Commonwealth Forum: Should Pennsylvania Tax Retirement Income?

YES

Pennsylvania is facing a structural budget deficit that will be exacerbated by an aging population. The Commonwealth is among the oldest states in the country and faces a 66.4 percent increase in residents age sixty-five and over between 2010 and 2040. More retirees equals less income tax revenue and more fiscal stress on the state through expenditures on programs that assist the elderly. The time has come to rethink our taxation scheme. Pennsylvania is one of only a handful of states that exempts all retirement plan income from taxation. This tax expenditure must be revised to promote the long-term fiscal health of the state.

Retirees have been productive members of society for decades and deserve recognition for their achievements. However, exempting public and private pension and retirement income is based on an antiquated notion that retirees cannot afford to be taxed, since they are no longer working. The facts do not support this case. The financial status of older people has gotten better over recent decades. Adjusting for inflation, the median income of married couples sixty-five and older has increased 129 percent since 1962 and 114 percent for non-married individuals in this age group. Almost 20 percent have incomes above $75,000.

The major concern about increasing taxes on retirement is how it would affect the poor. In Pennsylvania, 8.1 percent of those sixty-five and older live in poverty. However, national statistics show that the poorest quintile of Americans only relies on pensions or retirement plans for 3 percent of their income. More than 80 percent of their money comes from Social Security. Let's keep the Social Security income exemption but start to tax pensions and retirement plans like 401(k) plans. Pennsylvania will capture more revenue, while protecting its most vulnerable elderly. It will also prevent a generational shift of taxes onto younger people who are trying to raise families and buy homes.

NO

Pennsylvanians pay income tax, sales tax, property tax, local wage taxes, and a host of other taxes on top of the federal income tax. They do not need to pay more taxes when they are finally able to retire and have to live on a fixed income. Furthermore, implementing a tax on retirement income would be an administrative nightmare. Unlike the federal system, Pennsylvania does not allow the exemption of retirement contributions when paying the flat 3.07 percent income tax to the state. Taxing retirement income would then be a form of double taxation. Retirees would be forced to pay taxes twice: once when the money is put into retirement savings, and again when it is withdrawn. In addition, suddenly taxing retirement income would be an economic shock to the state's senior citizens and patently unfair. Out of the blue, they would have 3.07 percent less in their bank accounts, with little to no recourse to increase their earnings as the cost of living rises and incomes decline.

Those who support taxing retirement income have suggested the implementation of exemptions for low-income retirees in order to make the system equitable. However, when Pennsylvania first imposed an income tax, it included exemptions that were then ruled unconstitutional. It is likely the Commonwealth does not tax any form of retirement income because exemptions in this category would be ruled unconstitutional as well. Senior citizens continue to pay property taxes and sales taxes as they age while putting very little stress on public services. They deserve a break in their golden years.

For More Information

The **National Conference of State Legislatures** (http://www.ncsl.org/documents/fiscal/StateTaxOnPensions2015update.pdf) provides a report titled "State Personal Income Taxes on Pensions and Retirement Income" that provides detailed information concerning the types of tax breaks that are offered to retired people by different states.

"The Genesis of Senior Income Tax Breaks" (*National Tax Journal*, December 2012), by Karen Smith Conway and Jonathan C. Rork, gives an overview of how and why states developed tax breaks for older Americans. They show that exempting pensions from income taxes became popular starting in the 1970s.

“Revisiting State Tax Preferences for Seniors” (2006), by Elizabeth McNichol of the Center on Budget and Policy Priorities, outlines how coming demographic changes may change how states tax their older citizens. The article is available at https://www.cbpp.org/sites/default/files/atoms/files/3-6-06sfp.pdf.

The **Social Security Administration** (https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2016/fast_facts16.pdf) publishes the annual “Fast Facts and Figures about Social Security.” The file includes important information about what demographic groups rely most heavily on the federal program for their incomes. Sources of income are broken out across a range of sources including pensions.

From *Pennsylvania Politics and Policy: A Commonwealth Reader, Volume 2.* Edited by Michelle J. Atherton and J. Wesley Leckrone (Philadelphia, Temple University Press, 2019).