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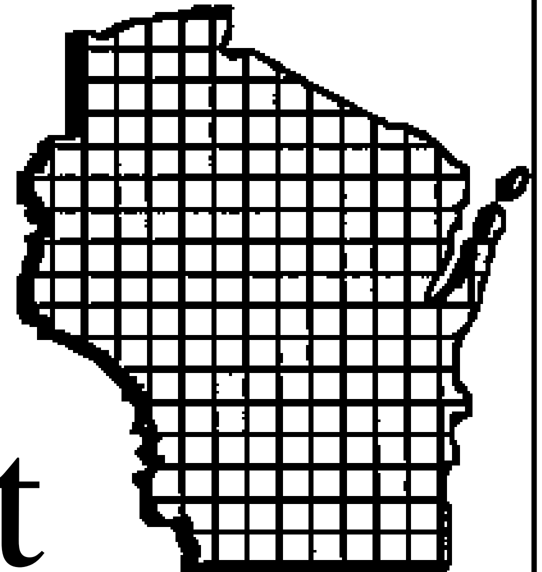

August 2006 Volume 19, Number 8

Retirement Migration In Wisconsin

The Impact of State Taxes

REPORT FROM THE PRESIDENT:

In 2011 the first of the baby boom generation will reach retirement age. In Wisconsin few events will have a bigger impact on the state's economy than this. The socioeconomic impacts will be enormous. For Wisconsin it will mean well over a million residents who are at least 65.

We contracted with Professor Sammis White of the University of Wisconsin-Milwaukee to provide an introduction to potential economic impacts on Wisconsin based on available census data. Professor White's study is clearly mixed; based on the 2000 census there is no immediate impact from senior citizens leaving Wisconsin. We have not suffered the same problems as other northern states – either in the Midwest or the East Coast. Yet, this study shows a potentially troubling problem.

Many states across the country now believe that setting tax policies to attract new retirees or retain current residents is an economic growth engine for the future. This is a pattern that becomes clear in the study. States, like Illinois and Pennsylvania, who have incurred large out-migrations, have moved to exempt all retirement income, including Social Security, from state taxes. This has been done in an effort to stop the large out-migration of the 1990s. Some states, like Mississippi, have enacted similar legislation in an effort to attract more retirees from the north to the south by creating policies that will give an enormous economic advantage to retirement there. Other states are looking at the impact of not only income taxes, but also estate and inheritance taxes on retirees.

Wisconsin appears to be doing almost nothing. They have introduced a long-term phase out of taxes on Social Security income, but that is hardly innovative compared to the rest of the country. Over the next several years as more data becomes available, we will highlight this issue because nothing will have a bigger impact over the latter half of the decade than what Wisconsin senior citizens decide to do with their net wealth. Whether they come or go will impact everyone in the state because of the taxes they pay and the energy they provide their local communities. It behooves state government to closely examine this population and create policies that will ensure Wisconsin thrives with a growing boomer population over the next generation.

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RETIREMENT MIGRATION IN WISCONSIN

The Impact of State Taxes

SAMMIS B. WHITE, PH.D.

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Executive Summary

An important issue that confronts Wisconsin is whether it will be able to attract and retain higher-income retirees, especially as the baby boom population begins to retire and the number of such individuals swells. Boomers, ages 40 to 60, are already beginning to retire sooner than preceding generations. Boomers also have higher incomes, better health, higher educations, and greater wealth than their predecessors. Boomers are correctly seen as assets to a community or state. The big question is whether a state, such as Wisconsin, should make a special effort through tax policy to attract and retain members of this population and its predecessors.

Retirees can bring many advantages to the places they choose to live in retirement. These include: disposable income, wealth to invest or share, time to give as volunteers, low levels of public service demands, and some retires even bring time to devote to various enterprises that generate additional wealth and income.

Retirees, on the other hand, can also generate costs for the places they choose to retire. Retirees may make new demands on public infrastructure, bid up house prices, generate jobs that are often low wage (retail and food service), contribute to traffic congestion, and add to health care expenditures. They may also vote to avoid public expenditures on services, such as K-12 education.

Many states have made efforts to attract retirees, using state tax policy. Nine states have no or almost no income tax. Three states have no tax on all forms of retirement income. Fifteen states offer some form of pension exemption from income taxes. Thirty-five states do not tax Social Security benefits, and the remaining 15 tax them somewhat differently. For retirees Wisconsin has only modestly limited its taxation of Social Security benefits; no other tax breaks exist for those with retirement income.

When it comes to deciding where to live after retirement, state taxes are determinate in only a fraction of the population. Other factors are weather, crime, quality of life, distance to family, and the like. Furthermore, while many states think that the key is income tax breaks newer research is showing that it is inheritance and estate taxes that are more likely influential, at least with regard to the migration decisions of the wealthy.

States that have inheritance taxes heavily experience net out-migration among the 65-and-over population. But when states are examined by total tax burden, a combination of income, sales, property, vehicle registration fees, inheritance, and estate taxes, the pattern of net migration of the over-65 population is mixed.

Migration patterns do vary by wealth and age. When states say they want to attract retirees, they really mean higher wealth retirees (such as professionals and business leaders). It is unclear why individuals in this group make the location decisions they do.

Location patterns for retirees are not always predictable. For example, two states that have eliminated all income taxes on all forms of retirement income, Illinois and Pennsylvania, have rather high net elderly out-migration rates (-28% and – 8%, respectively). Mississippi, on the other hand, also forgives all of these taxes and realized a gain of 7% among the elderly between 1995 and 2000.

Wisconsin, which is ranked near the top of many lists of states by tax burden on citizens, does experience a net loss of those over 65 years of age, and the income group that leaves at the highest rate are those with incomes of $75,000 or higher. Those population losses, however, are extremely modest.

Wisconsin lost an average of only 806 persons per year in this high income category, 1995 to 2000. This is out of a population of about 123,000 persons 65 and over living in households with incomes of $75,000 or more. Moreover, Wisconsin had net inflows of persons 65 and over from both Illinois and Minnesota during this period. The recent impact of Wisconsin taxes on retiree location has been rather modest.

Tax policy is not a cost-effective way to attract retirees. Too much of the cost of the tax incentive is directed to individuals who would have lived in state X regardless of state tax policy. In the example of Wisconsin during the 1995-2000 period, a forgiveness of taxes on all retirement income would have cost the state approximately $275 million a year in lost tax revenue from those who would have stayed here anyway in order to retain at most 806 additional persons a year.

Furthermore, attracting lower-wealth retirees might not be effective tax policy, since the economic multiplier for this group is much lower.

Recommendation: The state should take a very detailed look at the issue of tax policy toward retirees. The data currently available and used for this cost estimate, though instructive, are not sufficient to make conclusive recom-

mendations for the future. The evidence, especially with regard to the boomers, is not sufficient to be certain that they will react in the same fashion as those a few years older than they. These demographic cohorts come from very different generations and may well have very different responses to tax and location questions. This is especially true, since boomers are wealthier and healthier. Thus, the state might experience much higher out-migration rates among upcoming retirees. Given the size of the baby-boom population, all numbers will be larger.

Because of the importance of this boomer population to the fiscal health of Wisconsin, it is extremely important that the state seriously investigate what, if anything, should be done to assure Wisconsin that it attracts new and retains a very high proportion of the developing elderly population, especially the wealthy elderly. Income tax breaks may not be wise, but perhaps other new policies, such as estate or property tax changes, may be justifiable. The options should be examined to see if the benefits from retaining additional wealthy retirees warrant special tax treatment.

Introduction

As states look for ways to stimulate their economies, one option deserves some further examination. That option is the attraction or retention of retirees through tax policies. The basic question is should states, most notably Wisconsin, attempt to attract/retain retirees by reducing or eliminating their taxation of retirement income? Are the payoffs from being the legal residence of an increasing number of retirees worth the costs that might be involved in attracting and retaining these individuals? These are very important questions to a number of states, including Wisconsin, that do not currently have fiscal policies in place to make them appealing to retirees.

Retirees are an increasing proportion of the U.S. population, and their proportion will really begin to jump, starting in 2011, as the first group of baby boomers reaches 65 years of age. In 2000 only one state had an elderly (aged 65 and over) population that exceeded 17.5% of its overall population. Not surprisingly, that was Florida. But by 2025, 39 of 50 states plus the District of Columbia are projected to exceed 17.5% (Conway and Rork 2004).

Some states have already assumed that this is a group of individuals that should be attracted or retained. Two researchers (Longino and Crown 1989) termed retirees “pure gold.” Mackey and Carter (1994) wrote that “some states have recognized the possibility and are using the tax system to become retirement havens.” Retirees can move to states such as Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming, and, like all residents, not face any state income tax. They can move to New Hampshire or Tennessee and be taxed only on dividends and interest income. Or retirees can move to Illinois, Mississippi, or Pennsylvania and be fully exempt from state income taxation of all Social Security payments and all forms of retirement income, including both public and private pension income and 401(k), 403 (b), and IRA payouts.

Seven other states fully exempt public pensions (federal, civil service, military, state and local government) but do not fully exempt private pension income. Others have more limited exemptions from income taxes (Baer 2001). In all some 35 of the 41 states with a broad-based income tax offer some form of income tax reduction to retirees. Despite this pattern six states have done nothing to treat retirees as special, and several others (including Wisconsin with its taxation of up to 50% of Social Security benefits) give only small concessions to retirees. Fifteen states, in fact, tax Social Security benefits, but not all fully tax these benefits.

Appealing as it may be to think of retirees as terrific assets for one’s economy, the picture may not be as clear as earlier researchers have stated, because retirees are not all alike. It also may not be as clear to individual retirees as to just where it is they should be locating. The confusion on the latter comes because states raise revenue in a variety of ways, and states that may have low or no income tax may have high sales or property taxes that more than compensate for the lack of an income tax. Furthermore, there may be some question as to the responsiveness of individuals to fiscal incentives and to the true benefits that are supposed to accrue to the communities that enlarge their retiree populations. And there is evidence that the young-old (65-74 year olds) behave somewhat differently from the old-old (75 and over) in their location decisions. Because of these many issues, it is important that we take a closer look at the issue of retirees as economic development generators.

Who Are the Retirees?

In this paper the term “retirees” is often interchanged with the word “elderly.” That is done for variety, but it is not entirely accurate. Some individuals have retired before they reach age 60; others have timed retirement with their initial eligibility for Social Security at age 62. Still others do not retire until they are 80 or more or they merely cut back on the number of hours worked at some earlier age but keep right on working. Such patterns make it difficult to state precisely whom it is the paper discusses. Adding to the confusion are the options one now has when electing to receive Social Security. One can receive a lower payment, beginning at age 62, a higher payment at what has been 65, is now 66 for some (born between 1938 and 1960), and will then be 67 for those born after 1960. Postponing acceptance until after full retirement age or beyond yields a higher annual payment because actuarially those who start later are expected to receive support for fewer years, and most continue to pay Social Security taxes on their earnings.

Because of the variation in when individuals retire, the analysis will generally discuss patterns by age rather than true retirement status. Basically, when we say 65 years of age and over, we imply retirees. But since we know that

17.5% of males 65 and over participated in the labor force in 2000, it is clear that the use of age 65 does not equate with retirement. This is especially true in the 65-74 year-old cohort.

What confuses the picture further is that there has been a long-term trend for early retirements that in recent years has been exaggerated: individuals are retiring in their late 50s. This group is not waiting for Social Security. Many have sufficient private resources that they can live well on their own. Unfortunately, we do not have an accurate count of this population. We know that the numbers are increasing and that they are a group that is more mobile, both because of better health and because of additional resources. They are an increasingly important group to monitor; we just have few instances in which this has been done. What we also do not know is what proportion of these early retirees will re-enter the workforce, either out of boredom or necessity.

Despite these caveats, the number of individuals 65 years of age and older is approaching 35 million. These individuals are eligible for full Social Security at either 65 or 66. They also are eligible for private and public pensions, whenever they meet the age and "retirement" requirements. Furthermore, they must start taking payments from retirement accounts (401(k), 403(b), and IRAs), at age 70.5. Thus, individuals may begin to receive various forms of retirement income without even retiring. This means that some individuals may soon need to consider the tax consequences on the various proportions of their income streams.

Purported Advantages of Retirees

Numerous reasons are given as to why retirees, especially relocating retirees, are highly sought by states and localities. As is already clear, not all relocating retirees are equal. Some are moving to be with family; others move for health care or other service objectives. But there is a pool of retirees that is referred to as "amenity-seeking" retirees. These retirees are usually young-old (65-74) or even younger (55-64) and possess above-average incomes, educations, and work experiences (Biggar 1980; Conway and Houtenville 2003; McGranahan 1999). The pool that moves interstate is small but growing, and many are choosing locations outside the traditional Sunbelt states (Flynn et al. 1985).

These retirees bring with them transfer payments, pensions, and other unearned income, sources that produce high employment multipliers in local economies, since their dollars are largely spent on goods and services. In fact, one pair of authors (Green and Schneider 1989) estimated that it takes 3.7 manufacturing jobs to equal the economic impact of one new retiree household. Thus, retirees generate new jobs in the local economy through regular purchases that may include health services, personal services, financial services, entertainment, as well as food and household goods (Fagan and Longino 1993; Hoppe 1991). Furthermore, because their income and their expenditures are quite regular, they help to stabilize the local economy.

Some retirees (about 20% of those who move to a new state, according to the American Housing Survey 1995) also add more jobs through the construction of new homes. This contributes an additional multiplier to the local economy. Even renters who choose new apartments contribute in this fashion. And all of these residents contribute to their local communities through the payment of property taxes and, where they apply, sales taxes. Furthermore, most of the younger retirees make very few demands for service on their communities; the retirees are inexpensive to serve, thus making them more desirable as residents.

A Florida study estimates that the state reaped a $1.42 billion net economic benefit from its "mature" residents (those ages 50 and over) (Warren 2002). On a per person basis, mature residents had nearly twice the income, spent twice as much, and paid more in sales and use taxes than those under 50 years of age (White 2002).

In addition to income expenditures, retirees who move interstate tend to have high wealth relative to their incomes. As the years pass, many of these retirees transfer wealth to their retirement communities. The transfers accumulate in the retirement communities and actually have a greater impact than their income expenditures (Walters 2002).

Some states view the additional revenue they receive from the federal government to pay for social services for the elderly, such as Medicare, as a benefit. But that is not always the case. In some states, usually states that are southern and well connected politically, health care providers are reimbursed on the scale of $1.08 or $1.09 per every dollar spent on Medicare. In other states that are not as well connected politically are reimbursed as little as $.77 on a dollar expended. In Wisconsin, for example, providers of Medicare services receive $1 billion less annually than their

costs, creating additional expenses for other Wisconsin health care users to cover. Thus, a fiscal boon to some states is a net drag on others.

Retirees, however, more universally contribute in other ways. Some "retirees" continue to work. In 2001 about 30% of the income of those 65 years and older with incomes of over $24,000 came from earnings. A 2003 AARP survey revealed that this may grow further, as 80% of baby boomers claimed that they plan to work during retirement (Brown 2003). In either case, a sizable portion of the retirees brings with them skills and energy that can contribute to the local and state economies. Moreover, if they are in states with income taxes, those earnings are taxed like everyone's earnings, adding to state revenue.

A few of the wealthy retirees choose to become "business angels," defined as individuals who invest in new businesses that offer high risk and the possibility of high reward. Federal law requires that "angels" have a net worth of over $1 million. Such "angels" are highly sought today as sources of capital for new business development. Angels tend to invest only in businesses that are within two hours of their homes, so they can keep a close eye (and often a hand) on their investments. If more of these individuals are present, it is likely that the number and success of entrepreneurs will be greater, thus helping to ensure economic and subsequent tax growth.

Many elderly individuals are also likely to spend some of their time as volunteers. Numerous non-profit organizations have high proportions of their volunteer time committed by retirees. Their time and talents add yet another positive dimension to the communities in which they choose to live.

Furthermore, states see elderly with income and wealth as an environmentally sound option for development. Retirees are not smoke stacks, and they bring new money into their communities. Some characterize the attraction of elderly as "green" development, a double entendre.

COSTS OF RETIREES

As the reader can see, there is a long list of ways retirees contribute to the communities in which they choose to live. These many reasons are what have convinced numerous state legislatures that they must join the states that have created fiscal incentives to attract and retain retirees. To these eyes, the benefits of retirees are so great that they must take extra steps to try to ensure that a minimal number of retirees leave and that others are attracted.

But there are costs to attracting or retaining a higher proportion of retirees. If a state has created tax incentives for retirees, then there is the obvious tax revenue lost from this population. The scale of this revenue loss is dependent upon the number of retirees, the size of the tax reduction, the incomes of the retirees, and the proportion of retirees who would not have left the state at the old tax rate. In some instances a state may realize sufficient payback to justify the loss of potential tax revenue. In other instances, the out-migration of elderly may continue unabated, few retirees may be attracted, and the state coffers decline because the tax revenue from those who would have stayed anyway is lower.

A second cost of giving up tax revenue to attract or retain more retirees is the cost to the state of its share of Medicaid (for the elderly) contributions. Noted above is the possible problem of underpayment to health care providers and the subsequent expenses that must be paid by others. But states share Medicaid costs with the federal government. Since these payments vary because of the number of persons eligible, a program that increases the number of eligible persons in the state will cost the state more money. The state may still generate enough revenue from other sources that are attributable to the elderly that it comes out ahead. But such is not a likely scenario, unless it has been an explicit policy.

A third cost of having more retirees is the pressure it puts on the employment and subsequent earned income of prime-age adults. The higher-income elderly tend to continue to work. While that appears to positively contribute to the local economy, it may detract as well, since the elderly will be competing for employment and income with younger workers. At a minimum it may create slower movement upward in organizations, as the elderly continue to take the higher-level positions. It may well discourage younger workers who will then move to other states and communities where there is more upward opportunity. The size of this issue is not well documented, but it should be a consideration.

What we do not know is the degree to which future "retirees" will be more involved in the workforce, despite receiving various forms of retirement income (pensions from earlier employers, Social Security, mandatory payouts

from Individual Retirement Accounts, and savings). The AARP report suggests that upwards of 80% of baby boomers will continue to work in some capacity. Many want some way to continue to contribute, or to keep busy, or to try to gain enough income and assets to live reasonably once they really retire. But a growing fear is that of health care costs. Increasing health care costs and health insurance costs are likely to keep more elderly seeking at least part-time work, often with benefits, to cover those health insurance costs. Yes, almost all of the 65 and over population will qualify for Medicare. But many see the coverage as inadequate and want greater assurance of access to quality medical care. The younger retirees must worry about access to health insurance at least until they reach age 65. If retirees continue to work, then the influence of tax reductions aimed at retirement income will not be as great.

A fourth potential area of concern is that of adding new retirees to local communities. Skelley (2004) notes many potential costs for local communities in states that have been successful in attracting retirees. These potential costs include tension between locals and new entrants on social changes desired, the amount of new development welcomed, roles of local government, and service levels desired. Additionally, the young-old may become the old-old and require health services and possibly financial services, as they outlive their own resources.

Furthermore, within communities retirees may bid up housing prices and rents, generate jobs that are often low wage (retail and food service, for example), lead to higher property taxes to pay for new services that accompany development, and generate new traffic congestion. These costs are not often included in analysis of the attraction of more retirees (Walters 2002).

Current State Tax Treatment

The income tax pattern across states is a crazy quilt. Seven states do not tax income, period. Two others, New Hampshire and Tennessee, tax only interest and dividends. Most states that do tax income in some way do offer certain breaks for retirees, but often these are not large, and they certainly are not consistent across the states. For example, Social Security benefits are taxed differently in the fifteen states that do so. Some states do not tax Social Security benefits, if incomes are below certain levels, such as $50,000 for singles and $60,000 for joint filers in Connecticut (Baer 2001). Others use different criteria.

States tax different types of pension income differently. The states vary in how they treat income by source (private, military, federal civil service, or state or local government). Seven states fully exempt public pensions, but one of these, Hawaii, partially taxes public and private pensions that involve employee contributions. Fifteen states offer pension exemptions that usually treat public pensions more favorably than private pensions (Baer 2001). The amount of private pension exemption ranges from zero in several states to $2,000 in North Carolina; $4,400 in Oklahoma to $20,000 in New York and Colorado and $36,000 in Kentucky (Baer 2001). Alabama exempts both public and private pension income and Social Security, but the private pension must be a traditional company-funded retirement program to be exempt (Abbott 2005).

The list of variations goes on. Some states exempt military pensions; others do not. Some exempt either state or local pension income; others tax these incomes partially; still others exempt them. Variations also exist on the age at

Table 1 Shares of 2000 Aggregate Income for Persons Age 65 and Older by Income Range (in percents)

Income Sources	First Quartile up to $7,950	Second Quartile $7,950 - $13,357	Third Quartile $13,358-23,879	Fourth Quartile $23,880-515,077	Total for All Incomes
Social Security	86	82	57	22	40
Pension Income	2	5	18	20	17
Dividends and Interest	5	7	11	19	15
Earnings	1	3	7	30	20
Other	7	5	7	9	8

Source: Bureau of the Census, Current Population Survey, March 2001, conducted by the Bureau of the Census for the Bureau of Labor Statistics-Washington, DC: Bureau of the Census 2001.

which individuals are eligible for different tax treatment: some 14 states have age minimums, but the age varies across states (Baer 2001).

The next question is just how important is Social Security income or pension income to those who are 65 years of age or older? Do these tax breaks address an important need or are these sources inconsequential? Table 1 reveals the proportionate sources of income for persons in 2000.

The numbers in Table 1 reveal the relative importance of various sources of income to those individuals 65 years of age and older. Overall, 40% of income came from Social Security, 17% from pension income, 20% from earnings, and 15% from dividends and interest. But these figures vary widely, depending upon one's income. One of the most striking patterns is that of the role of Social Security benefits. At lower incomes, Social Security is extremely important. It is only when discussing the top income quartile that Social Security is less than 57% of income. Pension income is only important in the top half of the income distribution. And earnings are only important in the top quartile.

These distributions suggest that non-taxation of Social Security by states will not be very effective in attracting/retaining the top income quartile and that non-taxation of pension income will appeal to those in the top half of the income distribution. If states want to retain retirees, not taxing Social Security will help to retain the poorest and have limited effect on the highest income. Pension tax relief, however, will have little effect on location decisions of the lower half of the income distribution. What may matter most at the top is the treatment of earned income: with 30% of income coming from this source, this is most important. Thus, it would appear that states with no income tax would have an advantage. We'll revisit that tentative conclusion below.

Some twelve states still collected an inheritance tax as of 2005. By 2006 the number became eleven. At least fifteen states have death or estate taxes. How these are computed varies, as these states use different formulas. The effect is that it is more expensive to die in some states than in others, despite transfers of assets to spouses being exempt from taxation in all fifty states (Retirement Living 2004).

Do Retirees Respond to These Fiscal Incentives?

A key assumption of many state policy makers is that older households are responsive to the fiscal incentives of tax breaks. Those states that have decreased taxes for the elderly or for all citizens think that the desirability of their location is dependent, at least in part, on the tax burden their state imposes. But is there strong evidence that this is the case?

The question of whether retirees respond to fiscal incentives has intrigued many researchers. The issue is not as straightforward as some might presume. Retirees usually make residential location decisions on the basis of multiple criteria. Yes, income tax consequences are often among the concerns. But inheritance and estate taxes, climate, family, friends, hobbies, topographical preferences, health, health insurance, housing costs, and several other factors commonly are considered as well.

The question of motivation for elderly location moves has been examined for over two decades. Many early researchers concluded that the elderly were attracted to states with lower taxes (Rives et al 1983; Cebula 1990; Crown and Leavitt 1991). But these research efforts were not overly sophisticated. In fact, most failed to control for cost-of-living or failed to fully specify taxes and expenditures, thereby making it difficult to know what accounts for their results.

More recent efforts have attempted to account for many more nuances. One pair of researchers (Conway and Houtenville 2001) examined data from the 1990 Census migration flows and attempted to markedly improve on their own and others' techniques. They explored whether elderly migration was affected by state fiscal policy, taking into account not only taxes but also expenditures. They also paid close attention to net migration, not just in-migration, to judge impacts. They concluded that in addition to cost-of-living and climate considerations, elderly are attracted to states that exempt food from sales taxes and that spend less on welfare. Elderly are also attracted by lower personal and death taxes, but such findings are dependent upon how one measures the taxes. Using various specifications, they tentatively conclude that states with low death taxes and low personal income tax bills attract the elderly, but not as definitively as past studies might suggest.

Duncombe, Robbins, and Wolf (2003) also examined the 1990 Census migration data. With a fairly sophisticated, individual-level, discrete-choice model, they concluded that changes in tax burdens and service levels do affect

location decisions and that several different tax forms (income, inheritance, and property) have the highest relative impacts. However, they go on to assert that "very large tax reductions would be required to attract even one more retiree to a specific county." They maintain that unless tax breaks can be targeted narrowly at the group of retirees most likely to consider migrating, the revenue losses are likely to significantly outweigh the economic and fiscal benefits. Menchick (2002) speaks to this with his report that 1999 federal tax return data revealed that 92.8% of the $7.8 billion in total federally taxable pension and IRA income is exempt from the Michigan income tax, a state that is very kind to pension income but that experiences just slightly less than average levels of elderly out-migration.

Also recently Bakija and Slemrod (2004) examined how state tax policies affect the migration and reported estates of very high-income and high-wealth individuals. They used data spanning a 33-year period. They report that when they do a cross-sectional analysis, they find that inheritance, estate, sales, and income taxes all had significant effects on the number of federal estate tax returns filed in a state. But when they control for state-specified fixed-effects, income taxes on the wealthy are not conclusive; only inheritance and estate taxes clearly affect the migration decisions of the wealthy. But the inheritance tax may play a lesser role overall in location decisions, as less than one-quarter of the states have such taxes. (Wisconsin is not among them, although it does still have an estate tax.)

One piece of evidence that has been produced describes the sources of resources for retirement. The population of households was divided by relative wealth. The wealthiest 10% of households rely heavily on financial wealth for their retirement income. Some 65% of their resources come from financial wealth (excluding housing), 25% comes from pensions, and 10% comes from Social Security (Moore and Mitchell 1997).

What these numbers reinforce is that state tax policies that give tax breaks on Social Security income will not be very influential on the location decisions of the wealthier population. Pension income tax breaks will matter somewhat more, but with just one-quarter of the wealthiest's resources coming from pensions, tax breaks on pension income may be somewhat influential but not likely determining.

If we look for anecdotal information, the impact of tax breaks on retirement income remains clouded. Illinois has no income tax on retirement income. Wisconsin has taxes on retirement income. Does this greatly affect migration patterns between the two states? The answer appears to be that income tax policies, at least between these two states, may not make much difference.

Migration between Illinois and Wisconsin, 1995-2000 and 2003-04

	Into WI from IL	Into IL from WI	Net to WI
Overall (1995-2000)	80,569	41,774	38,795
65 and over	5,216	2,199	3,017
Overall (2003-2004)	17,460	10,856	6,604

Source: US Internal Revenue Service 2006. Statistics of Income: 2003-04 state to state migration flows. Special run.

These migration numbers for the entire population reveal that Wisconsin has been a net gainer from Illinois. If we look at the 65-and-over population, that remains the case: in the 1995-2000 period, Wisconsin gained a net of 3,017 older persons from Illinois. Some of these individuals were not retired and some were not higher income. But the net effect is that Wisconsin gained. Unfortunately, we do not have exact numbers on net migration by income by state, but when the Wisconsin Taxpayers Alliance (2005) created its list, it did not list Illinois as among the states with a net gain of persons with incomes over $75,000 from Wisconsin. Furthermore, the net migration from all states for the 55-and-over population with incomes reportedly at or above $75,000 between 1995 and 2000 was -4,030 persons (-806 per year) (Ibid., 2005). That number is remarkably small, given the modest nature of Wisconsin's tax breaks for this population.

Thus, there is some question as to just how influential special income tax rates for retirement income are on retiree location. There is certainly interstate movement of those 65 and over, and some are motivated by lower income taxes. Many informal data suggest that income tax rates do affect location, but as models have become more sophisticated, those links are not clearly found. Research suggests that some of the moves are generated in response to inheritance and estate taxes rather than income taxes. But interstate moves also seem to be motivated by a myriad of

other factors, including the weather. Will, therefore, special tax treatment cost specific or all states more in lost revenue than is gained from keeping some of the wealthy? The definitive analysis of the true net benefits of elderly to states has not been done. These are questions that need to be researched further: the answers are not immediately obvious.

Because the evidence is not entirely clear, it is still reasonable to attempt to gain further insight into what it is we do know about elderly migration patterns. And it may be that with the additional wealth that baby boomers have developed, they may well respond differently from the generation on which most of the recent research has relied, those who are 10 or more years older and products of the Great Depression. That generation has acted very differently from subsequent generations in its attitudes toward place and money. On the other hand, with rising health care costs, longer predicted lives (so individuals may outlive their current retirement savings), and new location patterns for their children, baby boomers are indicating that they will work for more years and may well make different decisions from their parents.

Retiree Relocation Patterns

The Census Bureau has done extensive analysis of the 2000 Census to learn what mobility (change of address) patterns exist for various age cohorts (He and Schachter 2003). The patterns of immediate interest to this report are the "old," those 65 years of age and older, and the "near old," those aged 55 to 64. For many analyses the older population has been divided into three sub-groups, those 65-74, those 75-84, and the oldest old, those 85 years and older.

Each group has different reasons for moving and different mobility rates. According to Warnes (1992), later life moves can be categorized into three types: the long-distance migration of healthy seniors; the short distance moves of the frail, moderately ill, low income or widowed; and the relocation of the severe or terminally ill to nursing homes or other institutions. According to He and Schachter, those 65 and older had a 22.8% mobility rate, in that almost 8 million of them moved between 1995 and 2000. Within the "old" group, those 85 years old and over had a mobility rate of 32.3%. Interestingly, individuals 5-64 years old were more than twice as likely (47.7%) as those 65 and over to have moved in the preceding five years.

The big question is what percentage of these populations moved to a different state versus moving within the same county or even within the same state. Overall among the elderly, the majority (59.7%) of moves were within the same county. About one fifth (21.5%) were to a different county. And almost one-fifth (18.8%) moved to a different state.

As one might expect, it is the young-old (65-74) that have the highest interstate move rate (21.2%) among the old population. Those 75 to 84 had a somewhat lower rate (17.3%). The oldest group, by contrast, had a rate of 14.9%. Those who were near old (55-64) had a rate of interstate movement virtually the same as the young-old (21.4%). Those 5-54 had an interstate move rate of 19.6%.

What these numbers reveal is both a modest increase in interstate moves as individuals reach near retirement age (55-64) and then a decline in interstate movement with age. It appears that movement does increase around retirement. But as individuals age, some move again, perhaps back to their home states for medical care or family. And other elderly either cannot move or decide not to move interstate. The numbers also reveal that for all of the talk about moving out-of-state upon retirement, less than one-fifth of elderly households do so. That means that when tax incentives are offered to elderly, they are likely to influence residential decisions of only a portion of that population.

Interstate Mobility Rates for Those 5 and Over, 1995-2000

Age Range	Mobility (%)
5-54	19.6
55-64	21.4
65-74	21.2
75-84	17.3
85 & Up	14.9

A related and important question is whether the elderly that do move are more likely to be wealthy, thereby depriving certain states of assets. The answer appears to be that, yes, those who move interstate tend to be wealthier. Kallan (1993) found that retired seniors with higher incomes and fewer social ties were more likely to move elsewhere.

Unfortunately, we do not have much detail on the wealthy. Instead we must rely on data on the general population for possible insights. To determine whether a state is a winner with regard to the migration of elderly, a couple of measures, such as the absolute number of in-migrants or the ratio of in-migrants to total elderly population, or the

Table 2 States with the Highest and Lowest Net Migration Rates of the Older Population, 1995-2000

States with Highest Rates		States with Lowest Rates	
State	**Rate (%)**	**State**	**Rate**
Nevada	114	New York	-45
Arizona	87	Alaska	-39
Florida	57	Illinois	-28
South Carolina	33	New Jersey	-21
Delaware	27	Connecticut	-20
North Carolina	22	Michigan	-18
Idaho	20	North Dakota	-16

Source: Wan He and Jason Schachter. 2003. “Internal Migration of the Older Population: 1995 to 2000.

net migration of in- and out-elderly might be used. Because net migration best reveals the overall appeal of a place to both new and old residents, it is the measure chosen. What the data show is just what states are most appealing to the retiree population. What appear in Table 2 are the states with the highest and the lowest net migration rates of the elderly.

The states with the highest net migration rates are the expected candidates — Nevada, Arizona, Florida, and the Carolinas. On the list of states with large negative rates are states in the Northeast and North. This might suggest support for the many studies that have linked migration from the north to the south and west.

What is intriguing about the overall list is that 25 of the 50 states had positive migration of the 65-and-over population. Among the young-old (65-74), the number of positive states was almost identical, 24. Five states had different losses or gains in one age group and not the other, again showing that the motivations may be more than financial. Conway and Houtenville (2003) researched these different migration patterns by age cohort among the elderly and concluded that all elderly age groups avoid moving to states with high estate/inheritance/gift taxes, although the effects weaken with age, and that younger elderly appear to be shopping around for destinations with a temperate climate and lower income taxes.

Experience of Low-Tax States

Are the states that have the highest rates of net migration of the elderly the same ones that have no state income tax? A quick glance at the nine states with no income tax or extremely low income tax reveals that there is no visual correlation between not having an income tax and having a positive rate of elderly migration, much less a high rate of elderly net migration (Table 3). In fact, the states with the highest and the second lowest rates of elderly net migration, Nevada and Alaska, are on the list of nine. True, six of the nine states with no income tax have positive rates of net migration. But pattern is suggestive but not convincing.

Table 3 Net Interstate Migration Rates for the Population 65 and Over, by State, 1995 to 2000, for States with No Income Tax

	States								
State	**AK**	**FL**	**NV**	**SD**	**TX**	**WA**	**WY**	**NH**	**TN**
Net Migration Rate	-39.4	56.9	114.2	-2.3	8.8	1.8	-0.5	4.9	15.2

Source: Migration rates are from W. He and J.P. Schachter, “Internal Migration of the Older Population: 1995-2000. US Census Bureau. August 2003. States with no income tax are identified by M. Abbott, “How States Tax Retirement Income,” Where to Retire, March/April 2005.

If the presence of a state income tax is not a clear factor, then what of those states that have no state income tax on Social Security and all forms of retirement income? Those three states, Illinois, Mississippi, and Pennsylvania, represent a range of outcomes (Table 4). Two states have a negative net migration rate. That outcome shows that the

elimination of these taxes on the elderly has not, as of yet, worked to attract large portions of elderly to two of the three states. Then again, states do not necessarily want large net migration numbers; they most want the wealthy retirees. Perhaps the tax laws have worked; we just are unable to identify their impact on the wealthy. Unfortunately, few data exist that allow a close examination of this issue.

Table 4 Net Elderly Migration Rates in States with No Pension and Social Security Tax, 1995-2000

Illinois	Mississippi	Pennsylvania
-28.1%	7.1%	- 8.2%

If we look at states with no tax on Social Security income to see if that is at all related to net migration of the elderly, the reader should not be surprised to learn that only one-half of the states that exempt Social Security income from state income taxes have positive net migration numbers. New York, for example, has a net migration rate of –45%. On the other hand, Arizona has a positive rate of over 87%. That is quite a range. Clearly, this tax break is not sufficient nor is it the key to location decisions.

What confounds the impact of Social Security earnings taxation further is the fact that of the fifteen states that do tax such earnings, five of the states have positive net migration rates. If this tax policy were to play a pivotal role, there would be greater consistency in these patterns.

When we examine states ranked by total estimated state and local tax burden, a measure that goes far beyond income taxes to include the many other ways local and state governments raise tax revenue (for example, sales tax, property tax, vehicle registration fees, license fees, and inheritance and estate taxes), we see a bit more of a pattern (Table 5). In examining the nine least-taxed states, six of the states have positive net migration rates. Three of these, Florida, South Carolina, and Delaware, actually have quite high rates of net migration. But confounding this pattern are three states that are negative in terms of migration. Alaska can be dismissed because the absolute numbers are so small (-1,428 over five years). And the other two have very small negative numbers, so that they barely contradict the pattern of the six. It would appear that total tax impacts, far beyond just income taxes, do make a difference. That tentative conclusion does conform with some of the research that has been done.

Table 5 Net Interstate Migration Rates, 1995-2000, for the Population 65 and Over, by States with the Lowest Combined Tax Burden, 2004

State	AK	NH	DE	TN	TX	FL	WY	SC	SD
Net Migration Rate	-39.4	4.9	27.2	15.2	8.8	56.9	-0.5	33.6	-2.3

Source: Migration rates are from W. He and J.P. Schachter, "Internal Migration of the Older Population: 1995-2000. US Census Bureau. August 2003. Tax burdens are from Retirement Living, "Taxes By State." November 15, 2004.

On the other hand, two of the states with the highest net migration rates, Arizona and Nevada, have combined tax burdens that rank them in the middle (20th and 30th highest), again suggesting that taxes are not the only reason for choosing a location among persons 65 and over.

What is mildly intriguing about this list of low-tax-burden states is their geographic location. Yes, three are in the deep South. But two others with positive net migration are north of the Mason-Dixon line, and two more mild losers (South Dakota and Wyoming) are clearly in the north. So it is not just warmer temperatures that are attracting or retaining retirees.

When we examine the twelve states that up through 2005 collected an inheritance tax, we can see another mixed pattern of net migration rates. The rates range from a -21% in New Jersey and –20% in Connecticut to +15% in Tennessee. Ten of the twelve rates are negative, which does suggest that this tax may be influential. In fact, Connecticut has been persuaded that it is and has phased out the inheritance tax as of 2006. Louisiana's last year of the tax was 2004. But the net migration rates only weakly suggest a link, given the range.

Yet another look at this somewhat confusing picture comes from a study done by Kiplinger. They tabulated the total state and local tax burden, defined as state income tax, local property tax, and local and state sales tax on a hypothetical retired couple with $60,000 income and living in the capital city in a median-price home in that community (MSN Money 2005). They looked at the really retired, those without earnings from work. Because of the Illinois

TABLE 6 NET MIGRATION RATES IN STATES WITH INHERITANCE TAXES, 2004

CT	IN	IA	KS	KY	LA	MD	NE	NJ	OR	PA	TN
-20	-8.3	-11.2	-1.2	-2.8	-4.8	-7.3	-8.1	-21	3.1	-8.2	15.2

Source: Migration rates are from W. He and J.P. Schachter, "Internal Migration of the Older Population: 1995-2000. US Census Bureau. August 2003. Tax burdens are from Retirement Living, "Taxes By State." November 15, 2004.

exclusion of retirement income from taxation and the resulting zero income tax and inexpensive housing in Springfield, being there in Illinois was the 15th least expensive place to live. Arizona (Phoenix) was 17th, and Florida (Tallahassee) was 27th. Basically, property taxes proved to be quite influential, as did housing cost. The costs to retirees varied from Dover, Delaware at $563 annually to Harrisburg, Pennsylvania at $7,391. Madison, Wisconsin was the third most expensive at $6,016. It had the combination of 6th highest income tax and 4th highest property tax. The key point is that with a high property tax bill, a low income tax bill ($0, if all retirement income were exempt) would help but would still place Madison no lower than the 10th most expensive place to live because of property and sales tax costs. Thus, an income tax reduction to even zero might not prove very influential in any of the higher property tax communities in Wisconsin.

What this cursory analysis suggests is that income taxes do not, by themselves, necessarily have a strong impact on the location of retirees. Special efforts to attract and retain the elderly through the forgiveness of taxes on retirement and Social Security incomes do not appear to be particularly effective, at least to date. But what does seem to somewhat affect location of the elderly is the total package of taxes. Research has suggested it is inheritance and death taxes that drive elderly away (Conway and Houtenville 2003 and Woo 2003). Since these were included in the measure discussed in Table 6, it is hard to make clear distinctions among the impacts of other taxes. But the combination is at least suggestive of steps states such as Wisconsin might take with individual taxes to be more appealing to the elderly.

And it could well be that the taxes individually are not that influential, but that in combination any particular tax could be construed as sufficient to tip a move one way or another. Some researchers disagreed about the ability of changes in one tax to make a difference. That may be true, but it is for reasons of overall impression, not overall actual impact of a particular tax on pocketbooks.

We do know that the wealthy tend to move across state boundaries more often than all others. That suggests that they are looking for advantages, be they tax or personal preference. Since we know they are more likely to move, they are more likely represented in these numbers and patterns. But we do not know for sure. We really need to do additional research into what it is that is motivating movement by the wealthiest ten percent to determine whether states can really compete for them through the use of tax and fiscal policy.

WHAT ARE THE IMPLICATIONS FOR WISCONSIN STATE TAX POLICY?

The issue for states that have not yet gotten involved in the bidding war for retirees is whether and to what degree they should get involved in the bidding. Do the benefits of attraction and retention really exceed the costs of lost tax revenue, much less the costs of serving the older elderly that a state has attracted or retained? Such a decision faces a state such as Wisconsin that taxes everyone relatively equally.

Wisconsin taxes the incomes of all ages of residents about the same. The state stresses horizontal equity. It has a slight new tax break on the first several thousand dollars of Social Security income and breaks on veterans' pensions and pensions received by persons who worked in some specific places in Wisconsin or were members of the state teachers' retirement fund prior to January 1, 1964. But otherwise there are no fiscal incentives for the elderly. In fact, the state is said to be the sixth-most-taxed state population ((Retirement Living 2004), suggesting that it is not a good place to live, if one is trying to preserve one's income or wealth. The question for the state is: Should it reduce the income tax on retiree income to attempt to attract and retain more wealthy households?

Wisconsin's northern climate would suggest it has a very difficult challenge. Wisconsin's net migration rate (-5.6%) of the 65-and-over population, however, is not as negative as many might imagine. Yes, it involved the net loss of about 4,000 individuals with annual incomes of $75,000 or higher over the five-year period of 1995 to 2000 (Wisconsin Taxpayers Alliance 2005). But among all elderly neighboring Illinois had a net migration rate of –28%, Iowa, –11%, and

Minnesota, –10%. With Wisconsin's seemingly modest loss, the question remains whether the tax losses of an amended tax policy would be worth the rewards from retaining or attracting a larger elderly population.

Such a question is not easy to answer at this point. One reason is that the data are not clear on just how positive an impact the elderly actually have. Much is conjectured, as appears above in our early discussion, but little is proven. A second issue is that despite not offering more than marginal tax breaks to the elderly, Wisconsin is able to attract more elderly than it loses to two neighboring states, Illinois and Minnesota. And it is Illinois that offers no tax on pension or Social Security income, and Minnesota that offers only modest retirement income exemptions for certain specified groups. Wisconsin's gaining retirees from Illinois suggests that such a tax tool as retirement income tax exemptions are not overly effective. At least it suggests again that taxes alone are not always the determinant of residential location.

On the other hand, it is clear that Wisconsin experiences some net out-migration of wealthy retirees (about 800 persons a year). Whether any affordable tax breaks would be sufficient to change the location decisions of these individuals must be explored further. And to be really helpful, that study should also focus specifically on the wealth of retirees from Wisconsin, so that the impact of the loss of these dollars can be included.

A Quick Analysis of the Fiscal Impact of Forgiving Retirement Income Taxes

A very quick analysis with the data available should lead to some insights on the merits of not taxing retirement income in Wisconsin. The reader must be forewarned that this is a very rough estimate and that a much more thorough analysis should be undertaken. Nonetheless, a quick analysis should add to the discussion.

Using the Census and IRS figures for elderly migration for the 1995 to 2000 period, as has been noted, Wisconsin experienced a net loss of 4,030 persons 55 years of age or older with incomes of at least $75,000 (Wisconsin Taxpayers Alliance 2005). That translates to 806 persons a year. That is not a very large number, despite the tax consequences of moving to Wisconsin.

Another figure needed for the analysis of a potential tax emption is the actual number of retirement age households within the state with incomes equal to or greater than $75,000. We did not have a specific source for this, so we used the Census 2000 Public Use Micro Sample data, restricted to the 65-and-over population. These data are sample data and are estimates, but they should be close. The estimates are that there were some 49,330 households with a person 65 or over that had an income in 1999 of at least $75,000. These households contained some 123,126 individuals. Average household income was $136,494 in 1999. They collectively had incomes of $6.773 billion.

We do not have data on exactly how much of this income came from retirement income. But we can guess that it may have matched the national figure in that 30% came from earnings and just guess that all but an additional 10% was retirement income. This assumes that 60% is retirement income and 40% comes from earnings and non-retirement income (non-sheltered investments). Thus, 60% of the $6.7 billion annual income among households with a person 65 years of age or older could become tax exempt in Wisconsin, with an appropriate tax law change.

If this were to occur, such a change would deprive the state of some $277 million in annual tax revenue — $6.7 billion x .6 = $4.04 billion tax exempt x .0685 the state's highest income tax rate = $277 million in lost tax revenue from this over 65 population. (If the sources of income were 50% tax exempt rather than 60% tax exempt, the lost tax revenue would be $231 million a year from this 65-and-over, higher-income population.)

If the 60% estimate is accurate, this means that the state would give up over $340,000 in revenue per year per person to try to attract or retain each of the 806 net persons with higher incomes who left each year. That does not make sense for the state, even if a very strong case can be made that the impact in terms of the wealth the 806 persons a year take with them is substantially more than the income loss. The point is that tax breaks cover all of the retirees, and the vast majority of them would remain regardless of the tax break. The break is a very expensive way to try to decrease the net loss of this high-income population. Unless the tax break can be highly targeted at the wealthiest, an unlikely event in Wisconsin, the break will be very costly to state tax coffers.

These figures are so large that the case for the tax break does not appear very compelling. But more refined numbers on retirees leaving and the incomes and wealth they take with them can not only make for better estimates, they can make the basis of sounder policy. Those with substantial assets are very important to the state. The case for their impact is made above. Furthermore, they are very likely to support the arts, culture and social organizations on which our communities rely. But whether changes in state retirement income tax policy is the way to keep the small net

number of migrating wealthy retirees in Wisconsin is somewhat in doubt. As the low net loss number indicates (and surprising to some), there is appeal to higher income households to be in Wisconsin despite its many efforts to tax all members of the state populace more than occurs in most states.

Boomers may react differently. Many more boomers (currently ages 40 to 60) have higher incomes and greater assets than their immediate predecessors. Boomers also have traveled more and are aware of more appealing location options. They have better health and are more active. Boomers have also approached life, investments, and numerous life decisions differently from those older than they. So insights we may have gained examining the current 56 (age 50 in 2000) and over population may soon have limited relevance for the population that is just beginning to reach 60 years of age in 2006. Already we are seeing signs of earlier retirements in the boomer population. That alone may steer greater proportions of this population to examine alternative locations and do analyses of the tax consequences of these various locations. When combined with the other differences just noted, the consequences for Wisconsin may be different from the seemingly minimal impact to date.

CONCLUSION

Given the benefits of retaining retirees, especially wealthy retirees, it appears that an additional study of the merits of using retirement income tax policies to attract and retain retirees in Wisconsin is warranted. Such a study should do a detailed assessment of the probability the state will attract and retain enough high-income retirees that the benefits outweigh the costs of substantial foregone tax revenue. In the simplest terms this might be an assessment of the foregone tax revenue compared to the new revenue generated through incomes generated by new expenditures by those 65 and over. Ideally, it would include an analysis of the many costs and benefits that are discussed above. It should also go beyond looking at income taxes to inheritance and estate taxes, property taxes, and the overall tax burden, since the research to date indicates that these seem to have a greater impact on residential decisions than income taxes. The study should also look at health care availability and costs, as they are becoming increasingly important in location decisions.

Despite Wisconsin being the sixth most heavily taxed state; 19,000 persons age 65 and over moved to the state between 1995 and 2000 and only a net loss of 4,030 higher-income individuals left. These numbers strongly suggest the need to do a more comprehensive analysis, if we are to learn whether retirement income breaks, or other ways to decrease tax burdens for the elderly, are good public policy. That analysis must be more encompassing than this and include more sophisticated assessment of how the boomers will react as they approach retirement.

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