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IRSI Pension **CliffsNotes**: Taxing Retirement Income

“Influential Senate President John Cullerton has suggested that the state should begin to look at taxing retirement income. Illinois does not currently tax pensions or retirement funds such as 401(k) plans, but Cullerton suggested that the idea be in the mix as part of an effort to change the state’s outdated tax system.”

-Chicago Tribune, March 7, 2011ⁱ

Why is taxing retirement income up for discussion?

The current exclusion of all retirement income from taxation in Illinois is neither fair nor rational, results in millions of dollars of lost revenue, and ultimately cuts to programs low income seniors rely upon.ⁱⁱ The rationale behind broad exclusion of all retirement income - not taxing low income seniors – is praiseworthy. Total exclusion, however, is too broad for this purpose.ⁱⁱⁱ

How much revenue would the state actually receive from taxing pension income?

According to a report issued in 2008 by the Commission on Government Forecasting and Accountability, Illinois taxpayers received \$37.3 billion in retirement income, including pensions, retirement annuities and Social Security.^{iv} It must be noted that a substantial percentage of individuals in the public sector – 78 percent – do not receive Social Security, while many individuals in the private sector receive Social Security and employer provided pensions.

According to the Illinois Department of Revenue, in FY2008 (the last year for which data is available) were only 228,785 individuals who reported receiving retirement income **over \$50,000**. This represents a relatively small portion - only **16.16 percent** – of the total number of filers who report receiving any retirement income.^v

That percentage gets even smaller as the income increases.

Again, according to the Illinois Department of Revenue in FY 2008, of the individuals who reported receiving any retirement income, **only 3.18 percent** reported receiving over \$100,000.

The Math: Small Percentage of Retirees = Inadequate Revenue

Illinois’ Current FY 2012 Deficit = **\$7.334 Billion**^{vi}
Unpaid Bills from FY 2011 = **\$6.05 Billion**^{vii}

Taxing Retirement Income Over \$50,000 = \$382.9 Million^{viii}
Taxing Retirement Income Over \$100,000 = \$118 Million^{ix}

What are the arguments in favor and against taxing retirement income?

- According to Ralph Martire, Executive Director of the Center for Tax and Budget Accountability, if the goal is to avoid creating high tax burdens for low-income seniors, then it would be far better to exclude retirement income from taxation solely for those seniors who really have limited or low, fixed incomes.

“In fact, including some retirement income in the income tax base will help Illinois provide significant tax relief to those who truly need it,” Martire said. “Low-income seniors and other low-income taxpayers who are struggling to get by, which generating significant revenue for the state’s General Fund.”

- Senator Matt Murphy (R-27) and Senator Kirk Dillard (R-24) have expressed concern that additional taxes would force high-income seniors to flee to states like Florida, which does not have an income tax.^x

3 States Do Not Tax Public or Private Pension Income^{xi}

- Illinois
- Mississippi
- Pennsylvania

- Bob Gallo, senior state director for AARP Illinois, thinks that other avenues should be explored before pension income is looked at as a source of revenue.

“We’re taxing you more at the same time that we’re taking away these other things. These are extraordinary times. There’s a lot that needs to be examined and explained before we go down this road.”

“At a time when severe cuts are being proposed to critical services that protect Illinois’ most vulnerable seniors, we believe the state should not be proposing piecemeal tax fixes one at a time but a comprehensive approach to a fair and progressive solution to what ails Illinois.

ⁱ Monique Garcia and Ray Long. “Cullerton suggests taxing retirement income.” Chicago Tribune. March 7, 2011.

ⁱⁱ Center for Tax and Budget Accountability. Funding Our Future: Reforming Illinois Tax Policy. October 29, 2010.

ⁱⁱⁱ Id

^{iv} Id

^v Illinois Department of Employment Security. “FY 2008 Stratified Individual Income Tax Data.”

^{vi} Center for Tax and Budget Accountability. Analysis of Proposed Illinois FY 2012 Budget. March 2011

^{vii} Id

^{viii} The amount is based off data from the Illinois Department of Revenue for FY 2008 after giving local municipalities and counties their 5% share of the Local Government Distributive Fund (LDGF).

^{ix} Id

^x Id

^{xi} National Conference of State Legislatures. “State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2010.” <http://www.ncsl.org/default.aspx?tabid=12657>. Ten states exclude all state and local government pension income. The states that offer an exclusion for all state and local government pension income are Alabama, Hawaii, Illinois, Kansas, Louisiana, Massachusetts, Michigan, Mississippi, New York and Pennsylvania.

The goal of the Illinois Retirement Security Initiative (IRSI) is to ensure public retirement benefits in the state of Illinois are adequately funded and designed to attract high quality public service providers to the public sector. The Initiative will research, educate and advocate for public policies toward that end.