

Elimination of State Tax on Social Security Benefits: A Big Price Tag with Little Benefit for Missouri Seniors

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A variety of bills have been proposed in the Missouri Legislature to exempt Social Security benefits from state income tax. While this may seem appealing, a careful review of the facts and impact of the proposal indicates a need to carefully weigh the benefits and risks.

The proposal would primarily benefit seniors at higher income levels. Yet it would require the state to cut \$100 million from state services *every year*, with detrimental impacts for services that benefit *all* seniors and *all* Missourians.

Nearly Half of Missouri Seniors Aren't Taxed on Social Security Benefits

- Less than half (40.5%) of Missouri's 493,000 senior households who receive Social Security benefits would be eligible for a tax reduction through this proposal;
- Low-income seniors, earning less than \$50,000 per year, and those who rely primarily on Social Security income will generally receive no benefit, as the majority are already exempt from tax on their benefits;
- The lowest income senior households earning less than \$10,000 per year receive no benefit from this proposal;
- 80% of the tax reductions would go to senior households with incomes above \$50,000 per year, and nearly 28% of the cuts would benefit senior households with incomes greater than \$100,000 per year. By comparison, senior households with incomes less than \$20,000 would receive no tax reduction.

Table 1: Who Benefits from Social Security Tax Cut Proposal

<i>Income Range of Senior Households</i>	<i>Number of Senior Households in Missouri</i>	<i>Average Tax Cut Range</i>	<i>Percent of Total \$100 Million Cost of Tax Cut</i>
Less than \$10,000	78,000	\$0	0%
\$10,001 - \$50,000	319,675	\$0 - \$291*	20%
\$50,001 - \$99,000	71,366	\$464-\$1,035	52%
\$100,000 and higher	23,696	\$1,144+	28%

Source: University of Missouri and the U.S. Census Bureau

*Very Few Households in this Income Group would receive a small tax reduction

¹ Tom Kruckemeyer of the Missouri Budget Project and Kelly Davis of the Institute for Tax and Economic Policy contributed to the research and data analysis for this report.

As indicated above, the 78,000 senior households at the very lowest income (less than \$10,000 per year) will receive no benefit from this proposal. The vast majority of Missouri senior households, those with the lowest incomes, would receive very little tax reduction as a group, averaging between \$0 and \$291 per year. By comparison, Missouri's highest income seniors, who comprise just 9% of the total senior population in the state, would receive the largest tax reductions. Over 27% of the cost of this proposal would fund the tax reductions for this highest income group of seniors, a disproportionate share.

By comparison, the cost of the proposal - \$100 million per year - could be invested in the following services that would benefit a greater number of low income seniors. Some examples:

- \$100 million could provide comprehensive health care to 16,000 of the lowest income seniors through Medicaid, and generate an additional \$250 million for the health care services through federal matching funds;
- \$100 million could provide the 400,000 senior households with incomes below \$50,000 per year with \$251 more per year in food assistance;

The Truth about Tax on Social Security Benefits

All Missouri seniors are currently exempt under state and federal law from paying tax on the first half of their Social Security Benefits, regardless of income. Seniors who rely primarily on Social Security for their income needs are not taxed at all if their incomes fall under \$25,000 per year after the first half of Social Security is exempted. For married couples, the threshold increases to \$32,000. For seniors whose incomes after the initial exemption are above \$32,000, an additional 15% of their Social Security benefits are disregarded when determining their tax liability.

Therefore, most seniors who have *adjusted gross incomes, after exemptions*, of less than \$25,000 are already not taxed on Social Security and will not benefit from this proposal. By comparison, for Missouri families under age 65 the tax threshold (the point at which these families begin to pay income tax) for the average two-parent family of four is \$16,700 of adjusted gross income.²

Tax Exemption Would Cost Missouri \$100 Million

Exempting Social Security benefits from state income tax would cost Missouri more than \$100 million in annual general revenue. Legislative advocates of this proposal refer to using the current year revenue "surplus" to pay for the tax reduction. However, as a *permanent tax reduction*, this proposal would require that the state reduce state revenue and current state services *each year* by \$100 million, not just in this one year of "surplus".

Basing long-term tax reductions on a temporary and tenuous influx of revenues is not good fiscal policy or good common sense. Imagine that a small business owner has a profitable year, after several lean years. The business may have accumulated debt, reduced personnel or made other cutbacks. The first use of new revenues in the "good year" would be to invest it in the business's infrastructure. This is similar to the situation Missouri faces with the current short-term revenue

² Center on Budget & Policy Priorities, "The Impact of State Taxes on Low Income Families in 2005" <http://www.cbpp.org/states/2-22-06sfp-fact-mo.pdf>

“surplus.” Rather than provide tax exemptions that primarily help higher-income Missourians, the state should invest in its critical services that benefit all citizens. Investments are greatly needed in health care, education, roads, parks and public safety.

As the legislators consider the exemption of Social Security benefits from taxation, they should consider carefully and be required to outline what services would be reduced in the following years to make up for the annual loss of \$100 million caused by this proposal.

A Better Idea to Help Seniors:

Missouri should move cautiously in any discussion of permanent tax cuts. The state has just begun to rebound from the fiscal crisis of the last five years. Basic services to Missourians have been significantly reduced or eliminated, including health care services that impact a significant number of seniors and Missouri families.

Rather than consider tax reductions that benefit higher-income seniors, legislators should enact legislation to assist Missouri’s most vulnerable seniors. Looking ahead, our rapidly-aging population will need investments in an array of services: health care; nutrition assistance; and senior care centers for our rapidly-aging population.

The Missouri Budget Project is a statewide fiscal analysis organization that provides information about the state’s budget and tax policy options...and their impact on low and moderate income Missourians. For more information visit: www.mobudget.org.