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6 Tax Factors to Consider When Picking a Retirement Destination

It pays to know how much you might pay in state and local taxes before you move.

By the Editors of Kiplinger\'s Retirement Report, October 26, 2015
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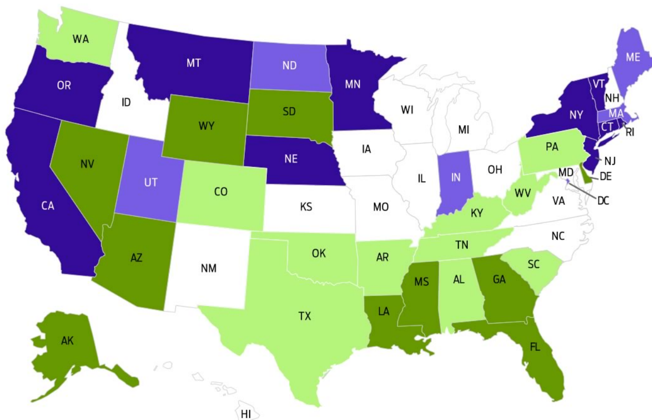

Maybe you're thinking about relocating in retirement, in hopes of enjoying milder weather and lower expenses. Before you make a move, it pays to assess the overall tax burden of your future home.

See Also: Retiree Tax Map

No matter where you live, your federal taxes will be about the same if you take the standard deduction. But you'd be amazed at how much your state and local tax burden may vary from one location to another.

People planning to retire "often use the presence or absence of a state income tax as a litmus test for a retirement destination," says Tom Wetzel, president of the Retirement Living Information Center. That's indeed one factor for retirees to consider. But Wetzel notes that "higher sales and property taxes can more than offset the lack of a state income tax."

Seven states -- Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming -- have no state income tax. Two states -- New Hampshire and Tennessee -- tax only dividend and interest income

that exceeds certain limits. But many of the remaining 41 states (and the District of Columbia) that impose an income tax offer generous incentives for retirees. If you qualify for the breaks, moving to one of these retiree-friendly areas could still be a good deal -- taxwise -- for you.

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Here are five other key tax factors to consider when comparing states as possible retirement destinations:

Taxes on retirement-plan distributions

Although most states that impose an income tax exempt at least a portion of pension income from taxation, they often treat public and private pensions differently. For instance, some states exclude all federal, military and in-state government pensions from taxation. Other states go even further, exempting all retirement income -- including distributions from IRAs and 401(k) plans.

Some states that tax pension income offer special breaks based on age or income. At the other end of the spectrum, several states are particularly tough on retirees, fully taxing most pensions and other retirement income.

Taxes on Social Security benefits

Depending on your income, you may be required to include up to 85% of your Social Security benefits in your taxable income when filing your federal return. (Read Strategies to Reduce Taxes on Social Security and Plan to Pay Taxes on Social Security to learn more about how benefits are taxed.) But in recent years, many states have been moving away from taxing Social Security benefits. Thirteen states now tax Social Security benefits to some extent.

Sales taxes

Don't forget to include state and local sales taxes in your personal budget analysis. Some states exempt food and medicine; other states famously have no sales tax at all, while some will tax every dime you spend.

And keep in mind that the sales-tax pain doesn't always stop at the state level. Most states allow cities and counties to assess their own sales taxes.

Property taxes

Property taxes are a major cost factor, particularly for retirees living on a fixed income. The median property tax paid in the U.S. on the median U.S. home value of $164,200 is $1,809, according to the Tax Foundation.

Tax rates vary significantly from state to state and among cities in the same state. But many local jurisdictions offer property tax breaks to full-time residents, some based on age alone and others linked to income.

Check to see how the local jurisdiction generates property-tax bills. There are two key numbers to evaluate: the percentage of a home's assessed value that is subject to tax and the property tax rate. Note

that, depending on the tax rate, a home taxed at 100% of its assessed value could have a lower tax bill than a property that is taxed at only 50% of its assessed value. For example, on a $100,000 property taxed at 100% of its assessed value with a 2% tax rate, the property-tax bill would be $2,000. If instead the property is taxed at 50% of its assessed value with a 5% tax rate, the tax bill would be $2,500.

Estate and inheritance taxes

In addition to the federal estate tax (only relevant to estates valued at $5.43 million or more in 2015), some states levy their own estate tax. Many of these taxes kick in at levels lower than the federal threshold. Wealthy retirees need to make sure their estate plans take into account both federal and state estate taxes, which can eat into the amount passed on to heirs.

In a handful of states, heirs have to pony up. States that levy an inheritance tax require heirs to pay taxes on inherited assets.

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