Louisiana Income Taxes and Senior Citizens

State governments provide a wide array of tax breaks for their elderly residents. Almost every state levying an income tax now allows some form of income tax exemption or credit for its over-65 citizens that is unavailable to non-elderly taxpayers. But many states have enacted poorly-targeted, unnecessarily expensive elderly tax breaks that make state tax systems less sustainable and less fair. This policy brief discusses Louisiana’s income tax treatment of seniors in the context of other states’ income tax laws.

The Starting Point: Federal Income Tax Breaks for the Elderly

Most states (including Louisiana) base their income tax on federal rules: the starting point in calculating a taxpayer’s taxable income for state purposes is usually the amount of taxable income reported on federal tax forms. This makes the process of filing and administering state income taxes much simpler for taxpayers and state tax administrators, but also means that states automatically allow some of these federal tax breaks to reduce state tax collections. Federal tax law provides two substantial tax breaks to elderly taxpayers:
- A larger standard deduction. An under-65 married couple gets a $10,000 standard deduction in 2005; an elderly couple receives an extra $1,000 for each over-65 spouse. (Louisiana does not allow this deduction.)
- A partial exemption for Social Security benefits. Seniors with incomes below $25,000 ($32,000 for married couples) pay no tax on Social Security benefits. (Louisiana conforms to this federal tax break, and actually goes beyond it by exempting all Social Security benefits.)

Most States Offer Additional Elderly Tax Breaks

Virtually every state conforms to at least one of the federal government’s elderly tax breaks. All 42 states that levy broad-based income taxes follow the federal exemption for Social Security benefits, and 10 states allow their seniors to claim the same higher federal standard deduction. But most income tax states go beyond these tax preferences inherited from federal income tax rules to allow special elderly-only tax breaks of their own, including:
- Higher personal exemptions for elderly taxpayers. 21 states (including Louisiana) allow senior citizens an extra exemption or exemption credit—allowing these taxpayers to shelter twice as much of their income from tax as similar non-elderly taxpayers can claim.
- Special elderly exemptions that only apply to certain types of income. 37 states allow exemptions for private or public pension benefits. 33 states provide an extra exemption for Social Security benefits in addition to the federal tax break, and 29 of these exempt all Social Security benefits from tax. A few states exempt interest, dividends, or capital gains income received by seniors. Louisiana provides a $6,000 exemption of this kind.

Design Issues for Elderly Income Tax Breaks

The goal of providing income tax relief to elderly taxpayers is a simple one—and lawmakers in virtually every state have taken steps to achieve it. But lawmakers seeking to provide such tax breaks must confront several important design issues that can make the difference between an effective tax-relief device and a poorly-targeted tax giveaway.
- Income limits. Some states allow elderly exemptions only for low-income seniors. For example, New Mexico offers an extra elderly exemption of up to $8,000 for over-65 single taxpayers earning less than $18,000. The exemption is gradually reduced to zero for taxpayers with incomes over $28,500 (for married couples, the range is $30,000 to $50,000). However, most
states extend elderly tax breaks to all income levels. Of the 37 states that provided extra exemp-
tions for their elderly residents in 2005, only 9 imposed income limits for eligibility. But cash-
strapped states have re-evaluated these poorly targeted tax breaks in recent years: most recently,
Virginia added a $75,000 income limit to its elderly exemption in 2004. Imposing income limits
helps target the benefits of pension tax breaks to truly needy seniors.

What types of income should be eligible for tax breaks? State income tax exemptions for
non-elderly taxpayers typically do not discriminate between wages and other income sources:
these exemptions can be used to reduce any source of taxable income. But many state income
tax exemptions for elderly taxpayers apply only to particular income sources, such as pension
benefits and Social Security benefits, while providing no relief for earned income such as salaries
and wages. Special tax breaks for pension benefits shift the cost of funding public services away
from retirees and onto working taxpayers—including working seniors.

How large a deduction? States that provide elderly exemptions usually limit the amount that
can be deducted. For example, Arizona allows seniors to exempt the first $2,500 of pension ben-
efits. But other states impose much higher caps on the deduction: a married Maryland couple
could deduct as much as $43,000 in benefits in 2005. And three states (Illinois, Mississippi and
Pennsylvania) completely exempt all pension benefits from income tax while fully taxing seniors’
wages. Imposing a low cap on these exemptions helps target the benefits of elderly tax breaks
to low-income seniors, and makes these exemptions more affordable.

Deduction or credit? States can provide income tax breaks through deductions and exemp-
tions, which reduce taxable income, or through credits, which provide a dollar-for-dollar reduc-
tion in tax liability. Deductions are usually worth much more to upper-income taxpayers, while
credits are more valuable for lower-income taxpayers.

Refundable or non-refundable credit? A refundable income tax credit is one that is avail-
able even to those who owe little or no income tax. Refundability is important for fixed-income
seniors, for whom sales and property taxes are often more burdensome than income taxes. Kan-
sas and Idaho each allow special “grocery tax” credits for seniors that are administered through
the income tax, but are designed to offset sales taxes on low-income seniors who may owe no
income tax. Refundable credits are the best-targeted, and least expensive, way to achieve income
tax relief for fixed-income seniors.

Demographic Trends Mean Growing Costs for Elderly Tax Breaks

Poorly targeted tax breaks for the elderly are a costly commitment for many states—and long-
term demographic changes threaten to make these tax breaks unaffordable in the long run. In
1994, as many states contemplated expanding elderly income tax breaks, 12.5 percent of Ameri-
cans were over 65. By 2030, almost 20 percent of the population will be over 65. Over time, this
demographic shift will mean that a shrinking pool of workers will be forced to fund tax breaks
for an expanding pool of retirees—heightening the need to target these tax breaks appropriately
in order to minimize their cost.

Elderly Tax Breaks: Matching Rhetoric with Reality

Few demographic groups receive more attention from state lawmakers than do fixed-income
seniors. There is a virtual consensus among elected officials that retirees should not be “taxed
out of their homes.” Yet state income tax breaks for seniors typically reserve the lion’s share of
their benefits for better-off elderly taxpayers. These poorly targeted tax breaks shift the cost of
funding public services towards non-elderly taxpayers, many of whom are less well-off than the
seniors benefiting from the tax breaks.

Louisiana lawmakers have, so far, enacted relatively small exemptions for elderly earners.
However, expanding these exemptions without imposing some income limits would threaten the
sustainability of Louisiana’s tax system as the state’s population continues to age.