

Planning to Relocate in Retirement? Keep an Eye on Potential Tax Issues

Of the 78 million baby boomers fast approaching retirement, more than half are expected to relocate to a different state when they retire. Once a family has defined their personal goals, they may find it beneficial to review the more quantifiable components of relocation. Such a review typically would include (among other factors) an analysis of state income taxes, state estate taxes and property taxes and can provide valuable insights into the true economic impact of a move.

Income Taxes

Generally, an individual is subject to income taxes in his or her resident state, on all income, regardless of the state in which it is earned. Compensation and business income sourced from outside the state of residence is also subject to the taxes of the state or municipality in which it is earned. Individual state income tax rates range from more than 10 percent to as low as zero percent.

Taken on its own, however, a state's marginal income tax rate can be very misleading. Many states don't tax social security benefits, but some states do. Several states with broad income taxes exempt all private and public pension payouts (including withdrawals from individual retirement accounts) from income taxes, and more than a dozen states exempt some part of retirement income.

For example, a retired executive with a pension, social security benefits, and a required minimum distribution from a taxable IRA will pay no state income taxes on retirement income in Mississippi. That same executive would be subject to a state income tax rate as high as 5 percent if he or she was still on the payroll and resided in Mississippi. Therefore, you must not only compare state-to-state income tax rates, but you must also analyze the type of income you have to determine your potential state income tax obligation.

Estate Taxes

In 2000 and prior, most states had estate taxes that were equal to the credit allowed for federal estate taxes. Thus, for each dollar of state estate tax paid, there was a dollar reduction for federal estate taxes. In 2001, Congress significantly changed the federal estate tax system, which resulted in numerous states changing their estate tax systems. Although approximately one-third of states eliminated their estate tax, the balance of states either increased or left unchanged estate tax liability from pre-2000 legislation.

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While current federal legislation exempts \$5,000,000 of assets from estate taxes, most states exempt a much smaller amount. Wisconsin, for example, exempts just \$675,000, while 10 other states exempt \$1,000,000. As a result, wealthy families must now address a new level of taxation in their wealth management plans. As an example, a surviving spouse with \$10,000,000 of assets can expect to pay state estate taxes of approximately \$650,000 if he or she were to pass in Illinois, but \$0 in Florida.

Property Taxes

A family contemplating a move must not overlook local taxes either. Property taxes are the largest funding source for local governments and often are the most onerous of local taxes. These taxes are not imposed by the states, but rather by the thousands of cities, townships, counties, school districts and various other assessing jurisdictions. The state's role is to set the legal standard that the local assessors follow. It is likely that neighboring municipalities in a general location may have significantly different taxes on real property.

Effects on Federal Taxes

Federal income tax planning compounds the complexities of comparing retirement locations. State income taxes and property taxes are itemized deductions at the federal level, and have become more valuable as the "phase-out of the phase-out" occurs for higher-income earners.

Conclusion

Choosing a retirement location is a difficult undertaking. As a trusted advisor, the Calamos Wealth Management group can guide clients through the wide ranging tax issues associated with retirement. Our knowledge in federal and state taxation can be a valuable resource for helping clients create and preserve wealth. We can assist in identifying the various tax rates, modeling the economic effect of those rates and consulting with you about tax minimization strategies. Please contact us at 888.857.7604 if we can assist you.

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For more information about federal and state taxes, please consult the Internal Revenue Service and the appropriate state-level departments of revenue, respectively.

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