

**Proposed Reduction of
State Income Taxes
for Federal Annuitants
and Survivors**

A Presentation Prepared for
Arkansas' Legislators



National Active & Retired Federal Employees
Arkansas Federation of Chapters

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National Active and Retired Federal Employees (NARFE) Association
(formerly National Association of Retired Federal Employees)

What is NARFE?

NARFE is a nationally recognized organization founded in 1921 for retired federal employees. Its former name originally reflected this representation, but was changed at the 2004 NARFE convention in Reno Nevada. NARFE's name and mission was expanded beyond federal retirees to also promote the general welfare of active (current) federal employees. This is done by advising them with respect to their rights under retirement laws and regulations both at the state and national levels.

NARFE's national office is located in Alexandria Virginia with state federations located in 50 states, the District of Columbia and several overseas locations including Puerto Rico and the Panama Canal Zone. National conventions of NARFE are held in even numbered years and regional training conferences in the odd-numbered years.

In Arkansas, some 44,126 active federal employees and retirees are eligible for membership in NARFE. The Federation convention is held in Arkansas every year and is attended by some 33 chapters. Chapter meetings are normally conducted monthly at the local level. National and state websites serve as one of the sources of information and provide help to members and links to federation and local websites. A **NARFE** national magazine also provides updates and information to NARFE members on a monthly basis.

NARFE is not only active in overseeing the benefits of active and retired federal employees, but also supports local and national programs that would be of interest to active federal employees and annuitants. One such program that NARFE has focused on is Alzheimer's research. The picture at the top of the page shows a NARFE chapter celebrating the results of a campaign to gather funds for Alzheimer's which has produced around \$8,000,000 nationwide. Additionally, some chapters support Arkansas state and local Alzheimer's programs.

NARFE chapter members are active in their local communities and provide a reservoir of volunteers for hospitals, community organizations and other such projects in need of helping hands. In 2007, NARFE members in Arkansas volunteered for over 250,000 hours. An estimate of the dollar cost of these hours ranges upward from around \$5,000,000, according to the Arkansas Department of Human Service, Division of Volunteerism publication, "Economic Impact of Arkansas Volunteers 2006".¹

Please visit the national website at <http://www.narfe.org> or the Arkansas website at <http://www.narfeark.org> for more information on the National Active and Retired Federal Employees (NARFE) Organization.

NARFE Officers in Arkansas

Federation President:

Mr. Charles Schmieder, 809 Meredith St., White Hall, AR 71602; Phone: (870) 247-4125; E-Mail: cschmeider36@sbcglobal.net.

Federation Executive Vice President:

Mr. Winston Wolfe, 9 Doscientos Circle, Hot Springs Village, AR 71909; Phone: (501) 922-1724; E-Mail: wowolfe@suddenlink.net.

Federation Secretary:

Ms. Anna Crow, 5401 S. 92nd St., Fort Smith, AR 72903; Phone: (479) 484-7630; E-Mail: ninax2@sbcglobal.net.

Federation Treasurer:

Mr. Ron Lambert, 35 McKenzie Drive, Bella Vista, AR 72715-5108; Phone: (479) 876-5392; E-Mail: ronlambert@cox.net.

Federation Legislative Chairman:

Mr. Wally Sheldon, P.O. Box 5153, Bella Vista, AR 72714-0153; Phone: (479) 855-3920; E-Mail: wsheldonbv@cox.net.

Federation Public Relations Chairman & Webmaster:

Mr. George R. Wilken, 15 Holly Brook Cove, Maumelle, AR 72113-6881; Phone: (501) 851-8019; E-Mail: arkwxman@sbcglobal.net.

PROPOSAL

Reduction of Arkansas State Income Taxes on Retirement Income of Federal Annuitants and Survivors

Present Taxation on Federal Annuitants and Survivors in Arkansas

Currently, an exemption of six thousand dollars (\$6000.), is allowed on yearly retirement income for federal annuitants and survivors, on Arkansas State Income Tax. The latest data, as of 2006, shows there are 24,486 federal annuitants and survivors in Arkansas.

Proposed Taxation on Federal Annuitants and Survivors for Arkansas

It is proposed that the exemption on retirement income for federal annuitants and survivors subject to Arkansas State Income Tax, be increased per the following schedule:

1. Through the period proposed, no federal annuitant or survivor will receive less than the six thousand dollar (\$6000.) exemption currently being allowed.
2. Starting in 2010 through 2014, federal annuitants and survivors will see their Arkansas State Tax on retirement or survivor income further reduced by twenty percent (20%) each year. In the year 2015, all taxes on federal retirement and survivor annuities will be reduced to zero (no taxation).

Precedent Setting Actions in the States Surrounding Arkansas

In the states surrounding Arkansas, state taxes on federal annuitant or survivor income are either non-existent (Louisiana, Mississippi, Tennessee and Texas), or are being reduced and eventually eliminated through a graduated schedule (Missouri and Oklahoma).

Tax Reduction Initiatives on Federal Retirement or Annuitant Income in States Not Surrounding Arkansas

Sixteen (16) states not adjacent to Arkansas provide total exemption from state income tax on federal retirement or annuitant income; while twelve (12) others provide a higher exemption from state income tax on federal retirement or annuitant income, than the six thousand dollars (\$6000.) Arkansas provides.

In all, thirty-four (34) states provide tax exemptions for federal annuitant or survivor income greater than what Arkansas provides.

Rationale for Decreasing State Income Tax on Federal Annuitant and Survivor Income

Why In-Migrating Retirees Are Desirable

Studies by Dr. Wayne Miller, et al, of the University of Arkansas Division of Agriculture (Cooperative Extension Service), stated that “In-migrating retirees make substantial contributions to the local community and to the state. As an industry, their contributions to the state’s economy are numerous, including the following:

- New jobs are created to meet the demands and services of the new residents.
- Some retiree households construct new homes, creating additional jobs and income.
- Retirees stabilize the business cycle because most retiree income is not cyclical.
- Retirees increase local and state tax revenue.
- Retirees enhance the local property tax base.
- Retiree investments increase the capital pool.
- Retirees provide an experienced pool of talent and committed volunteers.
- Retirees are a clean industry.
- Retirees diversify the economy.”²

In two other papers, “Arkansas Retiree In-Migration: A Regional Analysis”³ and “Arkansas Retirement-Age Migration: A Statewide Overview”⁴, Dr. Miller further discusses the numerous social and economic benefits to the communities in Arkansas where in-migrating retirees locate.

Attracting In-Migrating Retirees to Arkansas

On the “Retirement Living Information Center” located on the Internet at <http://www.retirementliving.com/>, various aspects of retirement are presented. Among considerations that are offered when a retirement location is selected, are the state taxes on retirement income, along with the various other taxes that

the respective state might have. A thorough state-by state analysis is provided on this website, for all the considerations that a person must make in contemplating retirement. When viewing each individual state, it is a simple process to compare states on a tax liability basis.

At <http://www.kiplinger.com/features/archives/2005/03/12places3.html>, the Kiplinger magazine website, twelve great places to retire are listed. Of those twelve locations, seven have no tax on retirement income and four others have a higher exemption on retirement income than Arkansas does. ***It is significant to note that no city in Arkansas is listed, although there certainly are several that compare favorably to those listed.***

Along with state and local tax liability, retirees consider the cost of living which includes housing and other amenities.

Estimate of Retiree Population Change in Arkansas

In “Arkansas’ Retirement Age Migration: A Statewide Overview”, Dr. Miller shows that between 1995 and 2000, 30,595 retirement age people migrated to Arkansas.⁴ He further stresses the need for Arkansas to “aggressively market” the various factors that make Arkansas an attractive state in which to retire.

In this same paper, Dr. Miller states that out-migration of retiree age people increased with the states of Texas, Missouri and Oklahoma receiving the largest number of people. These are states that have no state income tax or are reducing their state income tax on federal retirees. The net in-migration of retiree age people amounted to 8,276 people during this six year period.

A publication produced by the U.S. Office of Personnel Management (OPM), the federal personnel agency, estimates that over a half-million federal employees will be retiring in 2010, with that total nearing 1 million retirees for the year 2016.⁵ OPM has had an error of under 1% in past predictions of how many federal employees would retire. This estimate likely includes baby-boomers who will cause a strong upswing in the number of retirees across the United States.

Equalization with Social Security Benefits

Most federal retirees at present, retired under the Civil Service Retirement System (CSRS). A smaller number has retired under the Federal Employment Retiree System (FERS). Sources of their retirement income differ as does the taxation of this income.

Most federal retirees under CSRS do not receive additional Social Security income in retirement since Social Security was not deducted from their salaries. The FERS retirees, by contrast, receive a modest federal retirement, Social Security income and proceeds from a Thrift Savings Plan (TSP) which they may contribute to during their federal career. The proceeds from the TSP are fully taxable, since they are similar to a 401K type of account.

The State of Arkansas exempts Social Security benefits from state income tax, thus, the FERS retirees in effect already have an exemption on a substantial part of their retirement. Over the years, what is now a majority of retirees under CSRS, will gradually be replaced by a majority consisting of FERS retirees.

The gradual exemption of federal retirement benefits would simply equalize current federal retirees' and annuitants' benefits with that of persons receiving Social Security benefits, and would gradually decrease as the current FERS retirees replace the previous CSRS retirees.

Summation:

When trying to attract federal retirees from outside of Arkansas to move to the state, there are indeed many attractive aspects of the state that are desirable for retirees. Among the attractive aspects are outdoor recreation facilities such as state parks, medical facilities that compete on a global scale and cost-of-living that rivals any state adjacent to Arkansas.

However, one aspect of financial consideration for federal retirees that does not compete with adjacent states is the level of state income tax on retirees. By reducing and eventually eliminating this tax, Arkansas would successfully compete with any state in attracting retirees.

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- 5 Division of Strategic Human Resources Policy, U.S. Office of Personnel Management (OPM), 2008. *An Analysis of Federal Employee Retirement Data*, Washington D.C.