individuals younger than 65. Elderly couples filing jointly received \$1,150 for each spouse older than 65 in addition to the \$11,900 standard deduction for under-65 married couples. The tax credit amount for elderly or disabled individuals equaled 15 percent of the applicable base amount¹ reduced by nontaxable Social Security or other tax-free retirement benefits and one-half of the adjusted gross income exceeding a threshold amount.

¹ The applicable base amounts for the elderly or disabled tax credit depend on filing status as follows: \$5,000 for single, head of household, qualifying widow(er), and on a joint return where only one spouse is eligible; \$7,500 on a joint return when both spouses are eligible; and \$3,750 for a spouse, who has lived apart from the other spouse at all times during the tax year, and who files a separate return.

Elderly-specific exemptions, deductions, and credits vary considerably among states. Ten states offered deductions equivalent to those provided through the federal tax code in 2011. Several other states have much larger or smaller exemptions. Thirty-six states allowed seniors to claim an additional personal exemption, deduction, or credit in 2011. Ten of these states adopted the federal deduction. The amount of the additional state elderly deductions, exemptions, or credits ranged from \$20 in Iowa to \$2,500 in Delaware (Olin 2012).

Exemption of Social Security Benefits

Federal tax law provides elderly taxpayers a partial exemption for Social Security income. Notably, this source of income was not subject to federal or state taxation until the enactment of the Social Security Act Amendments of 1983 (Conway and Rork 2008a). This legislation taxed up to one-half of the Social Security benefits of individuals whose provisional income² exceeded \$25,000 (\$32,000 for married joint taxpayers) as regular income (CQ Almanac 1983).

Federal taxation of Social Security benefits expanded with the Omnibus Budget Reconciliation Act of 1993. The act added a secondary set of higher income tax brackets beyond the 1983 threshold, which subjected up to 85 percent of Social Security benefits to taxation (DeWitt 2010). The number of individuals subject to taxation did not increase; rather, tax liability increased for those with higher earnings already subject to the tax. After 1993, seniors with provisional incomes less than \$25,000 (\$32,000 for married joint taxpayers) paid no tax on Social Security benefits. Up to 50 percent of Social Security benefits were taxable for older individuals with provisional incomes between \$25,000 and \$34,000 (\$32,000 and \$44,000 for married joint taxpayers). Up to 85 percent of Social Security benefits were taxable for those with provisional incomes above \$34,000 (\$44,000 for married joint taxpayers) (Olin 2012). Federal tax treatment of Social Security has not changed since 1993.

States typically provide more generous tax treatment of Social Security benefits than the federal government. In the early 1990s the number of states taxing Social Security benefits peaked at 18, but this number subsequently declined (Conway and Rork 2012, 2008a). In 2011, of the 43 states that tax income, 30 fully exempted Social Security income, eight followed federal tax treatment, and five created their own taxation systems (Olin 2012). Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not tax residents' income.

Exemption of Pension Income

Many states offer elderly taxpayers full or partial exemptions for pension income. State tax treatment of pension income varies along several dimensions. Some states, such as Montana, New Mexico and Oregon, restrict pension income

² Provisional income is the sum of wages, taxable and nontaxable interest, dividends, pensions, self-employment other taxable income, and one-half of annual Social Security benefits.

exemptions by age or income level. States have numerous definitions of qualifying pension or retirement income. Tax treatment of pension income often differs for government retirement plans (military pensions, federal civil service pensions, state and local government employee pensions) and private pension plans. As shown in Appendix B, a majority of states provide exemptions for public pensions; these policies have remained fairly constant over time. State tax treatment of private pension income, in contrast, is much more diverse (Conway and Rork 2012, 2008b). The federal government has always fully taxed private pension income.

States began offering exemptions for private pension income in the 1940s; however, most of these exemptions were not maintained to current day. In 1964, one state, Delaware, exempted pension income (Conway and Rork 2012). Since then the prevalence of this tax benefit has grown substantially. Eighteen states fully or partially exempted pension income by 1985. Twenty-four states offered a private pension exemption in 1994 (Conway and Rork 2008b), and by 2007 this number increased to 28 (Conway and Rork 2012). Between 2007 and 2011, the number of states offering an exemption for private pension income remained constant. In 2011, four states fully exempted private pension income: Mississippi, New Hampshire, Pennsylvania, and Tennessee (Olin 2012).

As of 2011, Mississippi, New Hampshire, Pennsylvania, and Tennessee offered full exemption of all retirement income (Social Security and all pension income) from state taxation. New Hampshire and Tennessee tax only unearned income, such as interest and dividends. Hawaii, Illinois, and New York exclude Social Security and all federal, state, local, and military pension income from taxation, and they differ on the taxation of pension income from private-sector sources. Hawaii excludes employer-funded private pension income. Illinois exempts private pension income from qualified employee benefit plans or self-employed retirement plans. New York allows taxpayers to exempt up to \$20,000 of private pension income.

Other states are pursuing reductions in tax breaks for the elderly. In 2012, the state of Georgia repealed its income tax exclusion for higher-income retirees (National Conference of State Legislatures 2013). Similarly, the Kentucky Blue Ribbon Tax Commission recommended recently that the state reduce its pension income exclusions (Hoyt, Fox, Childress, and Saunoris 2012). In January 2012, Michigan reduced its long-standing full exemption of retirement income.

Neighboring States Income Tax Treatment of the Elderly

Wisconsin's neighboring states differ considerably in their tax treatment of the elderly, as shown in Appendix C. Illinois provides the most generous elderly-specific tax preferences. The state exempts all Social Security benefits and private (if from a qualified employee benefit plan or a self-employed retirement plan), state and local, federal civilian, and military retirement income. Each individual

65 or older also is entitled to claim an additional exemption of \$1,000 (Illinois Department of Revenue 2012).

Of the neighboring states, Minnesota offers the fewest tax preferences for older adults. Minnesota taxes all pension income and follows federal tax treatment for Social Security, taxing up to 85 percent of Social Security income (Olin 2012). Adults ages 65 and older may claim a standard deduction that is \$1,450 (\$2,300 for married filing joint) more than for individuals under 65. The state offers additional subtractions for taxpayers ages 65 and older with adjusted gross incomes less than \$33,700 (\$38,500 for married filing jointly) and combined railroad retirement and nontaxable Social Security benefits less than \$9,600 (\$12,000 for married filing jointly) (Minnesota Revenue 2012).

Iowa's elderly income tax policies most closely resemble those of Wisconsin. Taxpayers ages 55 and older can exclude up to \$6,000 of taxable income from private, state and local, federal civilian and military pensions (Iowa Administrative Bulletin Rule 701.40.47). Iowa is gradually phasing out its tax on Social Security income. All Social Security benefits are tax exempt for individuals with incomes less than \$25,000 (under \$32,000 for couples filing jointly). For higher-income individuals, 23 percent of Social Security benefits were taxed in 2012 and 11 percent in 2013. Starting in 2014, Iowa will exclude all Social Security benefits from state taxation (Iowa Administrative Bulletin Rule 701.40.23.3).

Indiana grants fewer elderly-specific tax breaks than Wisconsin. The state taxes all private, state, and local pension income. Taxpayers may exempt up to \$5,000 from military pensions starting at age 60 and up to \$2,000 from federal civilian pensions starting at age 63. Indiana exempts all Social Security income from state taxation. Adults ages 65 and older can take an additional \$1,000 exemption (Olin 2012).

In January, 2012, the Michigan Legislature reduced its long-standing full exemption of retirement income, replacing it with a taxation system with three tiers based on factors such as age and total income, that phases out certain pension and retirement income deductions. Michigan Governor Rick Snyder cited "the long-term structural stability of the state's budget" as a primary motivator of the policy change, estimating that the retirement income exemption cost the state approximately \$930 million each year (Snyder 2012, 2011). Prior to this policy change, all military pensions, federal civil service pensions, and state and local pensions were exempt. Private pension income was exempt up to \$47,309 or \$94,618 (for married joint filers). In the 2012 policy, military pensions, Social Security benefits, and railroad retirement benefits remain exempt from taxation. Taxpayers born before 1946 do not face any changes in the taxation of their pension and retirement income. For taxpayers born between January 1, 1946, and December 31, 1952, retirement income up to \$20,000 for single filers and \$40,000 for joint filers is not taxed. Once people in this age group turn 67 they qualify for a senior income tax exemption of \$20,000 for a single filer and \$40,000 for joint

filers, regardless of income source. This exemption is in addition to the Social Security and personal exemptions. For individuals born after 1952, all retirement income is taxed. Once adults in this age group turn 67 they also qualify for the \$20,000 senior income tax exemption. If a filer's Social Security exemption plus personal exemption is more than the senior income exemption, the filer takes the more generous of the two options (Michigan.gov 2012). The 2012 legislation also eliminated the special exemption for seniors ages 65 and older (Michigan Department of Treasury 2012).

Wisconsin Income by Age and Sources of Income

The distribution of gross income across income quintiles in Wisconsin differs for residents ages 65 and older as compared to those ages 64 and younger. In general, Wisconsin residents ages 65 and older have lower levels of poverty than do younger residents ages 64 and younger. As Table 1 shows, 16.5 percent of residents ages 64 and younger have incomes in the lowest income quintile (\$15,990 per year or less), while 4.5 percent of residents ages 65 and older have incomes in this quintile. Combining the lowest two income quintiles, which include all incomes less than \$31,519, we find that 32.4 percent of residents ages 64 and younger have incomes in this quintile compared to 21.3 percent of residents ages 65 and older. Differences at the lower end of the income range may be explained largely by the fact that older adults have access to Social Security income, which raises the gross income of this group relative to younger residents. Considering percentage of income in the top two quintiles (all incomes above \$51,253), it is notable that the gross income of approximately 50 percent of Wisconsin residents 65 and older and ages 64 and younger fall into these two quintiles.

**Table 1: Comparison of Wisconsin Elderly and Non-Elderly
Federal Gross Income by Income Quintile**

Federal Gross Income Quintile	Income Range	Ages 64 and Younger		Ages 65 and Older	
		Number of Individuals	% of Total Ages 64 and Younger	Number of Individuals	% of Total Ages 65 and Older
Lowest	\$15,990 or less	501,487	16.5%	24,401	4.5%
Second	\$15,991 - \$31,519	481,447	15.9%	90,098	16.8%
Third	\$31,520 - \$51,252	528,419	17.4%	153,972	28.6%
Fourth	\$51,253 - \$82,043	688,527	22.7%	157,370	29.3%
Highest	\$82,044 or more	832,636	27.5%	112,053	20.8%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

There are also differences between older and younger Wisconsinites in terms of the share of income coming from various income sources. Tables 2 and 3 describe the shares of total 2010 Wisconsin income by income source and by age. These

data are divided into three age groups: 25 to 54, 55 to 64, and 65 and older. Share of total income by income source is shown as both percentage of Federal Gross Income (Table 2) and Wisconsin Adjusted Gross Income (WAGI) (Table 3). WAGI is calculated by taking an individual's Federal Adjusted Gross Income (Federal Gross Income minus adjustments) and modifying it in various ways to reflect Wisconsin's definition of income. For a more detailed description of how WAGI is calculated, see Appendix D.

As shown in Table 2, labor is the primary source of Federal Gross Income³ for Wisconsin residents ages 25 to 54, with 84 percent of income coming from this source. On the other hand, for residents ages 65 and older, retirement income is the primary source of income, with 65 percent of income coming from this source and 11 percent of income coming from wages. The Wisconsin residents ages 55 to 64 are transitioning toward a greater reliance on retirement income, with 59 percent of income coming from labor and 23 percent from retirement sources.

Table 2: Share of Federal Gross Income by Income Source (2010)

Age Group	Federal Gross Income				
	Labor	Retirement	Capital	Business	Other
25 to 54	84%	3%	3%	8%	1%
55 to 64	59%	23%	7%	9%	1%
65 and older	11%	65%	15%	8%	1%
All (ages 25 and older)	67%	18%	6%	8%	1%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

Table 3 shows the shares of WAGI by income source for different age groups. WAGI is calculated after the application of certain income adjustments, such as the full exclusion of Social Security income from state taxation. As with Federal Gross Income, the share of WAGI from retirement sources differs among Wisconsin residents in different age groups. For Wisconsin residents ages 65 and older, retirement income comprises 46 percent of WAGI as compared to 16 percent for residents ages 55 to 64 and 2 percent for residents ages 54 and younger. On the other hand, wage income comprises 88 percent of WAGI for residents younger than 54 and 68 percent for residents ages 55 to 64.

³ Although Federal Gross Income is calculated with some minor adjustments, it is the most representative of Wisconsin residents' gross income before application of federal or state income tax adjustments.

**Table 3: Share of Wisconsin Adjusted Gross Income
by Income Source and Age Group (2010)**

Age Group	Wisconsin Adjusted Gross Income				
	Labor	Retirement	Capital	Business	Other
25 to 54	88%	2%	3%	8%	-1%
55 to 64	68%	16%	7%	10%	-1%
65 and older	20%	46%	24%	14%	-5%
All (ages 25 and older)	76%	10%	6%	9%	-1%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

Looking at the income of older Wisconsin residents, we see substantial differences in percentages of Federal Gross Income and WAGI by income source. For residents ages 65 and older, retirement income comprises a far smaller percentage of WAGI (46 percent) than Federal Gross Income (65 percent). This difference is due to Wisconsin's more generous retirement income tax preferences as compared to federal treatment, including the Wisconsin's full exclusion of Social Security income from state taxation. In 2010, in fact, \$13.8 billion of Federal Adjusted Gross Income from retirement sources was excluded from WAGI. On the other hand, for younger Wisconsin residents ages 25 to 54, there is very little difference in percentages of income by source between Federal Gross Income and WAGI, indicating that Wisconsin follows more closely the federal tax treatment for this group.

State Income Tax Policy and Migration Decisions of Older Wisconsinites

Proponents of expanding retirement income tax preferences argue that these tax breaks are necessary to limit state out-migration and attract middle-income and wealthy retirees to a state to retain and expand income tax revenue. If elderly income tax preferences provide a behavioral incentive to remain in or move to the state, this policy will result in maintenance or expansion of Wisconsin's sales and property tax base. As a group, younger retirees have considerable disposable income, and policies designed to retain and attract members of this groups may benefit the state economy. Middle-income and affluent elderly residents may contribute substantially the Wisconsin economy by patronizing local businesses, providing in-state capital for business investment and job creation, and paying other state and local taxes (Bark 2013; Kedzie 2013; Umhoefer 2013).

A good starting point in evaluating the expansion of retirement income tax preferences is to first describe current interstate migration patterns of older adults and then consider what is known about the impact of state tax policies on older adults' interstate migration behavior.

Interstate Migration Patterns of Older Adults in the United States

Policy discussions weighing potential economic costs and benefits of expanding retirement income tax preferences must consider the very low incidence of interstate migration among older adults in the United States. In 2011, only 2.3 percent of the overall U.S. population relocated to a new state, with an estimated 6.8 percent of these moves occurring among individuals near retirement age (ages 55 to 64) and only 5.9 percent occurring among individuals ages 65 and older. Looking at interstate migration by age group, 2011 Census data shows that only 1.3 percent of all individuals ages 55 to 64 and 1 percent of individuals ages 65 and older experienced an interstate move (U.S. Census Bureau 2011a).

In addition to the limited occurrence of interstate moves, research suggests that interstate migration patterns are remarkably stable over time, with older adults generally relocating to only a handful of states. Longino and Bradley (2003) found that 54.4 percent of older adult migrants relocate to one of 10 top destination states. When moving to a new state, older migrants prefer destination states with warmer climates and a lower cost-of-living. Elders also tend to move away from large metropolitan areas into smaller cities or towns.

Conway and Houtenville (2003) find consistent elderly migration patterns across time, with several states maintaining high rates of in-migration and other states experiencing consistently greater out-migration. These patterns diminish somewhat for the older elderly (75 and older). For this group, most interstate relocation patterns involve return-migration and border-state relocation (He and Schachter 2003). Although elderly migration has become slightly more dispersed among destination states in recent years, relocation rates and preferred destinations remain largely unchanged (Conway and Rork 2010).

Litwak and Longino (1987) describe three main types of late-life moves: 1) long-distance moves of healthy older adults, 2) short-distance moves of older adults with moderate or poor health who are need informal caregiving, have a limited-income, or are recently widowed, and 3) relocations to nursing homes or other congregate living environments. According to He and Schachter (2003), interstate moves between 1995 and 2000 were highest among older adults at retirement age (ages 55 to 64) and among the younger-old (ages 65 to 74), with just more than 21 percent of all movers in both age groups relocating to a different state. These numbers drop for older age groups, with an estimated 17.3 percent of all movers in the 75 to 84 age group and 14.9 percent in the 85 and over-age group migrating to a new state.

He and Schachter (2003) also describe how interstate migration patterns vary by age. They find that many states experiencing out-migration of young-old may subsequently experience the return migration of many former residents as people continue to age, perhaps to be near family and other caregivers. These return migrants tend to have lower incomes than elderly migrants as a whole (Litwak and Longino 1987).

Interstate Migration Patterns of Older Wisconsinites

Census migration data from 2007-2011 indicate that state out-migration among older Wisconsin residents is uncommon, with 0.8 percent of adults ages 60 and older migrating from the state each year (U.S. Census Bureau 2011b). As shown in Table 4, adults age 60 and older make up 8.3 percent of all movers leaving Wisconsin, the smallest proportion of any age group. By comparison, 59.1 percent of movers leaving the state are younger than 30, another 21 percent are 30 to 44 years old, and 11.6 percent are 45 to 59. On average, Wisconsin experiences a small yearly net loss of older adults ages 65 and older, with the top income group (\$75,000 or more) out-migrating at the highest rate; however, these numbers are very low (He and Schachter 2003). During the 15-year period between 1995 and 2000, Wisconsin lost an average of 806 adults per year in this age and income cohort, which translates to just more than one-half of 1 percent (White 2006).

Table 4: Wisconsin Yearly Average Interstate Migration by Age Group (2007-11)

Age Group	Number of Wisconsin Out-Migrants	Out-Migrants as a Percentage of Age Group	Number of Wisconsin In-Migrants	In-Migrants as a Percentage of Age Group	Population Loss/Gain Due to Migration
0 to 4	6,785	2.36%	6,633	2.30%	-152
5 to 17	13,388	1.36%	13,294	1.35%	-94
18 to 19	10,755	6.53%	10,059	6.10%	-696
20 to 24	18,721	4.82%	16,458	4.22%	-2,263
25 to 29	14,603	4.01%	13,004	3.56%	-1,599
30 to 34	9,595	2.79%	10,558	3.05%	963
35 to 39	7,484	2.13%	6,549	1.86%	-935
40 to 44	5,783	1.47%	5,582	1.42%	-201
45 to 49	5,209	1.19%	5,339	1.21%	130
50 to 54	3,878	0.90%	3,920	0.91%	42
55 to 59	3,556	0.94%	3,636	0.96%	80
60 to 64	2,930	0.97%	2,674	0.89%	-256
65 to 69	1,866	0.85%	1,557	0.71%	-309
70 to 74	1,425	0.83%	974	0.57%	-451
75 +	2,828	0.75%	2,272	0.60%	-556
Total	108,806	1.94%	102,509	1.83%	-6,297

Source: U.S. Census Bureau (2011b), American Community Survey five-year migration estimates 2007-2011

Border-state migration is Wisconsin's most common form of interstate migration, with Minnesota and Illinois being the top two states for both Wisconsin in-migration and out-migration. As discussed earlier, the Illinois tax code extends tax relief to older adults by excluding all retirement income from state taxation while Minnesota treats retirement income less preferably than does the Wisconsin tax code. Interestingly, according to 2011 Census ACS data, Wisconsin experienced a net inflow of 11,000 residents from Illinois and a small net outflow

of 1,300 residents to Minnesota.⁴ Florida represents the third most common destination state from Wisconsin, though the number of out-migrants from Wisconsin to Florida is much lower than for border state moves. The state of Florida has no state income tax, yet migration from Wisconsin to Minnesota and Illinois is 4.5 times as great as migration from Wisconsin to Florida (U.S. Census Bureau 2011b).

Examining interstate migration rates of Michigan and Minnesota further highlights the similarities between Wisconsin and its neighbor states, despite wide policy differences in the state treatment of income tax. As discussed previously, Minnesota offers few tax preferences for older adults. The state taxes all pension income and up to 85 percent of Social Security income. Michigan, on the other hand, fully exempted all retirement income until tax year 2012. Table 5 shows net migration as a percentage of total population by age group. These data demonstrate that although income tax preferences for the elderly differ considerably, both Michigan and Minnesota have net migration patterns similar to Wisconsin. Appendix E contains detailed tables displaying interstate migration rates for Michigan and Minnesota. These data also show that, similar to Wisconsin, individuals younger than 30 out-migrate at much higher rates than adults ages 55 and up.

Table 5: Wisconsin Net Migration Rates Compared to Neighboring States

Age Group	Minnesota Net Migration High State Taxes for Pension and Retirement Income	Wisconsin Net Migration Limited Exemptions for Pension and Retirement Income	Michigan Net Migration Large State Exemption for Pension and Retirement Income
55 to 64	-0.24%	-0.03%	-0.58%
65 to 74	-0.46%	-0.19%	-0.42%
75 and older	0.05%	-0.15%	-0.24%

Source: Authors' calculations based on U.S. Census Bureau (2011b) American Community Survey five-year migration data (2007-2011)

Another way to analyze Wisconsin's interstate migration patterns is to examine the migration of federal tax returns from state to state. Internal Revenue Service Statistics of Income (2012) data tracks the location of individual tax returns over time, providing information on the number of Wisconsin tax returns moving in and out of the state within a given tax year. State in- and out-migration as measured by federal tax return data has been fairly steady from 2004 to 2010. Table 6 displays median migration counts and annual ranges across these years. Appendix F contains the detailed migration figures from 2004 to 2010 along with

⁴ These numbers represent interstate moves within the general population rather than the older adult population alone. Neither Minnesota nor Illinois are considered tax-friendly destination states for non-retired individuals.

data on the 10 states accounting for the largest number of in- and out-migrants for each year. The median out migration of 47,476 represents just more than 2 percent of total income tax returns filed in Wisconsin during this period.

Table 6: Wisconsin Yearly Interstate Migration of Tax Returns (2004-10)

	Out-Migration of Tax Returns	In-Migration of Tax Returns	Population Gain/Loss Due to Migration
Median	47,476	42,335	-5,392
Maximum	49,104	43,545	-6,669
Minimum	43,781	37,112	-3,886

Source: Internal Revenue Service Statistics of Income (2012)

To estimate the fiscal impact of older adult interstate migration in relation to other age groups, we compare average WAGI across 10-year age brackets beginning with 25 to 34 year olds. Table 7 shows the average WAGI in each age bracket along with averages for the highest, middle and lowest quintile. These data show that average WAGI is highest for residents ages 45 to 54 and lowest for those ages 75 and older.

Table 7 also shows average per capita WAGI and the estimated percentage of overall WAGI exiting Wisconsin in 2010.⁵ To account for the fact that migration may not be representative of the age bracket's income breakdown we also estimate the average WAGI assuming that all migrants are in the highest, middle, or lowest income quintile. For example, in the highest quintile, percentages are calculated as the average quintile WAGI for an age group divided by the number of individuals in that age group and income quintile. Combining average WAGI with the migration data from Table 4 allows us to estimate the percentage of total WAGI associated with state out-migration for each group.

⁵ Percentages are calculated as the total WAGI in an age group divided by number of individuals in that age group.

Table 7: Average Wisconsin Adjusted Gross Income and Percentage of WAGI Leaving the State in 2010

Age Group	Average WAGI and Percentage Exiting Wisconsin	Average WAGI and Percent Exiting Wisconsin in Highest Quintile	Average WAGI and Percentage Exiting Wisconsin in Middle Quintile	Average WAGI and Percentage Exiting Wisconsin in Lowest Quintile
25 - 34	\$32,440	\$63,730	\$30,520	\$7,610
	0.59%	1.14%	0.56%	0.14%
35 - 44	\$45,420	\$76,930	\$29,610	\$6,890
	0.45%	0.77%	0.30%	0.07%
45 - 54	\$49,600	\$84,860	\$28,590	\$6,040
	0.34%	0.59%	0.20%	0.04%
55 - 64	\$43,930	\$81,170	\$23,110	\$5,260
	0.22%	0.40%	0.11%	0.03%
65 - 74	\$27,570	\$73,140	\$10,570	\$1,970
	0.07%	0.18%	0.03%	0.00%
75 and older	\$20,690	\$73,380	\$10,780	\$1,690
	0.04%	0.16%	0.02%	0.00%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

Note: Calculations use WAGI excluding negative incomes

During the five-year period 2007-2011, an average of 59,157 people exited the state annually, resulting in a loss of 1.71 percent of WAGI each year on average.⁶ Of those migrants, roughly 78 percent were younger than 55. Both numbers of movers and the percentage of WAGI lost to out-of-state migration are higher for younger age groups.

The average migration estimate above assumes that the rate of state out-migration occurs equally across all age and income groups. Instead, let's assume that only high-income residents 55 and older and low-income residents 54 and younger out-migrate from Wisconsin. In this special case, the amount of WAGI lost due to elderly migration would surpass the amount lost due to out-migration of younger residents. Specifically, out-migration of high-income elderly results in a 0.74 percent decrease in WAGI, while out migration of low-income residents ages 54 and under results in a 0.25 loss in WAGI.

In tax year 2009-10, Wisconsin lost more than \$2 billion of state adjusted gross income to out-migration. On a net basis, however, state out-migration resulted in a \$440 million loss to WAGI (Tax Foundation n.d.). The lowest income quintile

⁶ This number accounts for revenue loss due to out-migration only. To achieve a fiscal estimate of the impact of interstate migration on Wisconsin state income tax revenue, net interstate migration numbers must be used.

in Wisconsin has Federal Gross Income under \$15,000. The average WAGI in the lowest income quintile ranges from \$7,700 to \$1,700 (see Table 7). Next, we calculate the average WAGI per migrant to each state by taking the total adjusted gross income migrating into each state and dividing it by the number of tax returns migrating into that state. Florida has the highest adjusted gross income per return at \$66,155 and Mississippi the lowest at \$30,454 (Tax Foundation n.d.). If the hypothetical migration scenario described above were true (only the highest income quintile elderly and lowest quintile young people are leaving the state), we would expect the low-end range of adjusted gross income per tax return to be lower. This expectation suggests that Wisconsin's migration patterns likely reflect income distributions across age groups and that more WAGI is lost due to migration of younger residents than elderly residents.

One of the arguments in favor of expanding retirement income tax preferences is to retain and attract the elderly. One takeaway from analysis of the Wisconsin tax migration data is that younger residents are migrating in larger numbers and accounting for higher amounts of WAGI lost to other states. A second takeaway is that the only scenario under which elderly migration would account for more WAGI lost to other states would be if only highest-income quintile residents 55 and older and lowest-income quintile residents ages 54 and younger were leaving the state. This scenario, however, is not supported by Wisconsin migration data.

The Impact of State Income Tax Preferences on Late-Life Interstate Migration

Policy discussions around the exclusion of retirement income from state taxation in Wisconsin must include a consideration of the possible incentive effects of these tax preferences for retaining and attracting middle-income and wealthy older adults to the state. In this section, we consider the research evidence focused on the impact of tax policies on older adult interstate migration.

The public finance research related to the impact of taxation on residential location is grounded in the Tiebout hypothesis. Tiebout (1956) argued that, within a given metropolitan area, mobile households relocate to local jurisdictions offering the best mix of taxes and public services. Resulting is a process in which movers, by "voting with their feet," create efficient provision of public goods and services across local metropolitan jurisdictions. Researchers studying the effects of tax policy on late-life migration are interested in understanding whether older adults "vote with their feet" more broadly, by relocating to a destination state in response to a more attractive mix of taxes and government expenditures or by moving away from the state or origin to avoid burdensome taxes.

Research by Conway and Houtenville (2003, 2001) generalizes concepts from the Tiebout hypothesis to build a theory of late-life interstate migration. They argue that older adults' interstate migration decisions are influenced by a combination of factors, including state amenities, cost of living, government spending on

public services, taxes, the geographic distance between states, and other demographic push-pull factors of origin and destination states. The basic assumption underlying this model is that older adult migrants aim to maximize utility when choosing between different state relocation options. Older adults gain utility through access to amenities and government spending on public services. These benefits are offset by costs, including taxes, higher rents, and lower wages. Under this model, late-life migrants weigh the utility of each destination state under consideration and select the state offering the highest level of individual utility, after accounting for projected financial and personal costs (Conway and Houtenville 2001).

Another significant body of late-life migration literature is grounded in a second theory, the lifecourse model of residential mobility. This model argues that older adults move in response to specific life events such as retirement, loss of a spouse, income decline, and the need for assistance with personal care (Walters 2002). Boldt, Caruth, and Reschovsky (2011) suggest that both theoretical perspectives may play a role in older adults' migration decision-making process. They argue that residential relocation is the result of a two-stage decision-making process: a mobility decision followed by a residential choice decision. Specifically, a household initially makes a decision regarding whether to relocate. Once this decision has been made, the household then selects a new residential location.

Analysis of the impact of statewide tax policies on elderly migration relates to the second step of this two-stage decision-making process rather than the first. This finding suggests that differences between states' retirement income tax policies may be relevant primarily to older adults who have already decided to move to a different state. Thus, implementing a full exclusion of retirement tax income may offer behavioral incentives for only the small group of older adults considering interstate moves.

Research on the Impact of State Tax Preferences on Late-Life Interstate Migration

Much of the early research investigating the relationship between state tax preferences and elderly migration suggests that elderly tax preferences are associated with state in-migration, while higher tax burdens and cost of living are associated with state out-migration. In one early study, Conway and Houtenville (1998) used 1990 Census state-level migration rates to study the association between state taxes and state in-migration among older adults. They found an association between lower state taxes, especially the property tax, and state in-migration of residents ages 65 and older. A second study by Conway and Houtenville (2001) was the first to model the impact of state policies on elderly migration using elderly migration flow data rather than migration rate, which incorporates into the analytical model dynamic information about origin and destination states. The study uses 1990 Census migration flow data to establish a tentative link between state out-migration and high cost of living. It also found

that state in-migration is associated with a warm climate, a sales tax exemption for food, low welfare spending, pension income exemptions, and low estate, inheritance, and gift (EIG) and personal income taxes.

Based on the idea that younger and older elderly have divergent characteristics and may migrate for different reasons, Conway and Houtenville (2003) use 1990 Census flow data to investigate differences in migration patterns based the ages of older adults. In general, this study suggests differences between younger and older elderly age groups when making decisions about interstate migration. Younger elderly are more likely to place weight on characteristics of a destination state and state elderly tax preferences. On the other hand, older elderly tend to focus on cost of living and other state policies impacting personal wealth.

Taking a different approach, Duncombe, Robbins, and Wolf (2003) use Census county-to-county migration flow data from 1990 to 1995 to study the impact of location-specific factors on the migration choices of older adults. This study finds that higher state income, property, and inheritance taxes made states less attractive for older movers. The authors conclude that substantial tax reductions would be necessary to attract even one elderly migrant and that the costs associated with those tax breaks would greatly outweigh the benefits. Drescher (1994) came to a similar conclusion based on her individual-level study simulating a reduction in Massachusetts' estate tax. This study finds that older adults do not move in response to state and local tax policy. Her model also predicts that any revenue gains from elderly in-migration would be far overshadowed by revenue losses resulting from the lowered tax.

Many of the studies discussed above rely on cross-sectional, aggregate data, which produce results leading researchers to suggest that higher income tax and other tax burdens are associated with elderly out-migration from a state. These studies, however, fail to account for state-specific characteristics that may obscure the true relationship between tax policies and elderly migration (Conway and Rork 2012). This early research is also plagued by the "same sign" problem, in which findings seem to suggest that state tax preferences for the elderly are associated with older adults moving into and out of a state. Furthermore, although these studies suggest associations, they are unable to show a causal link between tax policy and elderly migration due to methodological limitations inherent in the use of cross-sectional data.

Recent research examining impact of tax preferences on older adult migration over time is more sophisticated, solving many of the methodological problems associated with earlier research on tax policy and elderly migration. These studies employ more advanced statistical modeling techniques, often using data from multiple time periods (panel data) to investigate the effect of state tax preferences on elderly interstate migration. These methodologies allow researchers to control for state unobservable characteristics and estimate causal effects over time, largely eliminating the same sign problem from earlier research. The following sections highlight two examples of recent studies providing credible evidence

regarding the relationship between state tax preferences and elderly interstate migration.

Onder and Schlunk (2009)

This study uses a gravity model of migration to study the impact of local government policies on elderly interstate migration for a five-year period using Census panel data from 1995 and 2000. Onder and Schlunk conduct a cross-sectional analysis in which they overlay older adult migration flow data detailing specific factors at the state and local level (e.g., state and local government finances, state amenities). The gravity model accounts for both origin state “push” effects and destination “pull” effects, which include state-specific factors that may influence migration behavior. Onder and Schlunk run three regression models in an attempt to account for “noise” in the data, including the original model, a second model eliminating migrations over very long and short distances to minimize non-fiscal effects on migration, and a third model restricting the sample to only higher per-capita income states in order to focus on affluent migrants while controlling for “counter-stream” migrants who may be free-riding on the better amenities offered by high-tax states. Study findings suggest that older adults prefer to migrate to states with low EIG taxes; high corporate income taxes; high property taxes; and a sales tax exemption for prescription drugs. The study also finds that if a state offers a pension tax exemption, older adult migrants prefer that this destination state has high income taxes.

Conway and Rork (2012)

This study provides the most comprehensive and methodologically sophisticated analysis to date of the impact of state tax policies on late-life migration. This study uses panel regression models with data from four censuses, 1970-2000, to study the relationship between state tax breaks on private pension income and late-life interstate migration. This study is the first to control for changes across time in both state policies and late-life migration. The panel data method also allows the authors to control for state-specific factors that may have an ongoing impact on late-life migration choices, such as natural and cultural amenities. This study also looks at differences in older adult migration patterns by income class. This provides the opportunity to compare the policy outcomes for the group of older adults most likely to be affected (the affluent elderly) with those less likely to be affected (lower-income elderly).

The results of this study are quite clear in finding no consistent effect of state income tax breaks on elderly interstate migration. Although elderly state income tax and EIG tax policies vary considerably across states and over time, late-life migration patterns remain largely static across both time and income groups. Based on their findings, the authors conclude that “our results, as well as the consistently low rate of elderly interstate migration, should give pause to those who justify offering state tax breaks to the elderly as an effective way to attract and retain the elderly” (p. 352).

Summary of the Migration Literature

The growing body of literature investigating the relationship between state tax policies and elderly interstate migration behavior point to an emerging consensus that state income tax preferences for older adults have limited or no impact on elderly interstate migration. This research has a number of limitations. For example, the relative rarity of an interstate move creates the need for a very large sample containing enough interstate moves with which to conduct a credible analysis. The persistence of elderly interstate migration patterns also necessitates a sample large enough to detect any changes in migration patterns over time. Because of the need for such large samples, researchers are often restricted to using U.S. Census tabulations to meet sample size requirements for acceptable statistical power. These aggregated data, however, provide limited information due to lack of individual-level characteristics. Most available data sources offering detail on individual characteristics do not contain large enough samples of elderly movers to allow for accurate estimates of the impact of state tax policies on late-life interstate migration (Conway and Rork 2012, 2010).

Despite these limitations, public finance scholars generally agree that projected revenue gains associated with avoiding state out-migration and attracting elderly in-migrants are far outweighed by the revenue losses projected to result from these targeted exemptions. The public finance research related to state EIG taxes and the millionaire tax provide additional evidence in support of the limited impact of state taxes on interstate migration. A summary of this literature can be found in Appendix G.

Tax Equity Considerations

One common criterion for analyzing any tax is to consider its horizontal equity. A tax is considered horizontally equitable if two people who have the same level of income pay equivalent taxes (Cordes 1999). In this section, we discuss differences in tax burden among age groups within the same income quintile under both the current Wisconsin income tax code and a simulation that excludes all retirement income from state taxation. We then investigate the differences in income tax treatment for earned income and retirement income for people within the same age group. Finally, the section concludes with presentation of a series of simulations demonstrating the differential effects of the retirement income tax exclusion on a series of representative taxpayers with varied levels and sources of income.

Impacts on Intergenerational and Horizontal Tax Equity

Wisconsin's tax system offers tax preferences for retired residents, including exemptions for Social Security income, military pensions, and certain public pensions for members of the pension system prior to 1964. Taxpayers ages 65 and older with incomes less than \$15,000 (\$30,000 for married joint filers) may exclude up to \$5,000 of pension income from state taxation. In 2010, \$9.5 billion

of Federal Adjusted Gross Income was exempt from Wisconsin state income taxes, with the majority of these tax preferences (\$5 billion or 53 percent) benefitting older adults in the form of exemptions for Social Security and retirement income from tax deferred retirement accounts (Wisconsin Legislative Council 2012). A full exclusion of all retirement income from state taxation would further increase these tax preferences for Wisconsin seniors.

Many preferential tax treatment policies for the elderly were enacted during the 1960s and 1970s when the poverty rates among individuals ages 65 and older were much higher (McNichol 2006). In 1970, nearly 25 percent of Americans older than 65 lived in poverty (U.S. Census Bureau 1971). In contrast, by 2011 the poverty rate among the 65 and older population in the United States declined to 8.7 percent (DeNavas-Walt, Proctor, and Smith 2012). During this same 40-year period, poverty rates for people ages 18 to 64 have risen from around 10 percent in 1970 to 13.7 percent in 2011 (DeNavas-Walt, Proctor, and Smith 2012). Targeted tax preferences were intended to address high poverty rates among the elderly in the 1970s. However, tax policy has not been updated to address declining poverty rates among the elderly, resulting in a growing number of high income seniors benefitting from existing tax preferences, despite declining need.

Table 8 summarizes the U.S. Census Bureau American Community Survey five-year estimates from 2007 – 2011, showing poverty rates among 10-year age brackets in Wisconsin (U.S. Census Bureau 2011c).

Table 8: Wisconsin Poverty Rates by Age Group

Age Group	Number of WI Residents	Number of WI Residents Below Poverty Line	% of Age Group Below Poverty Line	% of Total Poverty
18 - 24	491,018	130,038	26%	29%
25 - 34	697,694	87,761	13%	20%
35- 44	734,900	63,661	9%	14%
45- 54	862,521	61,337	7%	14%
55- 64	675,393	45,629	7%	10%
65 - 74	386,080	22,291	6%	5%
75 and older	349,733	34,773	10%	8%
Total (18+)	4,197,339	445,490	11%	100%

Source: U.S. Census Bureau (2011c), American Community Survey five-year poverty estimates, 2007-2011

According to these estimates, the 65- to 74-year age group has the lowest level of poverty in the total population and in terms of the percentage of age group below the federal poverty line. On the other hand, the 25- to 54-year age group comprises nearly 50 percent of Wisconsin residents in poverty. This group represents the prime working years for the majority of people.

In addition to poverty rates, income and state-level tax adjustments vary among age groups. These numbers closely approximate the magnitude of income tax adjustments included in the calculation of WAGI compared to gross income prior to any federal or state adjustments. Table 9 shows WAGI to Federal Gross Income ratios for different age groups in Wisconsin.

Table 9: WAGI as a Percentage of Federal Gross Income

Income Quintile	Income Range	Ages 25 to 54	Ages 55 to 64	Ages 65 and older
Lowest	\$15,990 or less	81.8%	69.3%	18.5%
Second	\$15,991 - \$31,519	90.5%	73.6%	23.4%
Third	\$31,520 - \$51,252	95.7%	79.9%	37.7%
Fourth	\$51,253 - \$82,042	96.5%	84.7%	49.7%
Highest	\$82,043 or more	96.1%	89.7%	70.0%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

The ratio of WAGI to Federal Gross Income for individuals ages 65 and older in Wisconsin's highest income quintile (greater than \$82,043 per year) is 70 percent. On the other hand, the ratio of WAGI to Federal Gross Income for working age adults ages 25 to 54 in the lowest income quintile (less than \$15,990 per year) is 81.8 percent. This difference suggests that a targeted policy excluding retirement income from state taxation offers a lower income tax burden for wealthy retired Wisconsin residents older than 65 relative to the income tax burden for younger persons earning substantially less income. In addition, retirement plan contributions are made on a pre-tax basis during an individual's working years, so fully excluding retirement income means that this income source would never be subject to state taxation.

Accounting for existing adjustments to WAGI, tax rates as a percentage of total income are substantially lower for the elderly in Wisconsin relative to younger taxpayers with similar income levels, but from different sources. Table 10 shows Wisconsin Net Tax as a percentage of Federal Gross Income. The exclusion of Social Security and exemption of other types of retirement income provide benefits to the elderly, resulting in lower relative income tax rates across all income quintiles for those ages 65 and older in the same quintile. The disparity is greatest within the second and third quintiles. Individuals ages 25 to 54 in the second income quintile face a relative average income tax rate 18 times higher than the those ages 65 and older. In the third income quintile, the relative average tax rate is nearly seven times higher for the 25 to 54 age group than for those ages 65 and older.

**Table 10: Wisconsin Net Tax as a Percentage
of Federal Gross Income**

Income Quintile	Income Range	Ages 25 to 54	Ages 55 to 64	Ages 65 and older
Lowest	\$15,990 or less	0.2%	0.4%	0.1%
Second	\$15,991 - \$31,519	1.8%	1.3%	0.1%
Third	\$31,520 - \$51,252	3.4%	2.5%	0.5%
Fourth	\$51,253 - \$82,042	4.1%	3.4%	1.3%
Highest	\$82,043 or more	5.1%	5.0%	3.6%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

Individuals ages 65 and older in the highest income quintile pay taxes at a rate similar to that of working individuals in the third income quintile (3.6 percent compared to 3.4 percent, respectively). An exclusion of all retirement income would certainly widen the differential tax burden between younger and older Wisconsin residents with similar levels of income. Table 11 shows that with this policy change, individuals ages 65 and older in the highest income quintile would pay taxes at a lower average rate than would those ages 25 to 54 in the third income quintile (2.4 percent compared to 3.3 percent, respectively).

**Table 11: Wisconsin Net Tax as a Percentage of Federal Gross
Income after State Retirement Income Tax Exclusion**

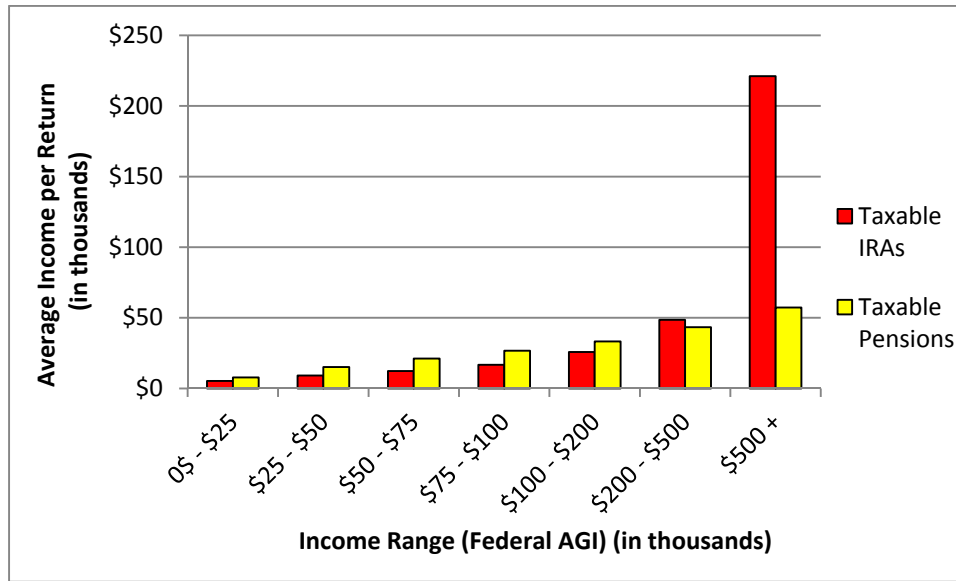
Income Quintile	Income Range	Ages 25 to 54	Ages 55 to 64	Ages 65 and older
Lowest	\$15,990 or less	0.2%	0.3%	0.0%
Second	\$15,991 - \$31,519	1.8%	1.1%	0.0%
Third	\$31,520 - \$51,252	3.3%	2.0%	0.2%
Fourth	\$51,253 - \$82,042	4.0%	2.7%	0.4%
Highest	\$82,043 or more	5.0%	4.3%	2.4%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

Differential Benefits from Retirement Income Tax Preferences

Preferential treatment of retirement income provides differential benefits to elderly individuals depending on income level and sources of income. Older Wisconsin residents remaining in the workforce and relying on earnings as a source of income are taxed at a higher average rate when compared with taxpayers of the same age who are no longer working. As shown in Figure 1, wealthier individuals receive much more income from retirement sources than do individuals with lower incomes.

Figure 1: Amount of Wisconsin Retirement Income per Tax Return



Source: Internal Revenue Service Statistics of Income (2013)

Table 12 shows how the retirement exclusion would affect individuals with different levels of income. Given the already low Wisconsin tax liability of residents ages 55 and older in the two lowest income quintiles, a full retirement income exclusion is projected to benefit principally the more affluent elderly. These data suggest that more than half of the total benefit from the retirement income exclusion would accrue to older adults in the highest income quintile.

Table 12: Comparison of Full Exclusion of Retirement Income with Current Policy for Individuals Ages 55 and Older

Gross Income Quintiles (Ages 55 and Older)	Income Range	Current Policy		Full Retirement Exclusion		
		Total Number of Returns	Average Tax Liability	Average Tax Liability	Percentage Reduction in Tax Liability	Percentage of Total Savings
Lowest	\$15,990 or less	49,291	\$22	\$18	20.49%	0.05%
Second	\$15,991-\$31,519	133,804	\$143	\$118	17.65%	0.71%
Third	\$31,520-\$51,252	187,691	\$554	\$394	28.94%	6.36%
Fourth	\$51,253-\$82,042	195,711	\$1,565	\$1,058	32.35%	20.93%
Highest	\$82,043 or more	172,200	\$7,850	\$6,344	19.19%	54.81%
Total (all)		738,695	\$2,413	\$1,882	22.00%	82.85%

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue

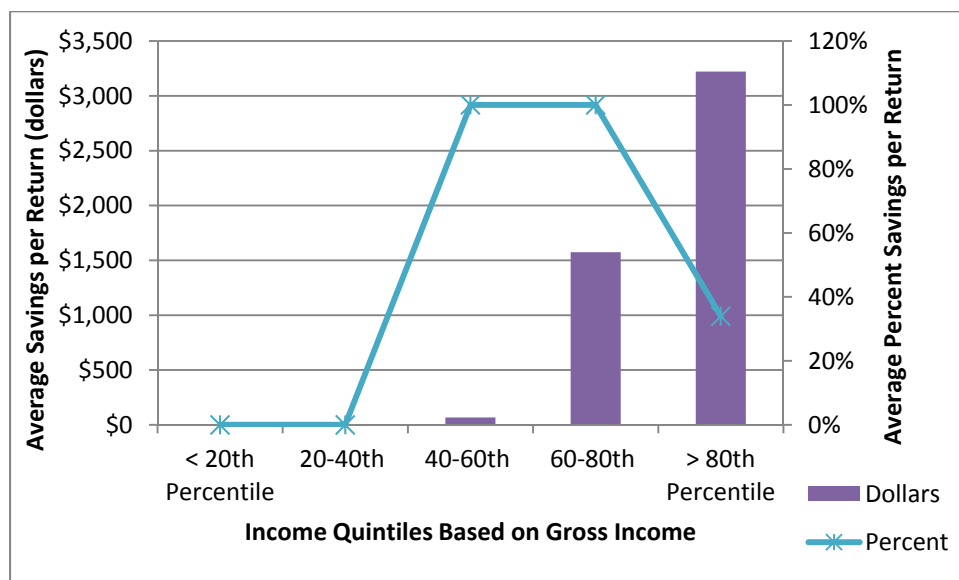
Notes: Calculations are based on the average reduction for each quintile rather than particular individuals. These results are not intended to be identical to the simulation presented in Figure 2. Percentage of total savings is calculated based on the overall population, including those younger than 55.

Simulation of Policy Impact on Representative Taxpayers

To illustrate the equity implications of a full retirement income exclusion in Wisconsin, we conduct a simulation to demonstrate how this policy change is expected to affect taxpayers ages 65 and older across income quintiles. Calculations for the simulations are based on hypothetical taxpayers with WAGI equal to the average WAGI for taxpayers in that income quintile.

Tabular data used to create the simulated tax exclusion are based on WAGI. We first estimate the tax liability under current policy of the average individual or couple ages 65 and above in each income quintile. We then repeat the estimate, but with a complete exclusion of retirement income. Figure 2 illustrates the dollar and percentage changes in tax liability resulting from full exclusion of retirement income from state taxation for joint filers across income quintiles.

Figure 2: Estimated Dollar and Percentage Reduction in Joint-Filer Tax Liability due to Exclusion of Retirement Income from State Taxation



Source: Authors' calculations, based on data from the Wisconsin Department of Revenue

Note: Calculations are based on a hypothetical person with the average WAGI and taxable retirement income of each quintile. Individual outcomes may vary.

The policy simulation demonstrates two trends. First, as income increases, taxpayers receive greater dollar savings from the full retirement income tax exclusion by avoiding taxation of retirement income that would have been paid at higher marginal tax rates than lower income taxpayers. Second, the tax preference provides greater dollar savings to taxpayers as income from exempted retirement sources increases. On average, individuals with higher incomes also have more income from retirement sources. Individuals with lower income, if they have any tax liability under current policy, experience a larger percentage reduction in taxation. However, under federal and state tax policy, a large portion of retirement

income is already exempt for this group. Therefore, a full exclusion would benefit primarily middle and upper income taxpayers.

Estimated Impacts of a Full Retirement Income Tax Exclusion on Wisconsin Revenue

Wisconsin relies on the state income tax as a primary source of revenue. In recent years, Wisconsin's individual income tax comprised roughly 52 percent of state General Purpose Revenue (Wisconsin Department of Administration [WDOA] 2012). Using data provided by the Wisconsin Department of Revenue, we calculate that retirement income makes up approximately 9 percent of overall taxable income in the state. A full retirement income tax exclusion, therefore, would reduce Wisconsin income tax revenues. In this section, we first estimate the revenue impacts of a hypothetical 2010 implementation of the full retirement income exclusion. Using 2010 as a base year, we then incorporate state population and national Consumer Price Index projections to estimate revenue implications through 2040. Last, we compare these budgetary impacts to the state's Social Security exemption enacted in 2008.

Estimated Policy Impact on Current Wisconsin Revenue

To analyze the annual reduction in income tax revenue resulting from a full exclusion of retirement income, we use aggregated 2010 tax data from the Wisconsin Department of Revenue. These data include number of returns, total income (gross, federally adjusted, and Wisconsin adjusted), type of income (labor, retirement, capital, etc.), and net income taxes. Data categories are broken down into gross income quintiles and, within those quintiles, five-year age groups. For more information on the Department of Revenue data, see Appendix H. We use these data to estimate foregone revenue from a full retirement income tax exclusion, had this policy been in place in 2010. By multiplying the retirement income of each age-income cohort by each group's average effective state tax rate, we arrive at an estimate of \$473,331,000 in foregone revenue.⁷ This decrease represents roughly 8.14 percent of all state income tax revenue collected in that year, based on our calculation with Department of Revenue data.

The above estimate assumes that elderly migration patterns are unaffected by the exclusion of retirement income from state taxation. As demonstrated in our literature review and summary of migration data among elderly Wisconsinites, such a policy would likely have a minimal effect on migration. However, we also consider the hypothetical scenario in which all Wisconsin out-migrants ages 65 and older would have instead remained in Wisconsin in 2010 because of the retirement income tax exclusion. As part of this estimate, we assume that these individuals are all older adults in the highest income quintile. The state would

⁷ A Department of Revenue fiscal analysis on 2013 SB 82 found similar results.

benefit by retaining these individuals, as the average non-retirement WAGI (still eligible for state income tax) for this group is more than \$49,000. Additionally, we assume that 50 percent of the gross income among these individuals is consumed on taxable services within Wisconsin. The state benefits through the 5 percent state sales tax on these purchases. This scenario represents a best-case policy outcome for Wisconsin revenue. Under this optimistic scenario, we estimate that state revenues would have increased by \$31,578,000 relative to the original estimate. This means that the policy still would have resulted in a net loss of \$441,753,000 in 2010, or roughly 7.6 percent of all state income tax revenue in that year.⁸

Wisconsin's Shifting Demographics

To project the revenue implications of fully excluding retirement income from state taxation, understanding Wisconsin's shifting demographics is necessary. According to the U.S. Census, Wisconsin's population in 2010 was 5,686,986. Working-age individuals, ages 18 to 64, make up nearly 63 percent of the population. Individuals between ages 65 and 84 constitute more than 11.5 percent of the state's population. The "old-elderly," those ages 85 and older, comprise just more than 2 percent of Wisconsin's inhabitants (Egan-Robertson 2012).

A 2012 University of Wisconsin-Madison Applied Population Laboratory report shows Wisconsin population growth projections and demographic trends in from 2010 through 2040 (see Table 13).⁹ This report offers a baseline projection, meaning its "predictions of the population of the state and its constituent areas are based on the primary assumption that past demographic and economic patterns, on a large scale, will hold true into the future" (Egan-Robertson 2012, p. 3). The author took population estimates for 2010 directly from the U.S. Census of that year.

⁸ Calculated using the 2007-2011 annual average of out-migrants ages 65 and older (see Table 4), average income characteristics and effective tax rates of individuals 65 and older and in the highest income quintile (from unpublished Department of Revenue data), and 5 percent state sales tax rate.

⁹ These projections were prepared for the Wisconsin Department of Administration.

Table 13: Wisconsin Population Projections by Age Group 2010-2040

Age Group	Wisconsin Population 2010	Projected Wisconsin Population in 2040	Wisconsin Population Change 2010-40	% Change in Wisconsin Population 2010-40
0-17	1,339,492	1,366,930	27,438	2.0%
0-4	358,443	371,210	12,767	3.6%
5-17	981,049	995,720	14,671	1.5%
18-64	3,570,180	3,585,330	15,150	0.4%
18-24	549,256	557,470	8,214	1.5%
25-44	1,447,360	1,493,030	45,670	3.2%
45-64	1,573,564	1,534,830	-38,734	-2.5%
65 and older	777,314	1,543,640	766,326	98.6%
65-84	658,809	1,256,930	598,121	90.8%
85 and older	118,505	286,710	168,205	141.9%
Total	5,686,986	6,495,900	808,914	14.2%

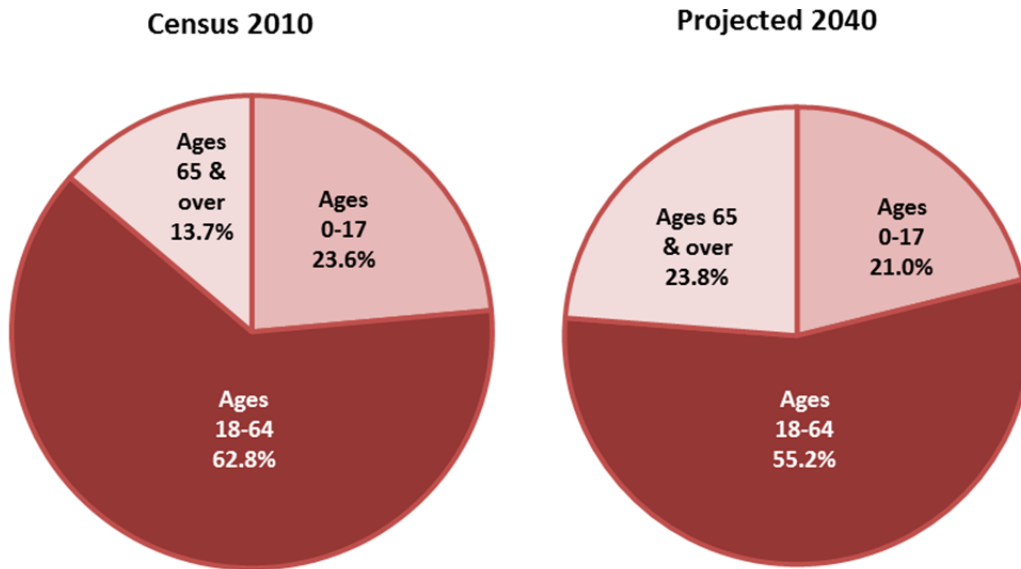
Source: Egan-Robertson (2012). University of Wisconsin–Madison Applied Population Laboratory

As shown in Figure 3, Wisconsin’s age composition is anticipated to shift dramatically between 2010 and 2040 toward an older population. Wisconsin’s working-age population (ages 18-64) is expected to remain relatively stable, rising less than 1 percent over 30 years. In the same time period, however, the number of people ages 65 and older is projected to nearly double. The number of old-elderly is expected to grow by more than 140 percent by 2040. While the share of working-age people in Wisconsin is projected to decline to just more than 55 percent by 2040, the state’s 65-and-older population will grow to almost 24 percent of the total.

Most of the growth in the state’s elderly population is expected to occur by 2030, the year in which the final members of the Baby-Boom generation (those born between 1946 and 1964) turn 65.¹⁰ Growth of Wisconsin’s aging population is attributed to the aging of current residents rather than a projected influx of retirees relocating to the state (Egan-Robertson 2012).

¹⁰ The first baby boomers turned 65 in 2011.

Figure 3: Wisconsin Population Percentages by Age Group in 2010 and 2040



Source: Egan-Robertson (2012), University of Wisconsin–Madison Applied Population Laboratory

Projected Impact of a Full Retirement Income Exclusion on Wisconsin State Revenue Through 2040

As baby boomers continue to retire, more and more of Wisconsin's taxable income is expected to come from retirement sources. We project that excluding retirement income from state taxation would significantly reduce state revenues, with the effect increasing over time as the Wisconsin population ages. To project the state revenue impact of the retirement income exclusion through 2040 we use the base year 2010 estimate, adjusting for inflation and projected demographic changes. Specifically, our model uses Applied Population Laboratory projections to account for demographic changes over time. Since the laboratory reports demographics in 5-year increments, we use linear interpolation to estimate demographics in the intervening years. Inflation rates used for these calculations come from IHS Global Insight projections of consumer price index provided by the Department of Revenue.¹¹

Our projections show that lost revenue resulting from a full retirement income exclusion grows substantially each year. By 2040, annual revenue losses surpass \$1.2 billion in nominal dollars. This total represents roughly 10.7 percent of all state income tax revenue in that year,¹² a considerable increase over the 8.14 percent in 2010. As shown in Appendix I, if the policy were to take effect in

¹¹ IHS Global Insight Consumer Price Index projections indicate that annual inflation will rise steadily from 1.6 percent in 2013 to 2 percent in 2023. We assume that inflation holds steady at 2 percent from that time through 2040.

¹² Percentage calculation is based on Department of Revenue data, with projection methodology for total state income tax revenue identical to foregone revenue projection methodology.

2014, total revenue lost during the 26-year period ending in 2040 is projected at just more than \$24 billion in nominal dollars.¹³

These projections include several implicit, simplifying assumptions. First, we assume no migration changes attributable to excluding retirement income from taxation. Second, because we project lost revenues based on 2010 income and tax data, variables that do not change over time include: labor participation rates within each age group, income distributions within each age group, proportion of income from different income sources within each age group, and marginal tax rates and tax brackets. In short, average individuals within each age/income cohort do not change; only the population within each age/income cohort changes.

Revenue Impacts of Wisconsin's Social Security Income Exclusion

The 2005-07 Wisconsin Biennial Budget instituted a full exclusion of Social Security benefits from WAGI. State revenue losses resulting from this exclusion are increasing rapidly as the state population ages and moves into retirement. Initial projections of the Social Security benefits exclusion forecasted roughly \$46 million in lost revenue in 2008 and nearly \$100 million in 2010 and thereafter (Wisconsin Legislative Fiscal Bureau 2005). However, state revenue losses grew much more rapidly than predicted. A retrospective analysis by the Wisconsin Department of Revenue found that the state-level Social Security exemption removed \$81 million of potential state revenue in 2008, about \$35 million more than initial projections (Wisconsin Department of Revenue Division of Research and Policy [WDOR-DRP] 2009). The gap between projected and actual revenue losses rose rapidly, equaling \$135 million in 2010 (WDOR-DRP 2011) and \$170 million in 2012. In 2012, the Social Security exclusion cost Wisconsin a total of \$270 million in lost revenue (Wisconsin Department of Revenue Division of Research and Analysis [WDOR-DRA] 2013).

Policy Implications: Offsetting Reduced Tax Revenue

The Wisconsin Constitution requires that the Legislature pass a balanced budget. If the Legislature chooses to enact a tax policy change, such as the full exclusion of retirement income, that results in a reduction in state tax revenues, the balanced budget requirement means that any lost revenues must be offset by reductions in spending or increases in revenues from other sources. In this section, we consider three ways to offset this revenue loss resulting from full exclusion of retirement income: (1) increases in the state income tax; (2) an increase in the state sales tax rate; (3) reductions in state government expenditures.

¹³ This projection is likely a lower-bounded estimate, as it assumes no increase in per-capita retirement income above inflation over time.

Increasing the State Income Tax

Revenue losses resulting from a full exclusion of retirement income from state taxation could be offset through raising taxes on sources of income. Consistent with our earlier estimate, we use the policy impact estimate of \$473.3 million in 2010 foregone revenue as the dollar value target for an income tax increase. As Table 14 demonstrates, an average tax rate increase of nearly half a percent would have been necessary for the policy to have remained revenue neutral in 2010. This translates to a percentage increase above current rates of roughly 10 percent for all other types of income. As the share of overall income coming from retirement sources grows over the next several decades, foregone revenue due to a retirement income tax exclusion would also increase. If revenue neutrality is to be maintained, income tax rates on all other types of income would need to be increased annually.

**Table 14: Calculation of Compensating
Income Tax Increase, 2010**

	State Income Tax Revenue	WAGI	Required Average Tax Rate
Current Policy	\$5,817,900,000	\$130,656,000,000	4.45%
Full Exclusion	\$5,817,900,000	\$118,691,000,000	4.90%
Percentage Increase over Current Average Rate			10.11%

Source: Wisconsin Department of Administration (2010)

Increasing the State Sales Tax Rate

Revenue losses might also be offset through an increase in the state sales tax. Currently set at 5 percent, the state sales tax accounted for nearly \$4 billion in General Purpose Revenue in 2010. To raise enough additional revenue to compensate fully for the \$473.3 million loss resulting from the retirement income tax exclusion, the state sales tax would have had to be raised to 5.6 percent.¹⁴

Budget Cuts to State Spending

Finally, revenue losses due to a full exclusion of retirement income might be offset by cuts to state spending. Based on total General Purpose Revenue expenditures of \$12.8 billion in 2010, the retirement exclusion would have required an across-the-board cut of 3.7 percent in general fund spending in that year (Wisconsin Department of Administration 2010). To illustrate the magnitude of spending cuts necessary to offset the revenue loss resulting from fully excluding retirement income from taxation, we calculated the percentage spending reduction that would have been necessary in 2010 had the entire revenue

¹⁴ This calculation assumes that the dollar value of sales is unaffected by the tax increase.

reduction been offset by spending cuts to a single state government program (see Table 15). If the offset came from spending cuts to K-12 School Aids alone, the budget for this program would have been reduced by 9.3 percent. If the offset came from Correctional Services, the program budget would have seen a 43.8 percent reduction. A targeted offset would have required the University of Wisconsin System to reduce its budget by 46.1 percent. If from Shared Revenue (funds distributed to local governments), a 58.3 percent budget reduction would have been necessary (Wisconsin Department of Administration 2010).

Table 15: Magnitude of Offsetting Spending Cuts to a Single State Government Program (2010)

GPR Program	FY 2010 Expenditure (\$Millions)	Spending Reduction for Policy Offset (\$ Millions)	% Reduction to Program Budget for Policy Offset
Shared Revenue	\$812.00	\$473.33	58.29%
UW System	\$1,027.40	\$473.33	46.07%
Correctional Services	\$1,080.40	\$473.33	43.81%
School Aids	\$5,092.70	\$473.33	9.29%

Source: Authors' calculations based on Wisconsin Department of Administration (2010) budget data

Opportunity Cost of Targeted Retirement Income Exclusion

Along with income tax revenue losses, any targeted tax cut carries an opportunity cost in the form of other types of tax cuts that could have been offered as alternatives. In this case, we compare the full exclusion of retirement income to an across-the-board tax cut on all types of income. To equal the same \$473.3 million figure for lost revenue in 2010, Wisconsin state income taxes could have been lowered by roughly 8.14 percent for all individuals. For reference, the individual income tax cut targeting the middle class proposed in Governor Walker's 2013-2015 budget is projected to cost \$172.6 million in fiscal year 2014 and \$170.6 million in fiscal year 2015, reducing the income tax liability of an average family by approximately 2 to 3 percent (Wisconsin Department of Administration 2013).

Summary

This report investigates the impacts of a full exclusion of retirement income from taxation in Wisconsin by exploring four main issues in the debate about taxing retirement income: (1) whether a full exclusion of retirement income from state taxation would decrease state out-migration and attract new elderly individuals to the Wisconsin; (2) a consideration of the distribution of tax benefits from a retirement income exclusion by income and age of taxpayers; (3) projecting the

fiscal cost of implementing a full tax exclusion of retirement income through 2040; and (4) a discussion of possible ways Wisconsin might offset the revenue losses generated by these tax preferences.

We provide a comprehensive review of the literature investigating the impact of state tax policies on late-life migration patterns. Overall, this literature suggests that state income tax preferences for older adults have limited or no impact on elderly interstate migration. Estimated revenue gains associated with avoiding state out-migration and attracting new elderly residents are far outweighed by projected revenue losses associated with extending these exemptions.

Next we explore the distributional implications of fully excluding retirement income from state taxation and illustrate the distributional burden of such a policy change. Our analysis concludes that further exemption of retirement income increases differences in intergenerational tax burden. This policy shifts the income tax burden primarily to working individuals and offers the greatest benefit to wealthier older adults with substantial retirement income. With the projected demographic changes resulting from a rapidly increasing aging population, a declining percentage of Wisconsin residents will be responsible for the majority of state revenue raised through the income tax. In addition, a tax preference targeted toward retaining middle-income and affluent elderly may be misplaced because the elderly represent a much smaller proportion of migrants leaving the state as compared to younger working-age adults.

We also estimate the tax revenue impact of fully excluding retirement income and projected revenue impacts of the policy through 2040. Our analysis estimates that, had the policy to exclude retirement income from taxation been in place in 2010, the state would have had \$473 million less in revenue that year, the equivalent of 8.14 percent of that year's actual income tax collections. We project that annual state revenue losses would grow to \$1.2 billion by 2040, amounting to a total loss of more than \$24 billion in state income tax revenue from 2014 to 2040.

Finally, to offset state revenue losses associated with full exclusion of retirement income from state taxation, we estimate that Wisconsin could (1) raise taxes on other sources of income by roughly 10 percent; (2) raise the state sales tax on goods and services from 5 to 5.6 percent; or (3) reduce overall state spending on General Purpose Revenue programs by 3.7 percent. Alternatively, the offset could be achieved by making cuts to a single state government program. If only K-12 School Aids were cut, a 9.3 percent reduction would be required. Other cuts to a single program would result in a 43.8 percent reduction to the Correctional Services budget, a 46.1 percent reduction to the University of Wisconsin System budget, or a 58.3 percent reduction in Shared Revenue distributed to local governments.

Appendix A: 2013 Wisconsin SB 82 Text and Fiscal Estimate

The text and fiscal estimate for Assembly Bill 97 are identical.



State of Wisconsin
2013 - 2014 LEGISLATURE



LRB-1175/1
MES:eev:ph

2013 SENATE BILL 82

March 13, 2013 - Introduced by Senators KEDZIE, LAZICH, LEIBHAM, TIFFANY and SCHULTZ, cosponsored by Representatives AUGUST, NASS, JACQUE, SANFELIPPO, TITTL, KESTELL, MURSAU, KERKMAN, T. LARSON, A. OTT, KAPENGA, BIES, LeMAHIEU, ENDSLEY, BROOKS and THIESFELDT. Referred to Committee on Workforce Development, Forestry, Mining, and Revenue.

- 1 **AN ACT** to amend 71.05 (1) (ae) (intro.), 71.05 (1) (am), 71.05 (1) (an), 71.05 (6)
- 2 (b) 4. and 71.83 (1) (a) 6.; and to create 71.05 (1) (af) of the statutes; relating
- 3 to: expanding and increasing the tax exemption for retirement plan income
- 4 received by an individual.

Analysis by the Legislative Reference Bureau

Under current law, the pension benefits of certain public employees are exempt from state taxation. The pensions that are exempt include payments received from the U.S. Civil Service Retirement System, the U.S. Military Employee Retirement System, the Milwaukee City and County Retirement Systems, the Police Officer's Annuity and Benefit Fund of Milwaukee, the Milwaukee Public School Teachers' Retirement Fund, the Wisconsin State Teachers' Retirement Fund, and the Sheriff's Annuity and Benefit Fund of Milwaukee County. For most of these pension plans, the exemption applies only to persons who were members of or retired from the plans as of December 31, 1963, although this limitation does not apply to retirement payments received from the U.S. Military Employee Retirement System or from payments received from the U.S. government that relate to service with the U.S. Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, or the commissioned corps of the U.S. Public Health Service.

Also under current law, up to \$5,000 of payments or distributions received by certain individuals from a qualified retirement plan under the Internal Revenue Code, or from certain individual retirement accounts, are exempt from taxation. To

SENATE BILL 82

be eligible, the individual must be at least 65 years old and have federal adjusted gross income (FAGI) of less than \$15,000, or less than \$30,000 if married.

Under this bill, the \$5,000 exemption for certain individuals who are at least 65 years old and have limited FAGI applies only for taxable years 2009 to 2014. Beginning with taxable year 2015, the \$5,000 exemption for payments or distributions received from a qualified retirement plan or from certain individual retirement accounts may still be claimed, to the extent that such amounts are not already exempt from taxation, but the exemption is not limited to individuals who are at least 65 years old and have FAGI of less than \$15,000, or less than \$30,000 if married. Under the bill, the exemption amount increases from \$5,000 to \$10,000 in 2016, to \$15,000 in 2017, and to \$20,000 in 2018 and thereafter.

Because this bill relates to an exemption from state or local taxes, it may be referred to the Joint Survey Committee on Tax Exemptions for a report to be printed as an appendix to the bill.

For further information see the *state* fiscal estimate, which will be printed as an appendix to this bill.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

- 1 **SECTION 1.** 71.05 (1) (ae) (intro.) of the statutes is amended to read:
- 2 71.05 (1) (ae) *Pension, individual retirement income.* (intro.) Except for a
- 3 payment that is exempt under par. (a), (am), or (an), or that is exempt as a railroad
- 4 retirement benefit, for taxable years beginning after December 31, 2008, and before
- 5 January 1, 2015, up to \$5,000 of payments or distributions received each year by an
- 6 individual from a qualified retirement plan under the Internal Revenue Code or from
- 7 an individual retirement account established under 26 USC 408, if all of the
- 8 following conditions apply:
- 9 **SECTION 2.** 71.05 (1) (af) of the statutes is created to read:
- 10 71.05 (1) (af) *Pension income.* Except for a payment that is exempt under par.
- 11 (a), (am), or (an), or that is exempt as a railroad retirement benefit, one of the
- 12 following amounts of payments or distributions received each year by an individual

SENATE BILL 82

1 from a qualified retirement plan under the Internal Revenue Code or from an
2 individual retirement account established under 26 USC 408:

3 1. For taxable years beginning after December 31, 2014, and before January
4 1, 2016, \$5,000.

5 2. For taxable years beginning after December 31, 2015, and before January
6 1, 2017, \$10,000.

7 3. For taxable years beginning after December 31, 2016, and before January
8 1, 2018, \$15,000.

9 4. For taxable years beginning after December 31, 2017, \$20,000.

10 **SECTION 3.** 71.05 (1) (am) of the statutes is amended to read:

11 71.05 (1) (am) *Military retirement systems.* All retirement payments received
12 from the U.S. military employee retirement system, to the extent that such payments
13 are not exempt under par. (a) ~~or~~ (ae), or (af).

14 **SECTION 4.** 71.05 (1) (an) of the statutes is amended to read:

15 71.05 (1) (an) *Uniformed services retirement benefits.* All retirement payments
16 received from the U.S. government that relate to service with the coast guard, the
17 commissioned corps of the national oceanic and atmospheric administration, or the
18 commissioned corps of the public health service, to the extent that such payments are
19 not exempt under par. (a), (ae), (af), or (am).

20 **SECTION 5.** 71.05 (6) (b) 4. of the statutes is amended to read:

21 71.05 (6) (b) 4. Disability payments other than disability payments that are
22 paid from a retirement plan, the payments from which are exempt under sub. (1) (ae),
23 (af), (am), and (an), if the individual either is single or is married and files a joint
24 return, to the extent those payments are excludable under section 105 (d) of the
25 Internal Revenue Code as it existed immediately prior to its repeal in 1983 by section

SENATE BILL 82**SECTION 5**

1 122 (b) of P.L. 98-21, except that if an individual is divorced during the taxable year
2 that individual may subtract an amount only if that person is disabled and the
3 amount that may be subtracted then is \$100 for each week that payments are
4 received or the amount of disability pay reported as income, whichever is less. If the
5 exclusion under this subdivision is claimed on a joint return and only one of the
6 spouses is disabled, the maximum exclusion is \$100 for each week that payments are
7 received or the amount of disability pay reported as income, whichever is less.

8 **SECTION 6.** 71.83 (1) (a) 6. of the statutes is amended to read:

9 71.83 (1) (a) 6. 'Retirement plans.' Any natural person who is liable for a
10 penalty for federal income tax purposes under section 72 (m) (5), (q), (t), and (v), 4973,
11 4974, 4975, or 4980A of the Internal Revenue Code is liable for 33% of the federal
12 penalty unless the income received is exempt from taxation under s. 71.05 (1) (a) ~~or~~,
13 (ae), or (af). The penalties provided under this subdivision shall be assessed, levied,
14 and collected in the same manner as income or franchise taxes.

15 (END)

Fiscal Estimate - 2013 Session

☒ Original ☐ Updated ☐ Corrected ☐ Supplemental

LRB Number 13-1175/1	Introduction Number SB-082
Description Expanding and increasing the tax exemption for retirement plan income received by an individual	
Fiscal Effect	
State: ☐ No State Fiscal Effect ☐ Indeterminate ☐ Increase Existing Appropriations ☐ Decrease Existing Appropriations ☐ Create New Appropriations ☐ Increase Existing Revenues ☒ Decrease Existing Revenues ☒ Increase Costs - May be possible to absorb within agency's budget ☒ Yes ☐ No ☐ Decrease Costs	
Local: ☐ No Local Government Costs ☐ Indeterminate 1. ☐ Increase Costs ☐ Permissive ☐ Mandatory 2. ☐ Decrease Costs ☐ Permissive ☐ Mandatory 3. ☐ Increase Revenue ☐ Permissive ☐ Mandatory 4. ☐ Decrease Revenue ☐ Permissive ☐ Mandatory 5. Types of Local Government Units Affected ☐ Towns ☐ Village ☐ Cities ☐ Counties ☐ Others ☐ School Districts ☐ WTCS Districts	
Fund Sources Affected Affected Ch. 20 Appropriations ☒ GPR ☐ FED ☐ PRO ☐ PRS ☐ SEG ☐ SEGS	
Agency/Prepared By DOR/ Bradley Caruth (608) 261-8984	Authorized Signature John Koskinen (608) 267-8973 Date 4/1/2013

Fiscal Estimate Narratives
DOR 4/1/2013

LRB Number	13-1175/1	Introduction Number	SB-082	Estimate Type	Original
Description					
Expanding and increasing the tax exemption for retirement plan income received by an individual					

Assumptions Used in Arriving at Fiscal Estimate

Under current law, pensions received by persons who were members of or retired from Milwaukee City and county retirement funds, the state teachers' retirement fund, and the civil service retirement system prior to January 1, 1964 are exempt from Wisconsin income tax. In addition, veterans' pensions are exempt from Wisconsin income tax.

Also under current law, up to \$5,000 of payments or distributions from a qualified retirement plan or individual retirement account (IRA) is exempt from taxation if the claimant is at least 65 years of age and the claimant has federal adjusted gross income of less than \$15,000 in the year to which the claim relates (\$30,000 for married joint filers).

Beginning in tax year 2015, this bill eliminates the current age and income restrictions that are part of the \$5,000 exemption for payments or distributions from a qualified retirement plan or IRA. In tax year 2016, the bill also allows individuals to exclude up to \$10,000 of qualified retirement income. In 2017, the allowable exclusion is further increased to \$15,000. In 2018 and thereafter, the allowable exclusion is \$20,000.

Based on simulations using 2010 individual income tax returns, inflated for income levels and law, the new exemption will reduce revenue by approximately \$42 million in fiscal year 2015, \$199 million in fiscal year 2016, \$318 million in fiscal year 2017, \$413 million in fiscal year 2018, and \$480 million annually beginning in fiscal year 2019.

Long-Range Fiscal Implications

Appendix B: Income Tax Preferences for Older Adults, 2011

Table B 1 details the range of income tax preferences for all 50 states, including Social Security, various types of pension income, an age-based deduction, and an age-based exemption or credit. With the exception of Michigan, the state tax preferences in this table represent the policies in place during 2012. Michigan's tax preferences are updated to reflect the income tax changes for retirement benefits effective for tax year 2012. Any other changes in state tax preferences for older adults since tax year 2011 are not included in this table.

In 2011, states and the District of Columbia had state individual income tax. Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—did not tax residents' income. New Hampshire and Tennessee taxed only unearned income such as interest and dividends.

Table B 1: Income Tax Preferences for Older Adults, 2011

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Alabama	Exempt	Defined benefit plans exempt	Most plans exempt	Exempt	Exempt		
Alaska	No State Income Tax						
Arizona	Exempt	None	Up to \$2,500	Up to \$2,500	Up to \$2,500		\$2,100
Arkansas	Exempt	Up to \$6,000	Up to \$6,000	Up to \$6,000	Up to \$6,000		\$23
California	Exempt	Taxed	Taxed	Taxed	Taxed		\$102

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Colorado	Up to \$24,000 total from Social Security and pensions	Up to \$24,000 total from Social Security and pensions	Up to \$24,000 total from Social Security and pensions	Up to \$24,000 total from Social Security and pensions	Up to \$24,000 total from Social Security and pensions	Federal- \$1,450 single; \$1,150 each spouse	
Connecticut	Exempt with income limitation	Taxed	Taxed	Taxed	50% exempt		
Delaware	Exempt	Up to \$12,500	Up to \$12,500	Up to \$12,500	Up to \$12,500	\$2,500	\$110 tax credit
Florida	No state income tax						
Georgia	Exempt	Up to \$35,000	Up to \$35,000	Up to \$35,000	Up to \$35,000	\$1,300	
Hawaii	Exempt	Exempt if employer funded	Exempt	Exempt	Exempt		\$1,040
Idaho	Exempt	Taxed	Up to \$27,876 for certain pensions less Social Security income	Up to \$27,876 for certain pensions less Social Security income	Up to \$27,876 for certain pensions less Social Security income	Federal- \$1,450 single; \$1,150 each spouse	

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Illinois	Exempt	Exempt if from qualified employee benefit plan or self-employed retirement plan	Exempt	Exempt	Exempt		\$1,000
Indiana	Exempt	Taxed	Taxed	Up to \$2,000	Up to \$5,000		\$1,000
Iowa	Exempt in 2014	Up to \$6,000	Up to \$6,000	Up to \$6,000	Up to \$6,000		\$20
Kansas	Exempt with income limitation, above limitation same as federal (up to 85% taxed)	Taxed	Certain plans exempt	Exempt	Exempt	\$850	
Kentucky	Exempt	Up to \$41,100	Exempt if retired before 1998, partial after 1997	Exempt if retired before 1998, partial after 1997	Exempt if retired before 1998, partial after 1997		\$40
Louisiana	Exempt	Up to \$6,000	Certain plans exempt, otherwise same as private	Exempt	Exempt		\$1,000

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Maine	Exempt	Up to \$6,000 less Social Security and railroad retirement benefits	Up to \$6,000 less Social Security and railroad retirement benefits	Up to \$6,000 less Social Security and railroad retirement benefits	Up to \$6,000	\$1,450	
Maryland	Exempt	Up to \$26,300	Up to \$26,300	Up to \$26,300	Up to \$26,300		\$1,000
Massachusetts	Exempt	Taxed	Contributory plan payments exempt	Contributory plan payments exempt	Exempt		\$700
Michigan	Exempt	Up to \$20,000 single; \$40,000 married filing joint	Up to \$20,000 single; \$40,000 married filing joint	Up to \$20,000 single; \$40,000 married filing joint	Exempt		
Minnesota	Up to 85% taxed	Taxed	Taxed	Taxed	Taxed	\$1,450 or \$2,300 for married filing joint	Additional exemptions
Mississippi	Exempt	Exempt	Exempt	Exempt	Exempt		\$1,500
Missouri	Up to 80% exempt	Up to \$6,000	Exclude greater of 80% or \$6,000	Exclude greater of 80% or \$6,000	30% exempt reduced by public pension exemption	Federal-\$1,450 single; \$1,150 each spouse	

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Montana	State calculation of taxable amount	Up to \$3,760 subject to income limitation	Up to \$3,760 subject to income limitation	Up to \$3,760 subject to income limitation	Up to \$3,760 subject to income limitation		\$2,190
Nebraska	Up to 85% taxed	Taxed	Taxed	Taxed	Taxed	Federal- \$1,450 single; \$1,150 each spouse	
Nevada	No state income tax						
New Hampshire	Exempt	Exempt	Exempt	Exempt	Exempt		\$1,200
New Jersey	Exempt	Up to \$15,000	Up to \$15,000	Up to \$15,000	Up to \$15,000		\$1,000
New Mexico	Up to 85% taxed	Up to \$8,000 exempt from all income sources with income limitation	Up to \$8,000 exempt from all income sources with income limitation	Up to \$8,000 exempt from all income sources with income limitation	Up to \$8,000 exempt from all income sources with income limitation	Federal- \$1,450 single; \$1,150 each spouse	
New York	Exempt	Up to \$20,000	Exempt	Exempt	Exempt		
North Carolina	Exempt	First \$2,000 excluded	First \$4,000 excluded, certain pensions exempt	First \$4,000 excluded, certain pensions exempt	First \$4,000 excluded, certain pensions exempt	\$750	

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Tennessee	Exempt	Exempt	Exempt	Exempt	Exempt		Exempt from taxation if older than 65 and total gross income less than \$16,200
Texas	No State Income Tax						
Utah	Up to 85% taxed	Taxed	Taxed	Taxed	Taxed	Federal- \$1,450 single; \$1,150 each spouse	
Vermont	Up to 85% taxed	Taxed	Taxed	Taxed	Taxed	Federal- \$1,450 single; \$1,150 each spouse	
Virginia	Exempt	Taxed	Taxed	Taxed	Exempt with a Congressional Medal of Honor		\$800
Washington	No state income tax						
West Virginia	Up to 85% taxed	Taxed	Up to \$2,000; law enforcement and firemen pensions exempt	Up to \$2,000	Up to \$22,000		

State	Social Security	Pensions				Age-Based Deduction	Age-Based Exemption or Credit
		Private	State and Local	Federal Civilian	Military		
Wisconsin	Exempt	Up to \$5,000 subject to income limitation	Up to \$5,000 subject to income limitation	Up to \$5,000 subject to income limitation	Exempt		\$250
Wyoming	No state income tax						

Source: Olin 2012

Appendix C: Tax Preferences for Older Adults in Neighboring States, 2012

Table C 1 details retirement tax preferences offered at the federal level, in Wisconsin, and in five of its neighboring states.

Table C 1: Wisconsin Income Tax Preferences for Older Adults Compared to Federal Tax Treatment and Neighboring States

	Federal	Wisconsin	Illinois	Indiana	Iowa	Michigan	Minnesota
Social Security	Up to 85% taxed ^a	Exempt	Exempt	Exempt	Exempt in 2014 ^b	Exempt	Up to 85% taxed ^c
Private Pensions	Taxed	Up to \$5,000 ^d	Exempt	Taxed	Up to \$6,000	Up to \$20,000 single; \$40,000 married filing joint ^e	Taxed
State and Local Pensions	Taxed	Up to \$5,000 ^f	Exempt	Taxed	Up to \$6,000	Up to \$20,000 single; \$40,000 married filing joint ^e	Taxed
Federal Civilian Pensions	Taxed	Up to \$5,000 ^f	Exempt	Up to \$2,000 ^g	Up to \$6,000	Up to \$20,000 single; \$40,000 married filing joint ^e	Taxed
Military Pensions	Taxed	Exempt	Exempt	Up to \$5,000 ^h	Up to \$6,000	Exempt	Taxed
Age-Based Deduction, Exemption, or Credit	\$1,450 single; \$1,150 each spouse and a tax credit ⁱ	\$250	\$1,000	\$1,000	\$20	\$0	\$1,450 single; \$2,300 married filing joint; additional subtractions ^j

a Eighty-five percent of benefits are taxed for provisional incomes above \$34,000 (\$44,000 for married joint). Fifty percent are taxed for provisional incomes between \$25,000 and \$34,000 (\$32,000 and \$44,000 for married joint). Social Security benefits are exempt for provisional incomes less than \$25,000 (\$32,000 for married joint).

b Twenty-three percent taxable in 2012, 11 percent taxable in 2013, and exempt from 2014 onward.

c Same as federal.

d Subject to income limitation (65 and older).

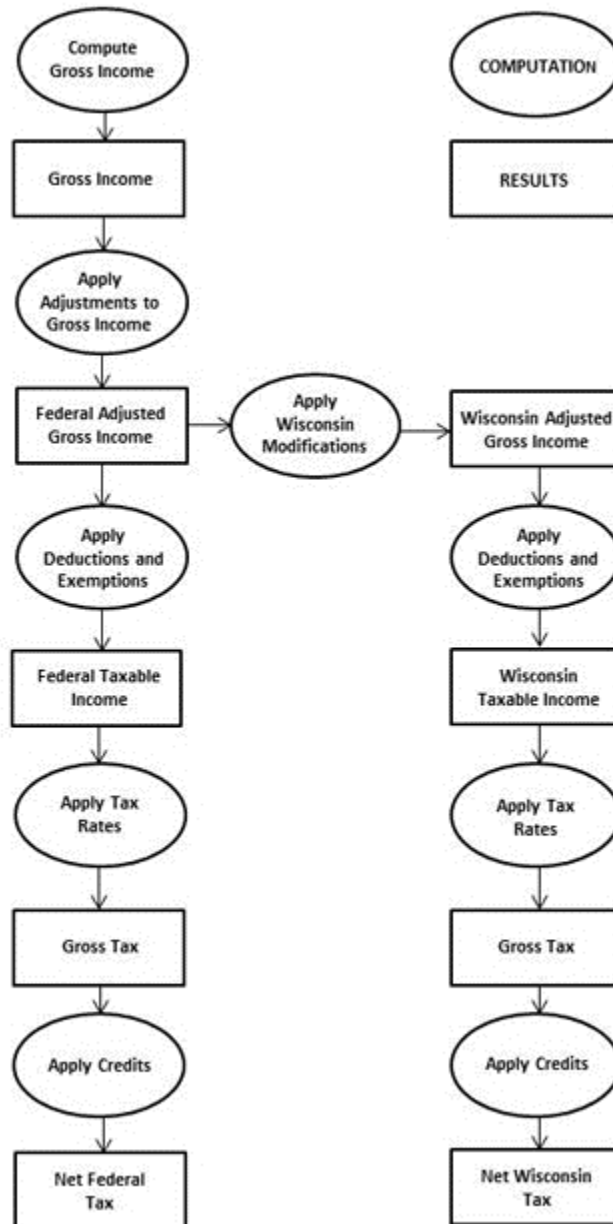
- e Legislation that took effect in the 2012 tax year phases out certain pension and retirement income subtractions based on date of birth. Prior to the legislation, all military pensions, federal civil service pensions, and state and local pensions were exempt, and private pension income was exempt up to \$47,309 (single or married filing separate) or \$94,618 (married filing jointly). After the legislation, military pensions, Social Security benefits and railroad retirement benefits continue to be exempt from taxation. Taxpayers born before 1946 did not face any changes in the taxation of their pension and retirement income. For taxpayers born between January 1, 1946, and December 31, 1952, retirement income up to \$20,000 for single filers and \$40,000 for joint filers is not taxed. Once people in this age group turn 67 they qualify for a senior income exemption of \$20,000 for a single filer and \$40,000 for joint filers, regardless of income source. This exemption is in addition to the exemption for Social Security and personal exemption. For individuals born after 1952, all retirement income is taxed. Once adults in this age group turn 67 they qualify for a senior income exemption of \$20,000 for a single filer and \$40,000 for joint filers, regardless of income source. If a filer's Social Security exemption plus personal exemption is more than the senior income exemption, the filer takes the better of the two options.
- f Subject to income limitation (65 and older); however, full exclusion if member of certain systems prior to 1964.
- g Less Social Security benefits (62 and older).
- h Ages 60 and older.
- i Tax credit equaled 15 percent of the applicable base amount reduced by nontaxable Social Security or other tax-free retirement benefits and one half of the Federal Adjusted Gross Income exceeding a threshold amount. The Federal Adjusted Gross Income threshold amounts depend on filing status as follows: \$7,500 for single, head of household, or qualified widow(er); \$10,000 for married filing jointly; and \$5,000 for a spouse, who lived apart from the other spouse at all times during the entire tax year, and who filed a separate return.
- j Minnesota residents ages 65 and older with an adjusted gross income of less than \$33,700 (\$38,500 for married filing joint) and combined railroad retirement and nontaxable Social Security benefits less than \$9,600 (\$12,000 for married filing joint) are eligible for additional subtractions.

Source: Olin 2012.

Appendix D: Computation of WAGI Flow Chart

Figure D 1 displays the step-by-step process by which Net Federal Tax and Net Wisconsin Tax are calculated. Within this larger process is the process resulting in the calculation of WAGI.

Figure D 1: Computation of Federal and Wisconsin State Tax



Source: Wisconsin Department of Revenue Division of Research and Policy (2006)

Appendix E: Yearly Average Interstate Migration by Age Group in Minnesota and Michigan

Tables E 1 and E 2 display information on average interstate migration rates for two of Wisconsin's neighboring states, Minnesota and Michigan. Data are broken down by age group, starting at age 20. Data are provided from ages 20 to 34 and ages 55 and older to compare these data to similar interstate migration rates in Wisconsin (see Table 4 of this report). Individuals ages 75 and older are categorized together.

Table E 1: Minnesota Yearly Average Interstate Migration by Age Group (2007-11)

Age Group	Number of Minnesota Out-Migrants	Out-Migrants as a Percentage of Age Group	Number of Minnesota In-Migrants	In-Migrants as a Percentage of Age Group	Population Loss/Gain Due to Migration
20 to 24	21,977	6.15%	17,616	4.92%	-4,361
25 to 29	15,254	4.19%	15,157	4.12%	-97
30 to 34	9,546	2.84%	9,407	2.78%	-139
55 to 59	3,249	0.96%	2,960	0.87%	-289
60 to 64	3,319	1.22%	2,121	0.78%	-1,198
65 to 69	2,516	1.28%	1,340	0.68%	-1,176
70 to 74	1,281	0.86%	873	0.59%	-408
75 and older	2,236	0.68%	2,389	0.73%	153

Source: Authors' calculations based on U.S. Census Bureau (2011b) American Community Survey five-year migration data (2007-2011)

Table E 2: Michigan Yearly Average Interstate Migration by Age Group (2007-11)

Age Group	Number of Michigan Out-Migrants	Out-Migrants as a Percentage of Total Age Group	Number of Michigan In-Migrants	In-Migrants as a Percentage of Age Group	Population Loss/Gain Due to Migration
20 to 24	33,436	4.91%	18,358	2.73%	-15,078
25 to 29	25,848	4.31%	16,953	2.84%	-8,895
30 to 34	18,042	3.10%	11,358	1.96%	-6,684
55 to 59	7,663	1.14%	4,222	0.63%	-3,441
60 to 64	7,159	1.30%	3,456	0.63%	-3,703
65 to 69	3,734	0.93%	2,251	0.56%	-1,483
70 to 74	2,852	0.93%	1,334	0.44%	-1,518
75 and older	5,006	0.79%	3,462	0.54%	-1,544

Source: Authors' calculations based on U.S. Census Bureau (2011b), American Community Survey five-year migration data (2007-2011)

Appendix F: Flow of Tax Returns In and Out of Wisconsin (2004-2010)

Table F 1 details annual state-to-state migration outflows from Wisconsin by individual tax return to the top 10 destination states from 2004 to 2010. Over this six-year period, Minnesota and Illinois remain consistently the top two destination states for movers from Wisconsin. Florida consistently ranks third, but receives fewer of Wisconsin's out-migrants than do the top two states. In general, migration patterns remain relatively stable during the time period displayed in this table.

Table F 1: Wisconsin State-to-State Annual Migration Outflows by Individual Tax Return (Top Ten Destination States)

2009-2010		2008-2009		2007-2008		2006-2007		2005-2006		2004-2005	
States	Returns	States	Returns	States	Returns	States	Returns	States	Returns	States	Returns
Minnesota	6,379	Minnesota	7,326	Minnesota	7,611	Minnesota	7,560	Minnesota	7,704	Minnesota	7,170
Illinois	6,218	Illinois	6,888	Illinois	7,383	Illinois	7,150	Illinois	7,011	Illinois	6,551
Florida	2,936	Florida	3,030	Florida	3,056	Florida	3,213	Florida	3,722	Florida	3,880
Texas	2,716	California	2,769	California	2,953	California	2,804	California	2,933	California	2,680
California	2,606	Texas	2,750	Texas	2,608	Texas	2,418	Arizona	2,166	Arizona	2,081
Michigan	1,827	Arizona	1,963	Arizona	2,018	Arizona	2,106	Texas	2,115	Texas	2,074
Arizona	1,692	Michigan	1,818	Michigan	1,976	Michigan	1,909	Michigan	1,946	Michigan	1,987
Colorado	1,431	Iowa	1,505	Iowa	1,497	Colorado	1,388	Iowa	1,380	Colorado	1,319
Iowa	1,361	Colorado	1,483	Colorado	1,467	Iowa	1,386	Colorado	1,367	Iowa	1,316
N. Carolina	975	N. Carolina	1,152	N. Carolina	1,122	N. Carolina	1,091	N. Carolina	1,070	N. Carolina	1,011
Total	28,141		30,684		31,691		31,025		31,414		30,069

Source: Internal Revenue Service Statistics of Income (2012) Migration Data from 2004-2010

Table F 2 details annual state-to-state migration inflows to Wisconsin by individual tax return to the top ten origin states from 2004 to 2010. During this six-year period, Minnesota and Illinois remain consistently the top two origin states for movers to Wisconsin. Michigan consistently ranks third but provides far fewer of Wisconsin's in-migrants than do the top two states. In general, migration patterns remain relatively stable during the time period displayed in this table.

Table F 2: Wisconsin State-to-State Annual Migration Inflows by Individual Tax Return (Top Ten Origin States)

2009-2010		2008-2009		2007-2008		2006-2007		2006-2007		2004-2005	
States	Returns	States	Returns	States	Returns	States	Returns	States	Returns	States	Returns
Illinois	7,349	Illinois	8,114	Illinois	8,698	Illinois	8,960	Illinois	9,162	Illinois	9,167
Minnesota	5,806	Minnesota	6,272	Minnesota	6,819	Minnesota	6,592	Minnesota	7,055	Minnesota	7,064
Michigan	2,225	Michigan	2,742	Michigan	2,896	Michigan	2,699	Michigan	2,566	Michigan	2,560
California	2,057	California	2,309	Florida	2,414	Florida	2,336	California	2,492	California	2,437
Florida	1,923	Florida	2,250	California	2,362	California	2,335	Florida	2,371	Florida	2,066
Texas	1,517	Texas	1,566	Texas	1,634	Texas	1,674	Texas	1,668	Texas	1,593
Iowa	1,200	Iowa	1,362	Iowa	1,441	Iowa	1,338	Iowa	1,366	Iowa	1,292
Arizona	1,103	Arizona	1,311	Arizona	1,299	Arizona	1,215	Arizona	1,169	Arizona	1,104
Indiana	906	Indiana	1,098	Ohio	1,131	Ohio	1,020	Indiana	1,036	Indiana	1,012
New York	872	Ohio	999	Colorado	922	Indiana	1,009	Ohio	972	Colorado	997
Total	24,958		28,023		29,616		29,178		29,857		29,292

Source: Internal Revenue Service (2012) Statistics of Income Migration Data from 2004-2010

Table F 3 provides data on total tax return inflows to and outflows from the state of Wisconsin during a six-year period from 2004 to 2010. There is a very small net outflow of tax returns from Wisconsin state each year.

Table F 3: Wisconsin State-to-State Migration Flows by Individual Tax Return (All States)

	2009-2010	2008-2009	2007-2008	2006-2007	2005-2006	2004-2005
Total Tax Return Outflow	43,781	47,229	49,104	47,722	48,084	46,057
Total Tax Return Inflow	37,112	41,507	43,545	42,498	43,408	42,171

Source: Internal Revenue Service Statistics of Income (2012) Migration Data from 2004-2010

Appendix G: Additional Evidence on the Relationship between State Tax Policy and Interstate Migration

This appendix discusses estate, inheritance, and gift taxes and a “millionaire tax.”

The Impact of Estate, Inheritance, and Gift Taxes on Late-Life Interstate Migration

Public discourse around estate, inheritance, and gift (EIG) taxes often centers on the question of whether wealthy older adults move out of state to avoid paying these state “death” taxes. In the small body of research considering this question, state EIG taxes have often been included as one of a number of policy variables studied in relation to interstate moves. As a whole, findings of earlier studies provide limited support for the idea that older adults move out of state to avoid EIG taxes (Clark and Hunter 1992; Conway and Houtenville 2001, 2003; Voss, Gunderson, and Manchin 1988). The credibility of these earlier findings is questionable, however, due to methodological limitations associated with the use of cross-sectional data that produce counter-intuitive results, such as the finding that states with high crime rates tend to be associated with high rates of in-migration (Conway and Houtenville 2003).

A study by Bakija and Slemrod (2004) corrects for many of these methodological challenges using panel data rather than cross-sectional analysis. This study employs 18 years of panel data (between 1965 to 1998) from federal estate tax return filings categorized by state and wealth-class to study the impact of state EIG and retirement income taxes the migration decisions of the affluent elderly. Results suggest that EIG taxes in particular discourage affluent older adults from relocating to a state. This study is limited, however, by the initial assumption that state in-migration is represented by a growth in the number of estates. Inaccuracies in this assumption may result from individuals engaging in activities that may be mistaken for migration in the data, such as changing wealth accumulation behavior in response to taxes or avoiding state taxes by switching their primary legal residence and thereby “pretending” to live in a different state. Furthermore, the construction of high-income wealth classes used in this study may exclude upper middle-class older adults subject to the state but not the federal EIG tax. Although the study finds some evidence that very wealthy older adults may change their real or reported state to avoid paying state EIG taxes, the revenue loss associated with this effect is negligible relative to the revenue gained from this tax.

A study by Conway and Rork (2006) builds upon the Bakija and Slemrod study by expanding the analysis to evaluate the impact of EIG taxes on older adults of all income levels, using migration patterns of younger residents as a “pseudo-control” group. This study uses panel data spanning a 40-year period during which a number of states and the federal government reduced EIG taxes. Results of this study provide evidence that state EIG policies have no overall impact on

elderly migration. In fact, the authors instead find limited support for the possibility that elderly in-migration to a state may instead result in EIG tax reduction. Methodological improvements over earlier research makes this study, along with the study by Bakija and Slemrod (2004), the most compelling evidence to date regarding the relationship (or lack thereof) between state EIG taxes and elderly interstate migration.

Effects of a State Millionaire Tax on Interstate Migration

Since 2003, eight states have enacted a “millionaire tax” to raise the tax on income for a state’s highest wealth group. Although studies investigating the impact of a state millionaire tax on migration behaviors are not focused specifically on late-life migration, the findings of these studies may suggest patterns that could apply to wealthy migrants from any age group. In 2004, the state of New Jersey introduced a new tax bracket for highest earners that raised the marginal tax rate by 2.6 percent on individuals with incomes greater than \$500,000. Young and Varner (2011) took advantage of this policy change to conduct a natural experiment, looking for evidence of an observable effect of the tax change on the migration patterns of New Jersey millionaires. The study employs a difference in differences model, constructing a comparison group from high income New Jersey taxpayers not subject to the new tax (those with incomes between \$200,000 and \$500,000). The study finds minimal evidence of changing patterns of migration in response to the tax and concludes that overall, state out-migration of wealthy New Jersey taxpayers does not appear to increase in response to the tax increase.

An analysis by Lai, Cohen, and Steindel (2011) at the New Jersey Department of the Treasury critiques Young and Varner (2011) and reanalyze New Jersey’s millionaire tax on interstate migration. They argue that the study by Young and Varner used too brief a study period (three years), was restricted to only New Jersey, and did not consider housing costs, all of which limited the scope of their findings. As an alternative, using aggregated Internal Revenue Service interstate migration flow data and the National Bureau of Economic Research TAXSIM series on state marginal tax rates, Lai, Cohen, and Steindel estimate an overall population response to an increase in the marginal tax rate, finding a small but significant effect on migration decisions. Immediate losses are small in comparison to the revenue gain from the tax increase. The authors caution, however, that these losses are cumulative and may, over time, offset a more meaningful share of the revenue increase.

A second study by Young and Varner (2012) uses individual income tax return data from 1992 through 2009 to investigate the impact of California’s 2005 millionaire tax on the interstate migration behavior of the state’s wealthiest taxpayers. Similar to the New Jersey findings, enactment of the 2005 California legislation did not cause tax flight among wealthy state taxpayers. In fact, contrary to economic theory, state out-migration actually declined among those subject to the tax in the years following its passage.

Appendix H: Description of Department of Revenue Data

The Wisconsin Department of Revenue provided us with unpublished tax data for the 2010 tax year. These data are described as follows:

Each year, the Internal Revenue Service sends the Wisconsin Department of Revenue federal tax return data received from filers with Wisconsin addresses. This includes data from the tax return (1040, 1040A, 1040EZ), some supporting schedules (A, B, C, D, E, F, for example), and informational returns (W-2s, 1099-G, 1099-Misc, 1099-R, etc.).

DOR started with 2010 state returns of residents, excluding non-residents, part-year residents, and returns with missing information. These returns were matched with federal returns to identify the specific sources of income, which are not as fully separated on the state returns. The resulting dataset includes 2,509,000 returns.

Gross income combines federal total income (line 22 of the federal 1040 form), tax exempt interest (line 8b of the 1040), non-taxable Social Security (line 20a of the 1040), and a portion of non-taxable IRA distributions, pensions, and annuities (lines 15a and 16a of the 1040). IRA rollovers, as determined by form 1099-R, are not included in gross income.

The returns are divided into five income categories (quintiles) based on the filers' calculated gross income. Each quintile is then split into age categories consisting of: younger than 20, 20 to 24, 25 to 29, 30 to 34, 35 to 39, 40 to 44, 45 to 49, 50 to 54, 55 to 59, 60 to 64, 65 to 69, 70 to 74, 75 to 84, and 84 and older. For married filers, if the spouses did not fall into the same age category, half the return is counted in each age category. For example, if one spouse was 65 and one spouse was 64, half of their income is in the 60 to 64 category and half of their income is in the 65 to 69 category. Moreover, they count as half of a return in the 60 to 64 category and half of a return in the 65 to 69 category.

Appendix I: Projected Foregone Revenue from Retirement Income Exclusion

Table I 1 displays projected revenue foregone as a result of a full exclusion of retirement income from Wisconsin state taxation through 2040. Not all years are represented; however, the calculation for total foregone revenue 2014-2040 includes all years, both displayed and omitted.

Table I 1: Projected Foregone Revenue from Retirement Income Exclusion (in thousands of dollars)

Age Range	2014	2015	2020	2025	2030	2035	2040	Total Foregone Revenue 2014-2040 (including years not shown)
Less than 20	\$141	\$143	\$160	\$180	\$202	\$225	\$245	\$5,140
20-29	\$3,197	\$3,246	\$3,601	\$3,932	\$4,420	\$4,815	\$5,185	\$112,244
30-39	\$14,595	\$14,923	\$17,459	\$19,646	\$21,655	\$23,497	\$25,711	\$547,245
40-49	\$31,432	\$31,080	\$33,393	\$39,107	\$45,553	\$50,550	\$54,359	\$1,129,570
50-59	\$126,887	\$130,742	\$138,292	\$136,019	\$144,356	\$167,465	\$194,977	\$4,031,796
60-64	\$138,998	\$145,843	\$178,676	\$196,991	\$191,046	\$196,823	\$226,104	\$5,069,080
65-69	\$99,759	\$106,308	\$139,481	\$172,351	\$190,531	\$185,002	\$190,772	\$4,423,837
70-74	\$68,406	\$71,882	\$103,618	\$137,305	\$170,346	\$188,839	\$183,782	\$3,829,546
75-84	\$66,830	\$68,198	\$86,553	\$122,477	\$169,731	\$218,274	\$256,408	\$4,013,503
85 and older	\$16,683	\$17,226	\$19,612	\$23,387	\$30,752	\$44,416	\$62,695	\$844,201
All ages	\$566,928	\$589,590	\$720,845	\$851,395	\$968,592	\$1,079,907	\$1,200,238	\$24,006,162

Source: Authors' calculations based on data provided by the Wisconsin Department of Revenue, IHS Global Insight consumer price index projections, and Applied Population Laboratory projections

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