

THE EVOLUTION OF STATE INCOME TAX PREFERENCES
FOR THE ELDERLY: INTELLIGENT DESIGN?

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ABSTRACT

Every state that has a personal income tax offers some form of differential treatment of elderly taxpayers. How and why did these tax preferences arise? How and why have they changed over time and across states? This research documents the existence of state income tax preferences for the elderly since 1900 – their inception – and then traces out how they have changed over time. These tendencies are then examined with the goal of explaining why they have evolved to where they are today. Explanations considered include state tax competition, demographic and political forces, changes in federal law, and other state characteristics such as ‘innovativeness’ and the emergence/contraction of related elderly policies, such as public pensions and estate/inheritance (EIG) taxation.

Our descriptive analysis reveals that such preferences were not always enacted as part of the original income tax, especially during the first part of the century. Preferences in general seem to be growing over time but not for all states. A substantial number of states have made a large number of changes to their policies while others have been virtually unchanged. Geographic neighbors often behave similarly and appear to react to each other; however, there are also several cases of apparently unrelated states behaving similarly. We also find strong parallels *over time* in the evolution of income tax preferences and other elderly programs; *across states*, however, the patterns are much weaker. The final goal of this research is to develop a summary measure(s) of income tax preferences for use in a multivariate analysis, with which to better understand the reasons for these patterns.

Every state that has a personal income tax offers some form of preferential treatment of elderly taxpayers. Furthermore, this state elderly tax ‘bonus’ appears to be nontrivial, especially for high income households. A recent study estimates that the tax savings of being elderly is \$1170 on average for high income households and is as high as \$2647 in South Carolina.¹ As a consequence, non elderly, high income households pay approximately double in state income taxes what an equivalent elderly household would pay. Low income elderly households enjoy a tax savings as well, but the very low estimated tax liabilities for low income households in general lead to a small bonus (e.g., \$106 on average in 2002, Conway and Rork 2007). The tax savings currently experienced by the elderly results from a combination of deductions/exemptions granted solely on the basis of age and, in many states, the exemption of social security and pension income from taxation, most of which also have an age requirement.

Interestingly, the federal government grants a much smaller tax savings to the elderly despite imposing a larger income tax liability overall.² Conway and Rork (2007) further demonstrate that the federal government has decreased its preferential treatment of the elderly over the last 25 years by taxing social security benefits and reducing the relative value of the elderly deduction. The states, in contrast, have remained steadfast in their preferential treatment and have actually increased their preferential treatment of pension income during the same time period.

As we show shortly, such preferences were not typically enacted as part of each state’s original income tax, especially during the first part of the century. The federal

¹ These estimates are for high income households in 2002. See Conway and Rork (2007) for how these estimates are calculated and for a more expanded discussion of recent state and federal income tax policy towards the elderly. A high income household is defined to have an income of \$74,276 in 2002, representing the upper quartile of the elderly income distribution.

income tax likewise included no preferences for the elderly at its inception. How and why did these tax preferences arise? How and why have they changed over time and across states? This research documents the existence of federal and state income tax preferences for the elderly since 1900 – their modern day inception – and then traces out how they have changed over time³. These tendencies are then examined with the goal of explaining why they have evolved to where they are today. Explanations considered include political forces, changes in federal law, and other state characteristics such as ‘innovativeness’ and policies towards the elderly such as public pensions and estate/inheritance (EIG) taxation.

2. In the beginning...

In 1900, only South Carolina and Virginia had personal income tax systems and neither contained any significant preferences for the elderly. The federal income tax had yet to be enacted (in 1916).⁴ As for taxes that target the elderly, the federal estate tax, enacted to finance the Spanish-American War in 1898, was repealed in 1902 (Cooper 2006). This tax would be re-enacted in 1916 to finance World War I, and it persists to the present.⁵ At the state level, 34 states enacted estate, inheritance and gift (henceforth called EIG) taxes between 1892 and 1916, resulting in a total of 43 states with such taxes (Cooper 2006). This is in stark contrast to the recent movement to reduce or eliminate such taxes (e.g., see Bakija and Slemrod 2004, Conway and Rork 2004 and Michael 2004). On the

² Specifically, high income elderly households are estimated to pay \$4999 in federal income taxes, which is only \$592 less than their non elderly counterparts (Conway and Rork 2007, Table 2).

³ This data was generously provided to us by Jon Bakija under the conditions of the NIH grant. The data is described in greater detail in Bakija (2006).

⁴ During certain earlier periods, especially during the Civil War, the federal government did levy taxes on income. For a succinct history of federal income taxation, including prior to 1900, see *US Treasury, Fact Sheet on the History of the U.S. Tax System*, accessed 5/18/07 at <http://www.treas.gov/education/fact-sheets/taxes/ustax.shtml>.

expenditure side, while the states would eventually lead the way in enacting universal old-age pensions (the Old Age Assistance program), no state yet had such a program. The inception of such programs was at least 15 years away (Costa 1998) and the inception of the federal social security program was 35 years away.⁶ Overall, then, the elderly appear to have received much less generous treatment from the public sector at the beginning of the 20th century than they enjoy today.

The prevalence and typical work experience of elderly Americans were also quite different. In 1900, less than 5 percent of the population was over age 64 (Costa 1998, Figure 9.1) in contrast to 12 percent in 2003. The life expectancy and survivor rates were also lower, weakening the incentives of the young to support programs to benefit the elderly. According to the Center for Disease Control (CDC), the life expectancy for a white man (woman) was 48 (51) in 1900 in contrast to 76 (81) in 2004. The probability of surviving past age 65 was likewise much lower at 41%, versus 82.7% in 2003⁷. Therefore, not only were there proportionately fewer elderly people to benefit from such policies, but the young were much less likely to expect to grow old enough to receive the benefits eventually themselves. Both factors likely led to reduced political support.

The elderly (those aged 65 and older) were also far more likely to participate in the labor force. More than 60% were ‘gainfully employed’ in 1900 compared to approximately 20% in 1990 (Costa 1998, Figure 2.1). The occupational distribution of

⁵ Over the last 30-40 years however, federal legislation has greatly reduced the scope and burden of this tax (Bakija and Slemrod 2004, and Michael 2004).

⁶ We return to the pattern of how the states adopted such programs when we explore alternative explanations for state income tax preferences. Costa (1998) provides an excellent history of such programs, including the period prior to 1900. In particular, she notes that the Civil War (again) represents an interesting period in the history of public pensions with the inception of Union Army pensions, which in the early 1900s was the most widespread form of assistance to the elderly.

⁷ All CDC data on life expectancy and survival probabilities are available on the CDC website.

these elderly workers has also changed dramatically, shifting from farming as the primary occupation to white collar jobs.⁸

We revisit these changes in other policies, demographics and labor markets when we explore alternative explanations for why elderly income tax preferences evolved as they have. First, however, we discuss in detail exactly how they have evolved, beginning with a simple timeline of policies (Table 1) and ending with an investigation of each state's experience (Table 2 and Figure 1).

A. How did we get here?

Table 1 provides a timeline of major changes to elderly tax preferences in federal and state income tax systems since 1900. Each column refers to a type of policy, and they are listed roughly in chronological order; i.e., the types of policies enacted earliest are listed first (on the left). The first column lists when (and where) an income tax was enacted. The next two columns list two of the three main income tax preferences typically discussed in the literature on current elderly tax preferences (e.g., see Zahn and Gold 1985, Mackey and Carter 1994 and Manzi 2005 for state income taxes; Nelson 1983 and Forman 1995 for federal). The first is the extra deduction/exemption/credit granted elderly (and typically also blind) taxpayers and the second is the exclusion of private pension income from taxation. The table does not report the third main preference – the exemption of social security benefits from taxation – because the federal government and virtually all states exempted these benefits until the Social Security Amendments (SSA) of 1983 began taxing

⁸ Specifically, 48.7% of men older than age 64 were engaged in a farming occupation in 1910 compared to 8.8% in 1990; the corresponding percentages for white collar workers are 18.3% and 52.4%, respectively (Costa 1998, Table 5.1).

them for high income taxpayers.⁹ Although not reported in the table, we include this preference in our discussion of tax preferences and also in our description of each state's experience. Note that the pension exclusion is likely to benefit higher income households relatively more than a deduction/exemption or exclusion of social security benefits, although the realized tax savings of all three grow with one's marginal tax rate (and thus income for progressive tax systems).

Only a handful of states taxed income prior to the enactment of the federal income tax in 1916, and several more enacted income taxes in the following 5-10 years. By 1928, fourteen states had enacted income taxes but none offered the elderly preferential treatment. The largest growth in the number of states with income taxes occurred during the early years of the Great Depression. Eighteen states enacted income tax systems between 1929 and 1935; 8 enacted income taxes in 1933 alone. During this period, the first elderly tax preferences also begin to appear. Up until that point, income tax systems were enacted without any of the main elderly tax preferences.¹⁰ In 1931, Vermont included a pension exclusion when it enacted its income tax; South Dakota and New Mexico behaved similarly in 1933 by including a pension exclusion and elderly deduction, respectively, when enacting their taxes.

Still, elderly tax preferences were quite limited and often subsequently repealed until the late 1940's and early 1950's. Beginning in 1947 with Vermont (again) and followed by Colorado and the federal government in 1948, states steadily began enacting elderly deductions/credits. By 1954, 11 states had already done so and two more enacted it

⁹ See Page and Conway (2007) for further discussion of this policy and other aspects of the SSA of 1983.

¹⁰ As noted in the table, one exception is North Carolina, which enacted a pension exclusion the year it enacted its income tax (1901); however, it was repealed the next year.

in the same year. By 1966, 11 more states plus DC had added deductions.¹¹ In less than 20 years, the prevalence of this preference had changed from one ‘state’ out of 34 with tax systems (in 1946) to 25 ‘states’ out of 36 (in 1966). Furthermore, most states that enacted income taxes later (e.g., Michigan, Illinois, Maine, Rhode Island) included an elderly deduction/exemption, while states with tax systems continue to add it (e.g., North Carolina, Utah). As a result, some type of elderly deduction or credit existed in the vast majority of states by the mid 1970’s.

As noted in Table 2, states vary in the degree to which they have adjusted these deductions. One substantial, widespread change, however, was the change in the federal deduction/exemption that resulted from the Tax Reform Act of 1986 (TRA86). As discussed in more detail by Conway and Rork (2007), TRA86 reduced the relative size of the elderly deduction and eliminated it for those households who itemize. A number of states changed their policies similarly. Nonetheless, it is still a widely offered elderly tax preference. In 2004, only four states – Alabama, Connecticut, New York, and Pennsylvania – of the 42 ‘states’ with broad-based income taxes did not grant some type of exemption, deduction or credit solely on the basis of age (Baer 2006).

The second type of preference listed is the exclusion of part or all of private pension income from the taxable income. While it was first enacted around the same time as the first deduction (in 1931), it took much longer to become widespread and is still far less prevalent. Hawaii was the first state to enact a pension exclusion (in 1954) without subsequently repealing or reducing it.¹² Hawaii and Delaware continued to be the only

¹¹ To ease the discussion, we henceforth refer to the District of Columbia as a ‘state’.

¹² Interestingly, this is the same year the federal government enacted its deduction, yet Hawaii did not enact an additional deduction until 1958. Also, recall that Hawaii was not yet officially a ‘state,’ as it gained

states offering an exclusion until Maryland added one in 1968 and Illinois included one when it enacted its income tax in 1969. Other states slowly followed, but few followed Illinois and Hawaii in offering a complete exemption of pension income. There does not appear to be one time period in which most of these policies were enacted. Rather, the number of states with some type of pension exclusion has steadily grown to where 29 states had some type of provision by 2004 (Baer, 2006). Five states (Alabama, Hawaii, Illinois, Mississippi and Pennsylvania) currently exempt the full amount of pension income.¹³

The last type of preference listed in Table 1 is for provisions that target low income elderly taxpayers. The widespread use of property tax relief for the low income elderly via circuit breakers and homestead exemptions makes this listing an incomplete indication of the states' attempts to offer relief to low income households. However, as noted by Conway and Rork (2007), considering these other policies is quite difficult both because of the differences in how they are administered (i.e., they are administered through the income tax system in less than half of the states) and because they blur the lines between income tax relief and property tax relief. We therefore consider only those low income tax preferences not tied to property. Furthermore, several states phase out their other elderly tax preferences, especially their pension exclusions, for high income taxpayers. In the rest of this paper, we focus primarily on the three types of preferences granted to the middle and high income elderly both because of these limitations and because we find it a more interesting phenomena to explain. Preferences for the low income elderly seem more likely

statehood in 1959. Delaware enacted its exclusion in 1947 but then enacted a maximum exclusion of \$2000/4000 (single/married) in 1953.

¹³ As noted in Baer (2006), Manzi et al (2005) and Conway and Rork (2007), a few states make a distinction among pension plan types. Alabama exempts defined benefit plans only, and Hawaii partially taxes pensions with employee contributions.

to be motivated by a desire to help the ‘deserving poor’ (e.g., see Zahn and Gold 1985). The motivation is less clear for granting preferential treatment to middle and high income elderly.

With these caveats in mind, we see from the last column in Table 1 that low income exemptions began much later (Delaware in 1971), are more likely to be subsequently repealed and have been enacted in far fewer states than the other two preferences.

The last major income tax preference granted the elderly is the exclusion of social security benefits from taxation, which is not reported in Table 1.¹⁴ The federal social security program was first enacted in 1935. These benefits were excluded from the federal income tax and almost all state income taxes until the Social Security Amendments (SSA) of 1983. The SSA required high income households to include up to one-half of their social security benefits as taxable income. The 1983 income thresholds have never been increased and more elderly households therefore pay federal taxes on their social security benefits each year. In addition, a second, higher set of income thresholds were enacted in 1993 beyond which up to 85% of social security benefits could be subject to tax (see Page and Conway 2007 for more discussion).

Thirteen states followed the federal government in 1983.¹⁵ In the nearly 25 years since, two states have returned to treating social security benefits as exempt (Georgia in 1988 and Oklahoma in 1985) and four began taxing benefits (Connecticut in 1991, New

¹⁴ Another way in which the states differ is in their age requirements for preferential treatment. While 65 is the most common, several states have younger ages. Some states offer reduced preferences for slightly younger (e.g., age 55-65) elderly taxpayers. Finally, some states offer preferential treatment of dividend and/or interest income. Exceptional cases of both policies are noted in Table 2 when we discuss the experience of each state.

¹⁵ Three states (Rhode Island, Nebraska and Vermont) based their tax liability on the federal tax liability and so automatically followed the federal government. The other states that immediately began taxing social security benefits are Colorado, Georgia, Iowa, Kansas, Minnesota, Missouri, Montana, North Dakota, Oklahoma and Utah (Page and Conway 2007).

Mexico in 1990, West Virginia in 1987, and Wisconsin in 1986).¹⁶ Overall, then, this particular preference has not changed much over the entire century except for the period right around the change in the federal tax law.

In sum, several patterns over time are apparent:

1. The movement by states to enact personal income taxes gathered momentum during the Great Depression. The first elderly tax preferences appear during this time as well.
2. Very few elderly tax preferences were in existence prior to the late 1940's and those few in existence were often repealed shortly thereafter.
3. The earliest, widespread elderly tax preference was in the form of an additional deduction/exemption/credit, beginning in the late 1940's and becoming widespread in the following years. The federal government enacted its own deduction during the earlier part of this period (1948).
4. Pension exclusions from state income taxation arose in the latter part of the century. While they have steadily increased in prevalence, they are not as widespread as elderly deductions/exemptions. The federal government has always treated private pension income as taxable.
5. Social security benefits were exempt from taxation for most of the century. The federal income tax began taxing them for high income households in 1983 and about 10-15 states followed the federal government with little change over time. The tax on social security benefits has grown over time due to inflation and a second change in federal tax policy in 1993.
6. State tax preferences for the elderly have grown in number, size and prevalence, with the exception of two instances of the states following a change in federal tax policy – taxing social security benefits (SSA of 1983) and limiting the elderly deduction (TRA86).

B. Patterns of behavior across states

In searching for explanations for why these preferences evolved in this way, it is helpful to next look at the experiences of the individual states. Table 2 summarizes the experience of each state with respect to its 1) overall income tax system, 2) elderly

¹⁶ We are grateful to Jon Bakija, Dan Feenberg and Inna Shapiro for numerous helpful discussions in determining the exact policies in place and when they changed during this period. Current policy (for 2004)

deductions, exemptions or credits, 3) private pension income exclusions and 4) taxation of social security benefits. Based on these four characteristics, we attempt to broadly characterize each state by comparing it to the behavior of other states, noting whether it is relatively 1) more generous to the elderly, 2) early in enacting tax preferences, and 3) active in changing its policies over time.

Any attempt to categorize states is going to be subjective, but we do rely on some basic criteria. First, states that are classified as more generous typically have a deduction and a sizable pension exemption, and exempt social security benefits. “Early” enactment of preferences is not only relative to other states, but also relative to when a state first enacted an income tax. A state such as Illinois, which did not even have an income tax until 1969, is still classified as early if it immediately enacted common preferences (in this case, the deduction) and also enacted some preferences that were not so common at that time (pension exclusion). The degree of change undertaken by the state is based on how much the state fundamentally altered its policies. A state that simply adjusts its preferences upward periodically (presumably due to inflation) would not be considered a ‘changer’.

Finally, a few states decidedly switched behaviors and therefore classifications. For instance, up until 1973, Mississippi was the only state to tax social security benefits prior to the federal policy; furthermore, it didn’t grant any tax preferences. Then, in 1973 it enacted both a deduction and a pension exclusion (that included social security benefits in its definition), and subsequently made three more policy changes to exempt social security benefits and expand the exclusion. By 1994, it was one of only five states to fully exempt

is listed in Baer (2006). Most states follow the federal policy exactly, but a few give social security benefits a more favorable treatment while still subjecting them to tax.

pension income. These ‘switchers’ are of particular interest – what led them to change their behavior? We therefore note them as well.

Figure 1 presents our attempt at classifying the states along two of these dimensions – how generous they are with their elderly tax preferences and how early they were in granting them. For each state, we also note whether it tends to change its policies in substantial ways (C), whether it makes small adjustments/fiddles (F) or makes very few changes/is stable (S). From this figure, we see that the states do not fall uniformly along these dimensions. ‘Early’ states tend to be more generous and ‘late’ states tend to be less so. Still, there are ‘late’ states that are generous and ‘early’ states that are relatively less so. Likewise, there are ‘changers,’ ‘fiddlers’ and ‘stable’ states scattered fairly randomly through the figure. However, the ‘late/least generous’ states do tend to change their policies the least and the ‘early/most generous’ seem to do so the most.

Geography also appears to play a role. The ‘early/most generous’ states (upper right) tend to be concentrated along the Atlantic seaboard. Two interesting exceptions are the neighboring states of Michigan and Illinois, which are also unusual in that that they enacted their income tax systems relatively late (1967 and 1969, respectively). Another pair of neighbors in this group, Pennsylvania and New Jersey, enacted their taxes even later (in 1971 and 1975). Moving towards the bottom left of the table, towards the less generous and ‘later’ states, the Plains and New England states are disproportionately represented. In general, these regional patterns correspond with the results from Conway and Rork (2007) except that they reveal that the more generous regions also tended to be among the first to enact elderly preferences.

We highlight three states that changed their behavior during the time period.

Kentucky was relatively early in enacting its very modest elderly credit, but did nothing other than enact occasional modest increases until 1995. It then enacted a limited pension exclusion and has increased it aggressively to where up to \$77550 in pension income was tax exempt (for married couples) by 2002. It now joins Michigan, who also increased its exclusion aggressively during this period, as the only two states to provide such large exemptions without fully exempting pension income. What happened in 1995? Why did these two apparently disparate states behave in the same way?

Another state that suddenly changed its behavior is Mississippi. Up until 1973, Mississippi was the only state to tax social security benefits and therefore, along with its policy of no elderly deduction, had the distinction of being the only state with an income tax that did not grant an elderly preference. (Connecticut now holds that distinction although it does treat social security benefits more favorably than the federal law.) In 1973, it added both an elderly deduction and a limited pension exclusion, making it a relatively 'early' state to offer a pension exclusion. In 1979 it exempted social security benefits from taxation and then later twice increased its pension exclusion such that in 1994 it became one of only five states to grant a full pension income exemption. Again, what happened in 1973? Why did it take Mississippi nearly 20 years to decide to fully exempt pensions? Is it a coincidence that Michigan and Kentucky began their large increases the following year?

Obscured in the figure and reported in only limited detail in Table 2 are instances of other states making important, but seemingly contradictory, changes to their policies. These states enact or expand preferences only to subsequently reduce or repeal them; some

states go on to repeat the pattern. As a result, many of these states are classified near ‘average’ generosity in Figure 1 and as ‘changers’ (C), because during some of the period they were generous with their preferences whereas during others they were not. States in this category include California, Colorado, Minnesota, Montana, New Mexico, North Dakota, Oregon, Utah, Vermont and West Virginia. Most other states that frequently and/or substantially changed their policies did so in a consistent manner – towards more generous elderly preferences.

Finally, at the bottom of Figure 1 we report three groups of states. The first is the list of states not included in the figure – those without broad income taxes during the latter half of the period. The second lists the states that are closely tied to the Federal tax system; states that have been completely tied to the federal system during the vast majority of the period are not reported in the figure. The last list is a group of states that began increasing their elderly deductions, lockstep with one another, in each year after TRA86. These increases are modest and appear designed to adjust for inflation.

In sum, several patterns across states are apparent from Table 2 and Figure 1:

1. States that were ‘early’ with their elderly preferences tend to be more generous. ‘Early, generous’ states tend to be along the Atlantic seaboard.
2. Similar to Conway and Rork (2007), the Southeast and Mid-Atlantic regions tend to be more generous (and ‘early’), whereas the Plains states tend to be less generous.
3. Many states have substantially changed their policies over time. While many of these have consistently increased and expanded their elderly preferences, as suggested by the timeline table, a significant number have changed their policies in seemingly contradictory ways, enacting/increasing preferences only to subsequently repeal/reduce them.
4. A few states seem to have fundamentally changed behaviors or ‘woke up’ to granting elderly preferences. More generally, a number of states experience a substantial number of changes (typically increases) to their preferences during short, isolated periods of time.

5. The states have not behaved in a uniform way over time. Along the dimensions of 1) timing of enactment, 2) generosity and 3) frequency of change, we find states scattered along the full spectrum of combinations.

3. Revelations

The previous section reveals several salient trends over time – the growing number, size and prevalence of elderly preferences, especially the emergence of pension exclusions – yet it also shows that the states have not behaved in a uniform way, nor have they strictly followed the federal government. Geography clearly plays a role, but cannot fully explain the differences across the states’ experience. In this section, we discuss several possible explanations for these behavioral tendencies and search for evidence that supports or refutes each explanation.

A. *Robbing Peter to Pay Paul? EIG taxes and OAA benefits*

One could rightfully argue that our analysis thus far has been incomplete. Income tax preferences are just one of several policies that affect the elderly. States can choose to tax estates and inheritances and, prior to Social Security, they could offer generous (or not) old-age pension benefits. One possible explanation, then, is that the difference in income tax preferences across states is due to looking at only one part of a broader portfolio. States may have increased their income tax preferences for the elderly because they began taxing estates and inheritances more heavily or because the federal system of social security differed from their desired system (as reflected by Old Age Assistance, OAA). We therefore look at the states’ behavior regarding these two policies.¹⁷ Table 3A reports the year of enactment (and elimination, if applicable) of each state’s EIG taxes, and the amount

¹⁷We recognize this is not an exhaustive list of policies, but view it as a reasonable indicator of how a state has treated its middle and high income elderly constituents. As discussed above, we choose to focus on

of state EIG taxes levied on a \$1 million estate in 1935 (Cooper 2006, footnote 200, p. 866). For each state's OAA program, we report the year of enactment (when available in Costa 1998) and its generosity in 1940 and 1950, measured by both average benefits' levels and coverage rates (Friedberg 1999, Table 1). The first column repeats our classification of the state with regards to 'timing' (early vs. late) and generosity (distilled from Table 2 and Figure 1).

We envision one of three possible patterns. First, states may be using these various policies as substitutes in their policy portfolio. Therefore, when the generosity (or fiscal burden) of one policy is reduced, the policy of another grows and the variation across states is due to our consideration of only one policy. Second, states may be behaving the same way with all 3 policies – i.e., they are generous (or not) across the board. In that case, income tax preferences is a good indicator of a state's overall treatment of the middle/high income elderly, and the differences across states is magnified if the entire portfolio is considered. Third, we may find no strong relationship among the three policies, which suggests that states may be considering income tax preferences in isolation from other policies. Complicating this, however, are the actions of the federal government. In the case of OAA, for example, the federal government took over this role – which might also have the effect of freeing up state revenues for other purposes.

Examining the behavior of states with regard to these other policies during the 20th century provides additional insights as well. Nowhere is this more evident than in Cooper (2006), which provides a fascinating account of the expansion and subsequent contraction of state EIG policies. Cooper (2006) notes the growth in state EIG taxes between 1892 and

policies that target the middle to high income elderly because their motivation seems less clear. Also, it helps to justify our decision to ignore property tax relief, which typically targets low income, elderly homeowners.

1915 in terms of both prevalence and fiscal impact. Beginning in 1916 and accelerating up until 1924, however, state EIG taxes began to decline. Cooper attributes this turnaround entirely to interstate competition and the concern by the states that EIG taxes would cause them to lose their wealthy constituents.¹⁸ Florida, in particular, aggressively used its tax policies (along with its climate and cheap real estate) to become a tax haven for wealthy individuals, and it resisted enacting an EIG tax. By 1924, Alabama, Nevada and California had either repealed their EIG taxes or were debating doing so (Cooper 2006, pp 849-50). Cooper notes that the 1926 enactment of the federal state EIG tax credit (commonly known as the ‘pickup tax’) was in direct response to the states’ pleas for help in ending this ‘race to the bottom.’¹⁹ By 1935, many new EIG taxes had arisen and even Florida had adopted a tax to take advantage of the credit.

Yet, the federal credit did not lead to uniform state EIG taxes (Cooper 2006). Rather, many states continued to impose EIG taxes beyond the ‘pick-up tax,’ especially on smaller estates, until 1976 when states (starting with New Mexico) began eliminating these extra taxes (as documented by Conway and Rork 2004). (Table 3A shows the large number of states that imposed extra EIG taxes on estates of \$1 million in 1935.) By 2001, the pick-up tax was the only EIG tax imposed by 38 states. However, for the largest estates (\$10 million in 1935) – presumably those the states were most worried about ‘losing’ to competitors -- state EIG taxes were largely uniform as early as 1935. In fact, only 6 states imposed an EIG tax on such large estates in 1935 beyond the credit, and five of these were

¹⁸ He also notes the role that the automobile played in the increased mobility of the population in the 1920’s.

¹⁹ The tax credit effectively allows the states to collect EIG tax revenues without increasing the overall (federal + state) EIG tax liability of the estate. It therefore helped to diffuse interstate EIG tax competition. As also discussed in Cooper 2006, as well as Michael 2004, EGTRRA of 2001 phased out this tax credit, completely eliminating it by 2005 and thus reopening the issue.

quite modest.²⁰ North Dakota stands out as the only state imposing a substantial additional tax on such estates.²¹

This brief history of state EIG tax policy uncovers some interesting parallels with state elderly income tax preferences. Foremost is the very real pressure felt by the states to enact tax policies that would not drive away their wealthy constituents. This raises the possibility that states began using their income tax systems to compete once state EIG tax competition was diminished. While the resurgence of EIG taxes in the 1930's corresponds to the emergence of state income tax systems and the first elderly tax preferences, elderly tax preferences did not become widespread until later. The subsequent elimination of state EIG taxes on smaller estates did not really begin until 1976, well after most states had adopted extra deductions and many had enacted pension exclusions. Thus, state EIG tax policy was relatively 'quiet' during the period in which income tax preferences began developing and expanding (1947-1976).

Is state EIG tax policy helpful in explaining patterns across states? We can look at the timing ('early' vs 'late') of the two policies (enacting tax preferences and EIG taxes) as a sign of state's policy "innovativeness" (an explanation we explore shortly). We can compare the generosity of the state's two policies by looking at how it was classified in Figure 1 and compare it to 1) when/if it eliminated its EIG tax, and 2) the EIG taxes it imposed on \$1 million and \$10 million estates in 1935.

In terms of timing, we see very little pattern. Although there are a large number of states that are 'early' with both its state income tax preferences and EIG taxes (e.g., CO, DE, HI, IL, MD, MI, MN, MT, NJ, ND and VT), there are also a large number for which

²⁰ These six states are IL, MS, NY, ND, OR and WV. Further, as noted in Cooper 2006, footnote 200 on p. 866, these states were also more likely to levy higher additional taxes on medium-sized (\$1 million) estates.

the patterns diverge (e.g., AR, CT, GA, IA, LA, ME, MA, MO and NM).²² Furthermore, the states seem reasonably scattered in terms of their relative tax preference generosity. In other words, the states that enacted both policies ‘early,’ for example, are no more likely to be more (or less) generous than those that diverge. No strong patterns exist between the generosity of the two programs either. The six states that continued, in 1935, to levy additional taxes on large estates (IL, MS, NY, ND, OR and WV) are distributed across the income tax preference generosity spectrum. Likewise, the states that have not yet eliminated their EIG taxes are evenly distributed. We construct a figure (not reported) similar to Figure 1 to compare the generosity of a state’s EIG taxes against ‘more’ vs. ‘less’ income tax preference generosity. This exercise reveals a slight positive relationship between the generosity of these two programs, but the pattern is far from strong.

Overall, then, while we see interesting parallels over time with respect to the two policies – especially interstate tax competition pressures – we do not see strong patterns across the states in terms of their behavior. In one sense, this is not too surprising as the policies seem likely to affect different groups of people. EIG taxes affect only the wealthiest elderly and, even so, are not imposed until after death. We therefore turn to a policy that benefits a much wider cross-section of the elderly while they are still alive – the Old Age Assistance (OAA) program.

Examining the history of OAA programs at the state level – and the history of the federal programs that would eventually take their place – both provided by Costa (1998, Ch. 8), reveals several interesting parallels with the behaviors of both state income tax

²¹ ND was, however, one of the early eliminators of EIG taxes, doing so in 1979.

²² No strong pattern exists among states that don’t have broad-based income taxes; they appear equally likely to have adopted EIG taxes ‘late’ versus ‘early’.

preferences and EIG taxes.²³ Costa (1998) notes that “Old-age pensions emerged as a political issue in the 1920’s,” (p. 167), and the timing of political activity corresponds closely with that of the state EIG tax crisis of 1924-26. Likewise, these programs first emerged as state EIG taxes began to wane. The first old-age pension programs were enacted in 1915 in Arizona and Alaska (although Arizona’s was subsequently found unconstitutional). Three more states enacted programs in 1923, and four more passed programs in 1925-26.²⁴ These programs were not statewide, mandatory programs, however. California and Wisconsin were first to enact statewide, mandatory laws in 1929. More generally, the old-age pension programs that were enacted prior to the Social Security Act of 1935 were quite limited in their scope. Many limited beneficiaries to those aged 70 or over, who had lived in the state for many years, did not own substantial property, had worked when judged able, etc. As a result, the coverage of such programs was quite small, ranging from 1% in Maryland to 22% in Arizona in 1933 (Costa 1998, p. 167).

Here again the early 1930’s prove to be a critical period. Costa (1998) notes “The year 1933 marks the creation of popular, grassroots old-age pension movements.” The Townsend movement, which we discuss shortly when we consider elderly political power as an explanation, arose during this time. By 1934, 28 states plus two territories had enacted old-age pensions programs. The new programs were more likely to be state administered, mandatory and at least partially state funded. This time period is therefore marked with the widespread enactment of both state income tax systems and old-age pension programs, the resurgence of state EIG taxes (after the reprieve from interstate

²³ Our discussion of OAA and Social Security programs history is taken largely from Costa (1998).

competition provided by the federal credit) and the emergence of the first, sustained elderly income tax preference.

The Social Security Act of 1935 (SSA35) further encouraged state old-age programs by offering federal subsidies for old-age assistance. Twelve months after SSA35, 36 states plus DC had developed old-age programs and were receiving federal payments. The OAA programs continued to grow in benefits and reciprocity rates in the years after SSA35 and were at their peak in 1950 (Costa 1998, p. 172). During the 1950's, the Social Security program expanded rapidly and the proportion of the elderly receiving Social Security payments rose steadily, from 17 to 62%. At the same time, the proportion receiving state benefits decreased from 22 to 14%. Social Security continued to expand until 1973, and the OAA program was incorporated into Supplemental Security Income in 1974.

Another federal event was the enactment of Medicare in 1965. Medical assistance for the aged was a growing concern for the states during the period leading up to Medicare; state and local expenditures on medical assistance for the elderly increased by more than 1000 percent between 1960 and 1965 alone (Costa 1998, p. 177). Beginning in the late 1970's, however, the federal government began to enact policies to solve the financial problems that had begun to emerge with regards to social security. The tax base was expanded, benefit increases were reduced, and benefits began to be subject to income tax for high income households.

Figure 2 provides a timeline of the major events facing these three policies – EIG taxes, OAA/Social Security/Medicare, and elderly income tax preferences. Taken together,

²⁴ NV, MT and PA enacted programs in 1923, but Pennsylvania's was subsequently ruled unconstitutional. Wisconsin, Kentucky, Maryland and Colorado passed programs in 1925-26.

the time patterns are quite suggestive that states view these policies as a portfolio – both in terms of budgetary pressures and as avenues to ‘compete’ for the elderly. The first old-age programs emerged just as concerns about interstate EIG competition were reaching a peak (1915-1926). As EIG competition was diffused and a ‘painless’ source of revenues was provided by the federal tax credit, old-age programs rapidly grew (1926-1934). At the same time, state income taxes became widespread and the first elderly tax preferences emerged. The SSA program further encouraged the growth of OAA programs and they reached their peak around 1950 – as Social Security began to take over. At the same time, modern-day elderly tax preferences started to become widespread, predating the federal deduction in several states.

By the mid to late 1960’s, Medicare had been enacted, again removing fiscal pressure from the states, and private pension exclusions started becoming more common soon afterwards. The federal government continued its expansion of Social Security until the mid to late 1970’s; at this time, the states began eliminating their state EIG taxes and appear to be engaging in interstate competition (Conway and Rork 2004). Federal preferences and benefits for the elderly are further reduced by the SSA of 1983 and TRA86. Many states moved in the opposite direction; seven added pension exclusions and 13 eliminated their EIG taxes during 1980-86. The federal government increased its taxation of social security benefits in 1993, and the states continue to enact and increase their pension exclusions and eliminate their EIG taxes. The federal government phased out its estate tax and the associated state tax credit with the EGTRRA of 2001. Medicare continued to be expanded with the addition of Part D that covered prescription medications in 2006. By the early 21st century, then, state and federal EIG taxes had all but

disappeared, sizable pension exclusions were widespread, and the elderly's medical expenses and pensions were mostly covered by the federal government.

We see two salient patterns from this timeline. The first is that the states tended to offer new elderly benefits when the federal government either provided a new source of revenues (the EIG tax credit and the OAA subsidies) or took over the responsibility of providing for the elderly (Social Security and Medicare). Notice that federal provision of pensions and health insurance also makes the elderly a more desirable group for the states to compete over, as the elderly now bring their income and health insurance with them. They therefore can provide a demand-side stimulus to the local economy without imposing much of a burden on the public sector. The second is that when the federal government reduced – or slowed its increase of – elderly benefits, the states often began increasing theirs (eliminating their EIG taxes and expanding their pension exclusions). The exception is changes to the federal income tax code; these were often followed by the states. This is not surprising given how closely tied many state tax systems are to the federal code. However, it is notable that the majority of states have not followed the federal government in its decision to tax social security benefits of high income households.

Looking at the patterns over time, the states seem to expand their elderly benefits when the cost of existing elderly programs subsides (so that they perhaps can better afford it and/or the elderly are a more desirable group to attract) or when the federal government limits its benefits (so that they perhaps feel more political pressure to compensate). What about the patterns across states? Costa (1998) notes very strong regional and demographic tendencies in the states' old-age pension policies. The very early states (those with programs by 1929) tended to be non southern with small elderly populations, while those

that enacted between 1929 and 1934 (prior to the SSA35) were also non southern but had relatively large elderly populations. The SSA35 therefore tended to benefit most those states that already had old-age programs. Table 3A reveals that the non southern states continued to be more generous with their benefit levels and coverage rates even after the federal government began subsidizing them. However, a number of states in the southeast region experienced very large increases in their benefit levels, their coverage rates or both between 1940 and 1950. These trends are discussed and explained by Costa (1998). She asserts that 50 to 60% of the variation in OAA payments is accounted for by region and the percentage of the population that is elderly. She also notes that an increase in the federal subsidy led the southern states to increase their number of recipients. Still, it is interesting to note that the same region that experienced the largest increases later became ‘early/generous’ providers of elderly income tax preferences.

A pairwise comparison between old-age pension policy timing/generosity (the third set of columns from Table 3A) and that of a state’s income tax preferences (the first) again does not reveal a strong relationship between the two programs. However, it is very likely that any relationship may be obscured by a failure to control for other factors, including a state’s EIG tax policies. This highlights the need for a multivariate analysis, which we plan to undertake in future work.

B. Intelligent Design?

Perhaps state income tax preferences for the elderly are an example of a ‘public policy innovation.’ Walker (1969) provides a thoughtful discussion of the difficulties in defining and measuring ‘policy innovativeness,’ and then creates a measure that is based on when a state first adopted each of 88 different policies. These 88 policies had to be enacted

by at least 20 states by 1965, and they span a wide range of issues, including various types of licensing (e.g., chiropractors, pharmacists, engineers), programs for vulnerable populations (e.g., mentally ill, deaf, the aged, children), aid for various public projects (highways, parks), establishment of state commissions (advertising, human relations), laws (child labor, fair trade, minimum wage) and taxes (cigarette).²⁵ Regardless of the states' motives for granting elderly income tax preferences, these preferences certainly qualify as a relatively new policy, and, having first started at the state level, may be another indicator of 'policy innovativeness.'

Table 3B reports the state ranking for 'policy innovativeness' according to Walker's overall index.²⁶ In future work, we may investigate decomposing this index by type of policy (e.g., those geared to the elderly or vulnerable populations) or by time period (to look for changes over time). The overall index, however, seems a good place to start. The policy innovativeness index shows strong regional patterns; the Mid-Atlantic, New England, Far West and upper Midwest States are disproportionately 'innovative' states. The states without income tax systems tend to be towards the bottom of the index.

Comparing this index to our classification of each state as 'early/late' and 'more/less' generous also reveals some interesting patterns. Many of the 'most innovative' states were also 'early' to adopt income tax preferences; the two highly 'innovative' New England states, Connecticut (#6) and Massachusetts (#2), stand out as exceptions. As we move down the scale, however, we see less of a pattern. Near the middle, we see southeast states that are relatively 'innovative' (NC and VA) compared to the rest of their region, but

²⁵ The full list of programs and policies are reported in the Appendix to Walker (1969).

²⁶ This index is available through the ICPSR, Study No. 66. It is created for each state based on the passage of time between the first adoption of a program and each state's adoption of the program, as a proportion of the total time lapsed between the first and last adoption dates. It is only available for the 48 contiguous states.

that are only ‘average’ in their income tax preferences. The two ‘later/less generous’ southeast states are quite different in ‘innovativeness’, as Alabama comes in at #30, and Mississippi last at #48. Once again, this analysis would benefit from a summary measure of income tax preferences and a multivariate approach. Our simple pairwise comparison, while suggestive at the top of the scale, does not appear to have strong explanatory power.

What about a broader definition of ‘innovativeness’? If states are motivated by a desire to ‘compete’ for the elderly, for example, these tax preferences may not be so much a ‘public policy innovation’ but an attempt to improve the economy of the state. A measure of innovativeness of the private sector, therefore, may provide additional insights. Skinner and Staiger (2005) consider a wide range of new technologies, including hybrid corn and the tractor in the early part of the century and, more recently, the use of home personal computers and Beta Blockers (to treat heart attacks). They find a consistent tendency by some states to adopt effective technology and they investigate the factors associated with this tendency. Clearly, income tax preferences are not a ‘technology.’ However, to the extent that they are being offered in order to attract elderly constituents who will benefit a state’s economy, they may be associated with a state’s propensity to adopt new technologies. We envision two scenarios. States that are quick to adopt new technologies are also quick to adopt policies that help the state to ‘compete’ in other ways. The same factors that lead the state to be an early adopter also lead it to figure out and quickly adopt ‘competitive’ policies. Conversely, states with private sectors that lag behind in adopting new technologies may attempt to compensate by devising policies designed to provide different avenues for economic growth.

Table 3C reports the ranking of states' rate of technology adoption based on the 'tractor adoption' measure considered by Skinner and Staiger (2005).²⁷ This measure is the state's rank in when it first achieved a rate of tractor use of at least 10%. The year this milestone is reached corresponds roughly to the period spanning the emergence of state income taxation to the beginning of elderly tax preferences (1916 for SD to 1947 for MS). Skinner and Staiger (2005) also consider two more recent measures, which are reported in the Appendix. These two measures are a state's rank in the use of home personal computers in 1993 and of Beta Blockers to treat heart attacks in 2001. These more recent measures can be used in a couple of ways. One is to identify those states that are consistently early adopters, as in Skinner and Staiger (2005). Another is to search for states that seem to have changed in their propensity to adopt technology and see whether and how it is related to their elderly tax preference policies. Perhaps the states we identify as having 'switched' in their tendencies for state tax preferences have done so in adopting technology also. Finally, given the continuing expansion of elderly tax preferences in some states, it is helpful to have a current measure of technology adoption as well.

The early measure (tractor adoption) has a strong regional tendency, not surprisingly, to the heavily agricultural states (SD, ND, KS and IL in the top 5). Nonetheless, it also is positively associated with the timing of a state's income tax preference policy. Six of the top 10 states in tractor adoption are classified as 'early' adopters of income tax preferences; only one is 'late'. (There is less of a relationship between the level of generosity.) Again, at the bottom of the scale, the pattern is less strong, although such states also are a bit more likely to be 'late' in adoption income tax

²⁷ We are indebted to Professors Jonathan Skinner and Douglas Staiger for generously providing us with their innovations data, and also to the original source of the tractor data (Paul Rhode) who made the

preferences as well. Comparing Tables 3A and 3B also reveals, however, a relationship between technology adoption and ‘public policy innovativeness,’ and both measures have strong regional patterns, further emphasizing the need for a multivariate approach.

What about the two states, KY and MS, that appeared to ‘switch’ in their income tax preferences, as identified in Figure 1? Both states receive low rankings in technology adoption, across the past and present measures. Therefore, the change in their state tax preference behavior does not appear to be reflected in a change in their propensity to adopt new technology. Both are also in the bottom half of states in their ranking of ‘policy innovativeness,’ although Kentucky (#27) is considerably higher than Mississippi (#48).

Finally, a few states stand out as being consistently ‘early’ with regards to all three dimensions (state tax preferences, public policy and technology adoption) – Colorado, Minnesota, Illinois and Maryland. At the other extreme, Missouri, Oklahoma, Arkansas, Alabama and Mississippi were consistently among the bottom group. While the latter group has an obvious regional tendency, the connection among the former group is less clear.

C. Survival of the (Politically) Fittest?

The vast majority of past work by economists on elderly political power has focused on social security and other elderly expenditure programs (e.g., Mulligan and Sala-i-Martin 1999 and 2004, Slavov 2006, and Galasso and Profeta 2004). Likewise, studies of the history of the elderly political movement, such as Pratt (1976) and Amenta and Zylan (1991), focus exclusively on expenditure programs. Benefits given the elderly via the tax system have been, to our knowledge, completely ignored by these literatures. The one exception is our earlier paper, Conway and Rork (2007), which borrows from the

economic political power literature mentioned above in identifying factors that can measure political power. These measures are then used to try to explain the trends in state income tax preferences over the last 25-30 years, with mixed results. One limitation of their approach is that the elderly political movement was already reasonably well established at the beginning of their study period.

Such is not the case here. Once again, looking at the history of elderly political movements reveal interesting parallels, over time, with state income tax preferences, as well as EIG and OAA policies. Pratt (1976) and Costa (1998) both note the emergence of the early pension movement in the 1920's and credit it, at least in part, for the growth in state old-age pension programs prior to the SSA of 1935. Pratt (1976) and Amenta and Zylan (1991) both note how the Townsend movement (and related movements) peaked in the late 1930's. Briefly, the Townsend movement was begun by a California physician, Francis E. Townsend, who proposed that every person over age 60 receive \$200 a month (which was more than twice the earnings of full-time workers), provided the money was spent within one month of receipt (Costa 1998). However, the Townsend movement fell off dramatically in the early 1940's (Pratt 1976 and Amenta and Zylan 1991). According to Pratt (1976), there was a hiatus after the decline of the Townsend movement, followed by the birth of the senior movement in the 1950's. He notes that the decade of the 1950's was 'a prelude... to a time of marked activism among the aging, involving the emergence in the sixties of politically influential, mass-based organizations and interest groups,' (Pratt 1976, p. 39).

This brief history reveals that the early elderly political power movement, as measured by the early pension and Townsend movements, peaked in the 1930's and

corresponded with the enactment of the SSA of 1935, widespread state old-age pension programs and income tax systems, and the first elderly income tax preference. Its rebirth, in the 1950's, corresponds very well both to the growth in the federal Social Security Program and the eventual enactment of Medicare in 1965. While this relationship has been well established, the fact that income tax preferences for the elderly also emerged and quickly expanded during this period appears to have been overlooked.

To search for a pattern across states, we use state-level, Townsend Club membership data reported in Amenta and Zylan (1991). This measure captures membership between 1934 and 1950, and so it mostly predates the onset of elderly income tax preferences. This ranking is reproduced in Table 3D, along with our classification of a state as 'early/late' and 'more/less' generous in its income tax preferences. One salient trend is that the states with a strong Townsend presence are far more likely to not have income tax systems (five of the top 10 do not have broad-based income taxes, although SD did have one at the time). As noted above, states without income tax systems were also found to be less 'policy innovative.' Perhaps the lack of public policies led to the growth of the movement in those states. Regional patterns are evident here as well, as they were with our other explanations. As discussed in greater detail by Amenta and Zylan (1991) the Townsend movement was strongest in the West and weakest in the South²⁸; the Midwest had a stronger presence than the Northeast.

However, there appears to be no discernable pattern between Townsend Club membership and the timing or generosity of a state's elderly income tax preferences. If anything, states with a smaller Townsend presence were slightly more generous. The

Townsend measure is admittedly imperfect. Not only is the movement itself hard to measure, as noted by Amenta and Zylan (1991), it also may be only loosely related to the ‘senior movement’ that Pratt (1976) describes as emerging in the 1950’s. In future work, we plan to search for improved measures of the more recent elderly movement. Pratt (1976) notes the important role that senior centers played during this time period and the extent to which they expanded. This could be a promising alternative measure of state-level elderly political power. Still another option is to use the more indirect measures used by Conway and Rork (2007), such as the relative wealth and labor force participation of the elderly.²⁹

4. Preliminary Conclusions and Future Directions

This paper reflects our first attempt to report and explain the trends we see over time and across states in the income tax preferences granted elderly citizens. Our analysis has uncovered several trends over time and across states. Elderly tax preferences first appeared, in a sustained and soon widespread manner, in the late 1940’s and prior to any offered by the federal government. The first preferences were predominantly an additional deduction/exemption given on the basis of age. In the late 1960’s, private pension income exclusions, which the federal government has never granted, began to emerge as a widespread phenomena. The general trend over time, therefore, is an expansion of both the type and generosity of elderly tax preferences, tempered only by two federal actions – the

²⁸ The authors present as a possible explanation the link that the Townsend movement had with the Grand Army of the Republic (GAR), which was a Civil War veterans’ organization. In addition, the role of Protestant churches in aiding the movement may have played a role in these regional differences.

²⁹ Another possible measure is the size of the elderly population. As summarized in Conway and Rork (2007), the size of the elderly population actually exerts conflicting influences on policy. While it increases the age of the likely median voter (and thus makes them more likely to see the benefits of such policies), it also increases the policy’s costs.

taxation of social security benefits in 1983 and the reduction in the elderly deduction as a result of TRA86. Currently, only one state – Connecticut – does not grant the elderly any of the three main tax preferences we consider (deduction/exemption, pension income exclusions and tax exempt social security benefits). Even it, however, treats social security benefits more generously than the federal government.

These salient trends over time have interesting parallels with the alternative explanations that we offer in Section 3. The history of state estate, inheritance and gift (EIG) tax policies and state old-age pension policies provide suggestive evidence that the three policies are connected and that states may be viewing them as part of a larger ‘portfolio.’ The waxing and waning elderly political movement also corresponds well with the expansion and relatively ‘quiet’ periods of state income tax preference policy.

Uncovering patterns across states has proven much more challenging, however. Complicating any attempt to categorize the states is the fact that many states did not have broad-based income tax systems until the expansion of elderly income tax preferences was well underway. Some salient patterns do emerge. As in Conway and Rork (2007), the Southeastern and Mid-Atlantic regions are more likely to be both ‘early’ and ‘generous’ in the preferences they offer. The Plains states are less likely. Isolated pairs of geographic neighbors (e.g., Illinois and Michigan, New Jersey and Pennsylvania) enact similar policies at similar times. Trying to explain these trends with our explanations, however, is difficult.

Our preliminary research so far therefore suggests that all three forces – other state (and federal) elderly policies, a state’s ‘innovativeness,’ and the political power of the elderly – have played a role in the evolution over time in these preferences. It is far less clear whether and how these forces can explain the differences in policy across states.

What is needed is a multivariate analysis that can control for these forces simultaneously, as well as other state ‘initial conditions’ or characteristics that might explain their differences. And, a multivariate analysis requires that we somehow distill state income tax preference behavior into a quantitative, summary measure. Complicating this task is the fact that a significant number of states did not have income tax systems until the latter part of the century and that states offer a wide variety of preferences.

To accomplish these dual goals, we propose constructing a measure/index for each type of preference with regards first to whether/how long each state has granted the preference and second to the generosity of that preference. This measure must adjust for how long the state has had an income tax while also recognizing the tendencies of states to grant more preferences over time. We propose the following measure, constructed in these steps:

1.) Construct a measure, Y_{Ai} , that measures the proportion of state i 's income tax history that it had tax preference A relative to states that have had income tax systems during the same years,

$$(1) \quad Y_{Ai} = \frac{\sum_{t=t'}^T D_{it}^A}{\sum_{t=t'}^T \sum_{j=1}^J \left(\frac{D_{jt}^A}{J_t} \right)}$$

where t denotes time and t' denotes the point in time when the state enacted an income tax, and T is the last period for which we have data (currently, 2002). For states with income tax systems prior to the year when the first elderly tax preference appeared (e.g., 1931 for pension exclusion), we set t' to that year. D_{it}^A is an indicator variable equal to one if state i

has income tax preference A in time period t . The numerator, therefore, calculates the number of time periods that the state had income tax preference A during the state's t' to T history.³⁰ The state's history is defined as the period of time during which *any* state had income tax preference A or, for states that enacted income taxes more recently, the period of time that they have had an income tax. The denominator performs the same calculation for the average over all states with income taxes ($j=1, \dots, J_t$) in each time period. Note that the number of states with income tax systems (J_t) changes over time. Y_{Ai} therefore captures how often during a state's tax history it had income tax preference A compared to all other states that had income tax systems in each period.

This measure may not perfectly adjust for states that enacted income tax systems relatively late, such as Illinois, as such states may have tax preferences during more of their history (although not necessarily *relatively* more than other states during the same time period). Likewise, states that enacted the preferences very early are going to have very large values for the first few years before others joined them. We include the year that a state enacted its income tax system as another factor in our multivariate analysis to capture these possibilities.

This measure equals 1.0 for a state that had the average experience and equals zero for states that never have an income tax preference. It has no logical upper bound. We therefore rescale the measure to create a 100 point index. Doing so provides an upper bound and also creates a measure that we can compare and sum across different tax preferences.

³⁰ If we divided by $T-(t'-1)$ we would get the more intuitive proportion of time that a state had an income tax preference, but because we are redefining this to be relative to all states during this period, we would end up dividing the denominator in the same way and the two would cancel out.

2.) Using Y_{Ai} , create a 100 point index I_{Ai} that ranges from 0 to 100 by calculating

$$(2) \quad I_{Ai} = \left(\frac{Y_{Ai} - \min(Y_{A1}, \dots, Y_{AJ})}{(\max(Y_{A1}, \dots, Y_{AJ}) - \min(Y_{A1}, \dots, Y_{AJ}))} \right)$$

This measure will range between 0 (for the state with the lowest value) and 100 for the state with the highest value for preference A .³¹

3.) To combine the indices for each preference, A , into one summary measure for all preferences, we consider two alternative weighting schemes. The first simply weighs all three preferences equally (deduction/exemption/credit, pension exclusions and taxing social security benefits) and calculates the average of the three:

$$(3a) \quad I_i = 1/3 \sum_{A=1}^3 I_{Ai}$$

The second weights each index according to its likely tax savings for the high income elderly household,

$$(3b) \quad I_i = \sum_{A=1}^3 w_A I_{Ai} .$$

Possible candidates for the weight w_A include using the composition of pension income and social security benefits reported in Conway and Rork (2007) for high income households in various years, or using the maximum possible tax savings from each preference (calculated by multiplying the marginal tax rate by the amount deducted or exempt).

³¹ Note that we cannot substitute this normalization for the one performed in equation 1. This normalization rescales the variable relative to the other states' values. The normalization in equation 1 adjusts for the changing number of states in each time period with income tax systems.

4.) These measures only capture the timing and prevalence of tax preferences; they do not measure their level or generosity. To do so, we can rewrite equation (1) such that the indicator variable, D , is replaced with the dollar amount of the deduction or pension exemption (or maximum amount of social security benefits exempt).³² D is still zero for states in years without the tax preference. We can build an index for each preference separately as before. To create a summary measure, we can either take the (weighted) average of the three indices (as in equation 3a and 3b) or we can sum the raw measure (from equation 1) first and then create an index from it. The latter approach places more weight on preferences with higher dollar values, similar to equation 3b) above.

With such summary measures, we can conduct a multivariate analysis and thus capture all of the forces simultaneously, as well as regional effects and other state characteristics. As proposed above, these measures are state-specific; they do not vary over time. They therefore are most helpful in searching for trends *across states*. However, we also could decompose the indices into certain periods of time. For example, we can construct each state's index defining its history using the time before and then after some event (such as TRA86 or the enactment of Medicare) and see how each state's behavior has changed over time. In other words, we can decompose our index into separate time periods to bring back some of the variation over time.

We also have two data-gathering tasks. First, several of our measures are not available, from our sources, for all of the states. Alaska, Hawaii and DC may prove to be impossible to locate given their statehood status, but we are optimistic that we can locate information for the other missing states. Second, we need to define and create measures of

³² For states that grant elderly tax credits, the equivalent deduction/exemption can be calculated using the state's maximum marginal tax rate.

interstate competition if we want to be able to consider it as another possible explanation. While there is considerable overlap among all of our explanations, interstate competition seems especially problematic to isolate. A starting point could be the measures used by Conway and Rork (2007) – the mobility of a state’s elderly population (measured by summing in-migration and out-migration rates) and the elderly tax policies of the state’s ‘competitors,’ (as defined by long-run state-to-state migration flow patterns). Another option is a state’s apparent aggressiveness in other interstate competition arenas, such as business recruiting or taxes on other mobile factors (Rork 2003).

With additional and improved measures, more complete data and a method of summarizing income tax preferences, our future work will better reveal how and why state income tax preferences have evolved as they have. What is clear from the preliminary research here is that such tax preferences have grown over time – in contrast to those of the federal government – and interact in interesting ways with other forces at work during this time period. How these forces have impacted the policies of each state, however, remains to be seen.

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TABLE 1 -- A Brief Timeline of Major Changes in Elderly Tax Preferences Since 1900

| Year | Income Tax | Deductions | Pension | Low Income Preferences |
|------|---|------------------------------|------------------------------|------------------------------|
| 1900 | SC, VA already have income tax system in place | | | |
| 1901 | HI enacts income tax | | | |
| 1901 | NC enacts income tax | | NC enacts pension exclusion | |
| 1902 | | | | NC repeals pension exclusion |
| 1908 | OK enacts income tax | | | |
| 1911 | WI enacts income tax | | | |
| 1912 | MS enacts income tax | | | |
| 1916 | FEDERAL GOVERNMENT ENACTS INCOME TAX | | | |
| 1917 | DE, MA, MO enacts income tax | | | |
| 1918 | SC repeals income tax | | | |
| 1919 | NY, ND enact income tax | | | |
| 1922 | SC re-enacts income tax | | | |
| 1923 | NH enacts income tax on interest & dividend income only | | | |
| 1928 | AR enacts income tax | | | |
| 1929 | GA, OR enacts income tax | | | |
| 1929 | TN enacts income tax on interest & dividend income only | | | |
| 1931 | ID, UT, VT enact income tax | | VT enacts pension exclusion | |
| 1933 | AL, AZ, IN, KS, MN, MT, NM, SD enact income tax | NM enacts elderly deduction | SD enacts pension exclusion | |
| 1933 | | SC enacts elderly deduction | | |
| 1934 | IA, LA enact income tax | | | |
| 1934 | | OR enacts elderly credit | | |
| 1934 | | SC repeals elderly deduction | | |
| 1935 | | | | SD repeals pension exclusion |
| 1935 | CA, WV enact income tax | | | |
| 1936 | KY enacts income tax | | | |
| 1937 | CO, MD enact income tax | | | |
| 1939 | DC enact income tax | | | |
| 1939 | | OR repeals elderly credit | | |
| 1942 | WV repeals income tax | | | |
| 1942 | | ND enacts elderly deduction | | |
| 1943 | SD repeals income tax | | | |
| 1945 | | ND repeals elderly deduction | | |
| 1947 | | VT enacts elderly deduction | VT repeals pension exclusion | |
| 1947 | | | DE enacts pension exclusion | |

TABLE 1 (continued) -- A Brief Timeline of Major Changes in Elderly Tax Preferences Since 1900

| Year | Income Tax | Deductions | Pension | Low Income Preferences |
|------|---|--|------------------------------|------------------------|
| 1948 | | FEDERAL GOVERNMENT ENACTS ELDERLY DEDUCTION | | |
| 1948 | | CO enacts elderly deduction | | |
| 1949 | AK enacts income tax | | | |
| 1950 | | MD, VA enact elderly deduction | | |
| 1951 | | MN enacts elderly credit | | |
| 1952 | | GA enacts elderly deduction | | |
| 1953 | | OR re-enacts elderly credit | | |
| 1953 | | ND re-enacts elderly deduction | | |
| 1953 | | DE, KS enact elderly deduction | DE reduced pension exclusion | |
| 1954 | | KY enacts elderly credit | | |
| 1954 | | NY enacts elderly deduction | | |
| 1954 | | | HI enacts pension exclusion | |
| 1956 | | NH enacts elderly deduction | | |
| 1957 | | DC, MT enacts elderly deduction | | |
| 1958 | | HI enacts elderly deduction | | |
| 1959 | | ID enacts elderly deduction | | |
| 1960 | | SC re-enacts elderly deduction | | |
| 1961 | WV re-enacts income tax | | | |
| 1962 | | AZ enacts elderly deduction | | |
| 1962 | | WI enacts elderly credit | | |
| 1963 | | IA enacts elderly credit | | |
| 1963 | | WV enacts elderly deduction | | |
| 1964 | | ID enacts additional elderly addition to st. deduction | | |
| 1964 | | IN enacts elderly deduction | | |
| 1965 | | FEDERAL GOVERNMENT ENACTS MEDICARE | | |
| 1965 | | ID, IN enact elderly credit | | |
| 1966 | | MA enacts elderly deduction | | |
| 1967 | MI enacts income tax | MI enacts elderly deduction | | |
| 1967 | | KS enacts additional elderly addition to st. deduction | | |
| 1967 | | VT repeals elderly deduction | | |
| 1967 | | | MD enacts pension exclusion | |
| 1968 | NE enacts income tax | | | |
| 1968 | | NC, UT enact elderly deduction | | |
| 1969 | IL, ME enact income tax | IL, ME enact elderly exemption | IL enacts pension exclusion | |
| 1969 | RI enacts income tax on dividends, interest & capital gains | RI enacts elderly deduction | | |

TABLE 1 (continued) -- A Brief Timeline of Major Changes in Elderly Tax Preferences Since 1900

| Year | Income Tax | Deductions | Pension | Low Income Preferences |
|------|---|--|---|-------------------------------------|
| 1969 | CT enacts income tax on capital gains | | | |
| 1970 | | OR replaces elderly credit with elderly deduction | | |
| 1971 | PA enacts income tax | | PA enacts pension exclusion | |
| 1971 | CT expands income tax to include dividends | CT enacts elderly exemption | | |
| 1971 | | ID, KS repeals additional elderly addition to st. deduction | | |
| 1971 | | OK enacts elderly deduction | | |
| 1971 | | | VT re-enacts pension exclusion | |
| 1971 | | | | DE enacts low income exemption |
| 1972 | RI enacts full income tax | RI repeals elderly deduction | | |
| 1972 | OH enacts income tax | | | NM enacts elderly low income credit |
| 1973 | CT repeals income tax on dividends | CT reduces elderly exemption | | |
| 1973 | | | UT, WV enacts pension exclusion | |
| 1973 | | MS enacts elderly deduction | MS enacts pension exclusion | |
| 1973 | | OH enacts elderly credit | OH enacts pension exclusion | |
| 1974 | | | CO, MI enact pension exclusion | |
| 1975 | NJ enacts income tax on dividends, interest and capital gains | NJ enacts elderly exemption | | |
| 1975 | | AR, LA enact elderly credit | | |
| 1976 | NJ enacts full income tax | | NJ enacts pension exclusion | |
| 1976 | | | TN enacts pension exclusion | |
| 1976 | | | | HI enacts low income credit |
| 1976 | | | | WI enacts low income exemption |
| 1978 | | | MN enacts pension exclusion | |
| 1978 | | IN repeals elderly credit | IN enacts retirement credit | |
| 1980 | AK repeals income tax | | | |
| 1980 | | WV enacts large elderly deduction | WV repeals pension exclusion | |
| 1980 | | LA enacts elderly credit based on federal, repeals separate elderly credit | | |
| 1981 | | | LA, MT, NY enact pension exclusion | |
| 1982 | | | GA enacts pension exclusion | |
| 1983 | | OR replaces elderly deduction with elderly credit | | |
| 1983 | | | SC enacts pension exclusion | |
| 1985 | | | AR enacts pension exclusion (cannot claim elderly credit too) | |
| 1985 | | | NM enacts pension exclusion | |
| 1986 | | | | WI repeals low income exemption |

TABLE 1 (continued) -- A Brief Timeline of Major Changes in Elderly Tax Preferences Since 1900

| Year | Income Tax | Deductions | Pension | Low Income Preferences |
|------|--|---|---|--|
| 1987 | | NE enacts elderly deduction | | |
| 1987 | | OR replaces elderly credit with elderly deduction | | |
| 1987 | | CO, GA, ID, IL, ME, MD, MI, MN, OK, NY, ND, SC, UT repeal elderly deduction | | |
| 1987 | | CO, DE, GA, ID, MD, MN, MO, NE, ND, SC, UT enact max deduction | | |
| 1987 | | CA enacts elderly credit | | |
| 1987 | NE tax system no longer based on federal liability | NE allows 50% of federal elderly credit | | |
| 1988 | | KS enacts max deduction, repeals additional elderly addition | | |
| 1988 | | MI re-enacts elderly deduction | | OK enacts low income provision |
| 1989 | | MD enacts elderly deduction, repeals max elderly deduction | | |
| 1989 | | NC enacts max exemption | NC enacts pension exclusion | |
| 1989 | | ME enacts max elderly deduction | | |
| 1990 | | | VA enacts pension exclusion | |
| 1990 | | IL re-enacts elderly deduction | | |
| 1991 | CT enacts full income tax | | | |
| 1991 | | OR repeals elderly credit | | |
| 1991 | | | AL, OR enact pension exclusion | |
| 1991 | | | | AR enacts elderly low income exemption |
| 1992 | | OR re-enacts elderly credit | | |
| 1992 | | CT repeals elderly exemption | | |
| 1992 | | | VT repeals pension exclusion | |
| 1992 | | | | GA enacts elderly low income credit |
| 1995 | | | IA, KY enact pension exclusion | |
| 1996 | | DE enacts elderly credit | | |
| 1996 | | DE repeals elderly deduction | | |
| 1997 | | | OK enacts pension exclusion | |
| 1997 | | | | DE repeals low income exemption |
| 1997 | | | | CO enacts elderly low income exemption |
| 1998 | | WI enacts elderly deduction, repeals elderly credit | WI enacts pension credit | |
| 1998 | | | MO enacts pension exclusion | |
| 1999 | | ME enacts elderly credit (based on federal) | | |
| 1999 | | MO enacts additional elderly deduction | MO enacts pension exclusion | |
| 2000 | | | WI enacts pension deduction, repeals pension credit | |
| 2000 | | | ME enacts pension exclusion | |
| 2002 | | | | CO repeals elderly low income exemp. |

TABLE 2 -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Income Tax | Deductions & Exemptions |
|--------------|--|--|
| Alabama | 1933: enacts income tax | |
| Alaska | 1949: enacts income tax 1980: repeals income tax | |
| Arizona | 1933: enacts income tax | 1962: enacts elderly deduction increased annually between 1979 and 1990 reduced in 1990, increased in 1993 |
| Arkansas | 1928: enacts income tax | 1975: enacts elderly credit |
| California | 1935: enacts income tax | 1974: \$4000 exclusion of dividend/interest increased annually from 1979-1984, repealed in 1985 1979: allow 100% of federal age credit 1986: reduced to 50%, repealed in 1992 1987: enact it's own credit, increased annually |
| Colorado | 1937: enacts income tax | 1948: adds extra deduction of \$750 1987: replaces deduction with a max. deduction adjusted annually (along with a group of states) |
| Connecticut | 1969: enacts income tax on capital gains 1971-1973: also taxes dividends 1991: enacts full income tax system | 1971: enacts elderly exemption when tax dividends 1974: repeals elderly exemption when no longer taxing dividends |
| Delaware | 1917: enacts income tax | 1953: enact elderly deduction 1988: add annual maximum deduction 1996: deduction now a credit |
| DC | 1939: enacts income tax | 1957: enacts elderly deduction (\$500) 1975, 1987-91: increases elderly deduction (to \$1370) |
| Georgia | 1929: enacts income tax | 1952: enacts elderly deduction 1987: replaces deduction with max deduction |
| Hawaii | 1901: enacts income tax | 1958: enacts elderly deduction frequent small increases since 1958 |
| Idaho | 1931: enacts income tax | 1959: enacts elderly deduction by 1965, has elderly deduction, credit, and add'l standard deduction 1971: repeals add'l standard deduction 1987: replaced deduction with max deduction adjusted annually (with a group of states) |

TABLE 2 (continued) -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Income Tax | Deductions & Exemptions |
|---------------|-------------------------|---|
| Illinois | 1969: enacts income tax | 1969: enacts elderly deduction 1986/87: repeals, then re-enacts, elderly deduction |
| Indiana | 1933: enacts income tax | 1964: enacts elderly deduction, allows federal credit 1978: repeals federal credit allowance |
| Iowa | 1934: enacts income tax | 1963: enacts elderly credit 1979-1983: moderate increases to credit |
| Kansas | 1933: enacts income tax | 1953: enacts elderly deduction 1967: enacts add'l elderly deduction to std deduction 1971: repeals additional deduction 1987: replaces original deduction with max deduction |
| Kentucky | 1936: enacts income tax | 1954: enacts elderly credit modest increases until 1976 |
| Louisiana | 1934: enacts income tax | 1975: enacts elderly credit 1980: switches to 10% of federal credit |
| Maine | 1969: enacts income tax | 1969: enacts elderly deduction 1989: replaces elderly deduction with max deduction adjusted annually (with a group of states) 1999: allows % of federal credit |
| Maryland | 1937: enacts income tax | 1950: enacts elderly deduction 1987: replaces elderly deduction with max deduction |
| Massachusetts | 1917: enacts income tax | 1966: enacts elderly deduction small increases in 1968, 1979 |
| Michigan | 1967: enacts income tax | 1967: enacts elderly deduction 1967-1989: increased, reduced, repealed and re-enacted |
| Minnesota | 1933: enacts income tax | 1951: enacts elderly credit 1987: replaces elderly credit with max deduction |
| Mississippi | 1912: enacts income tax | 1973: enacts elderly deduction 1979: increases deduction amount |
| Missouri | 1917: enacts income tax | 1987: enacts maximum deduction |
| Montana | 1933: enacts income tax | 1957: enacts elderly deduction increases in 1974, annually starting in 1979 |

TABLE 2 (continued) -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Income Tax | Deductions & Exemptions |
|----------------|--|---|
| Nebraska | 1968: enacts income tax based on federal liability 1987: income tax no longer based on fed. liability | 1987: allows federal elderly credit 1987: enacts maximum deduction adjusted annually (with a group of states) |
| New Hampshire | 1923: enacts income tax on interest & dividends | 1956: enacts elderly deduction (\$600) 1982: doubles deduction to \$1200 |
| New Jersey | 1975: enacts income tax on interest/dividend and capital gains 1976: expands income tax to gross income | 1975: enacts elderly deduction (\$1000) |
| New Mexico | 1933: enacts income tax | 1933: enacts elderly deduction (\$200) 1964: enacts minimum addition to std. deduction 1970: increases regular elderly deduction 1971: repeals minimum addition 1987: replaces deductions with max deduction |
| New York | 1919: enacts income tax | 1954: enacts elderly deduction increased off and on until repealed in 1987 |
| North Carolina | 1901: enacts income tax | 1968: enacted elderly deduction 1989: replaces deduction with max deduction |
| North Dakota | 1919: enacts income tax 1991: income tax now based on federal income | 1942: enacts elderly deduction (\$500) repealed in 1945, re-enacted in 1953 (\$600) 1967: add minimum addition to std. deduction 1973: repeals minimum addition to std. deduction 1987: replaces deduction with max deduction follows group of states until 1991, then rejoins in 2001 |
| Ohio | 1972: enacts income tax | 1973: enacted elderly credit |
| Oklahoma | 1908: enacts income tax | 1971: enacts elderly deduction 1987: repeals deduction 1988: enacts exemptions for low income |
| Oregon | 1929: enacts income tax | 1934: enacts elderly credit, repeals in 1939 1953: re-enacts elderly credit 1970: switches credit to deduction 1983: switches deduction to credit 1987: switches credit to deduction 1992: re-enacts credit |
| Pennsylvania | 1971: enacts income tax | |

TABLE 2 (continued) -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Income Tax | Deductions & Exemptions |
|----------------|---|--|
| Rhode Island | 1969: enacts income tax on interest/dividend and capital gains 1972: income tax system a % of federal liability | 1969: enacts elderly deduction (\$2000) |
| South Carolina | 1900: enacts income tax 1918: repeals income tax 1922: re-enacts income tax based on fed liability 1926: changes system to gross income plus deduction | 1933: enacts elderly deduction, repeals in 1934 1960: re-enacts elderly deduction 1987: replaces deduction with max deduction adjusted annually (with a group of states) |
| South Dakota | 1933: enacts income tax 1943: repeals income tax | |
| Tennessee | 1929: enacts income tax on interest/dividend income | |
| Utah | 1931: enacts income tax | 1968: enacts elderly deduction (\$200) 1977: increased deduction 1987: replaces deduction with max deduction adjusted annually (with a group of states) |
| Vermont | 1931: enacts income tax 1967: income tax system a % of fed liability | 1947: enacts elderly deduction 1967: repeals elderly deduction |
| Virginia | 1900: enacts income tax | 1950: enacts elderly deduction (\$500) increases deduction in 1972 reduces deduction in 1987 & 1988 |
| West Virginia | 1935: enacts income tax 1942: repeals income tax 1961: re-enacts income tax, based on federal liability 1963: changes system to gross income | 1963: enacts elderly deduction (\$600) 1980: increases elderly deduction to \$8600 1983-84, increases deduction slightly |
| Wisconsin | 1911: enacts income tax | 1962: enacts elderly credit (\$5) 1986: increases elderly credit and repeals low income credit of 1976 1998: repeals credit |

TABLE 2 -- Summary of Major State Actions

| State | Pensions | Tax Social Security? |
|--------------|---|-----------------------------|
| Alabama | 1991: exempts ALL pension income | no |
| Alaska | no action | |
| Arizona | no action | no |
| Arkansas | 1985: add pension exclusion (\$6000, can be taken instead of credit) | no |
| California | no action | no |
| Colorado | 1974: add pension exclusion (\$3000 pp) for age 55+ 1982: pension exclusion changes (\$20000 pp) 2000: extra pension exclusion (\$4000) enacted | since 1984 |
| Connecticut | no action | since 1991 |
| Delaware | 1947: enacts pension exemption 1953: reduce pension exemption 1997, 1999: expand definition of pension income | no |
| DC | no action | no |
| Georgia | 1982: enacts pension exemption | since 1988 |
| Hawaii | 1954: exempts ALL pension income | no |
| Idaho | no action | no |
| Illinois | 1969: exempts ALL pension income | no |
| Indiana | 1978: enacts retirement credit | no |
| Iowa | 1995: enacts pension exemption with low age limit (55) | since 1984 |
| Kansas | no action | since 1984 |
| Kentucky | 1995: enacts pension exclusion aggressive increases to exclusion annually | no |
| Louisiana | 1981: enacts pension exclusion | since 1984 |

TABLE 2 (continued) -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Pensions | Tax Social Security? |
|----------------|--|----------------------|
| Maine | 2000: enacts pension exclusion | no |
| Maryland | 1967: enacts pension exclusion increased annually since 1971 | no |
| Massachusetts | no action | no |
| Michigan | 1974: enacts pension exclusion (\$7500) 1995: increases pension exclusion (\$30000) 1997: allows non-pension income \$3500 exemption | no |
| Minnesota | 1978: enacts pension exclusion | since 1984 |
| Mississippi | 1973: enacts pension exclusion 1994: exempts ALL pension income | from 1936 to 1979 |
| Missouri | 1998: enacts pension exclusion increased annually | since 1984 |
| Montana | 1981: enacts limited pension exclusion 1987: increases exclusion amount tenfold | since 1984 |
| Nebraska | no action | since 1984 |
| New Hampshire | no action | no |
| New Jersey | 1976: enacts pension exclusion 2000: began increasing exclusion amount | no |
| New Mexico | 1985: enacted pension exclusion 1987: only increase in amount | since 1990 |
| New York | 1981: enacted pension exclusion (\$20000) never changed | no |
| North Carolina | 1901-02: one year of pension exclusion 1989: enacts modest pension exclusion (\$2000) | no |
| North Dakota | no action | since 1984 |
| Ohio | 1973: enacts pension exclusion 1983: changes exclusion to credit | no |
| Oklahoma | 1997: enacts pension exclusion | since 1984 |
| Oregon | 1991: enacts pension exclusion | no |

TABLE 2 (continued) -- Summary of Major State Actions Towards Elderly Tax Preferences

| State | Pensions | Tax Social Security? |
|----------------|---|-----------------------------|
| Pennsylvania | 1971: excludes ALL pension income | no |
| Rhode Island | no action | since 1984 |
| South Carolina | 1983: enacts pension exclusion | no |
| South Dakota | 1933: excludes ALL pension income 1935: repeals exclusion | n/a |
| Tennessee | 1976: enacts pension exclusion increased in 1980, 1985, 1999, 2000 | no |
| Utah | 1973: enacts pension exclusion 1987: reduces pension exclusion 1988: broadens def'n of pension income and raises maximum exclusion | since 1984 |
| Vermont | 1931: excludes ALL pension income 1947: repeals exclusion 1971: re-enacts pension exclusion 1992: repeals exclusion | since 1984 |
| Virginia | 1990: enacts pension exclusion increased amount in 1993, 1994 reduced amount in 1995 broader definition, higher amount in 1996 | no |
| West Virginia | 1973: enacts pension exclusion 1980: repeals pension exclusion | since 1987 |
| Wisconsin | 1998: enacts pension credit 2000: replaces credit with deduction | since 1984 |

TABLE 3A--State Behavior in Elderly Programs

| State | Income Tax Preferences | | EIG | | OAA | | |
|-------------|------------------------|-------------------|-------------------------|------------------|--|-------------|-------------|
| | <u>timing</u> | <u>generosity</u> | <u>start</u> | <u>eliminate</u> | <u>1940</u> | <u>1950</u> | |
| Alabama | late | less | 1931 \$33,200 | by 1960 | no date available benefit amount reciency rate | 113 14.6 | 134 40.9 |
| Alaska | NONE | | 1919 N/A | ??? | 1915 | | |
| Arizona | average | average | 1912 N/A | 1980 | 1915*, 1933 benefit amount reciency rate | 336 34 | 320 30.2 |
| Arkansas | late | more | 1901 \$57,150 | 1947 | no date available benefit amount reciency rate | 91 18.4 | 152 44.8 |
| California | average | average | 1900 N/A | 1982 | 1929 (m) benefit amount reciency rate | 455 25.5 | 472 29.9 |
| Colorado | early | average | 1901 \$53,020 | 1980 | 1925-26 benefit amount reciency rate | 405 47.6 | 454 43.7 |
| Connecticut | late | less | before 1900 \$33,200 | 2005 | no date available benefit amount reciency rate | 323 13.3 | 371 11.1 |
| Delaware | early | more | before 1900 \$33,200 | 1999 | 1931 benefit amount reciency rate | 134 13.1 | 183 6.4 |
| Florida | NONE | | 1931 \$33,200 | by 1960 | no date available benefit amount reciency rate | 144 26.8 | 260 29.2 |
| Georgia | early | more | 1913 \$33,200 | by 1960 | no date available benefit amount reciency rate | 96 17.8 | 144 46.1 |
| Hawaii | early | more | before 1900 N/A | 1983 | 1933 benefit amount reciency rate | | |

TABLE 3A (continued)--State Behavior in Elderly Programs

| State | Income Tax Preferences | | EIG | | OAA | | |
|---------------|------------------------|---------------------------|--------------|------------------|-------------------|-------------|------|
| | <u>timing</u> | <u>generosity</u> | <u>start</u> | <u>eliminate</u> | <u>1940</u> | <u>1950</u> | |
| Idaho | average | average | 1906 | 1988 | 1931 | | |
| | | | N/A | | benefit amount | 263 | 305 |
| Illinois | early | more | before 1900 | 1983 | no date available | | |
| | | | \$40,800 | | benefit amount | 251 | 291 |
| Indiana | average | average | 1913 | still in place | 1933 | | |
| | | | \$33,200 | | benefit amount | 216 | 236 |
| Iowa | late | average | before 1900 | still in place | 1934 | | |
| | | | \$40,050 | | benefit amount | 251 | 324 |
| Kansas | early | less to average | 1907 | 1998 | no date available | | |
| | | | restart 2002 | still in place | benefit amount | 234 | 331 |
| Kentucky | early late | less more (since 1995) | 1905 | still in place | 1925-26 | | |
| | | | LT PU | | benefit amount | 105 | 130 |
| Louisiana | late to average | average | before 1900 | 2004 | no date available | | |
| | | | N/A | | benefit amount | 143 | 316 |
| Maine | late | average to more | before 1900 | 1986 | 1933 | | |
| | | | \$33,200 | | benefit amount | 259 | 277 |
| Maryland | early | average to more | before 1900 | still in place | 1925-26; 1934 (m) | | |
| | | | \$33,200 | | benefit amount | 212 | 238 |
| Massachusetts | late | less | before 1900 | 1997 | 1930 | | |
| | | | \$35,250 | | benefit amount | 344 | 416 |
| Michigan | early | more | before 1900 | 1993 | 1933 | | |
| | | | \$33,200 | | benefit amount | 203 | 304 |
| | | | | | reciency rate | 22.2 | 21.7 |

TABLE 3A (continued)--State Behavior in Elderly Programs

| State | Income Tax Preferences | | EIG | | OAA | |
|----------------|--------------------------------------|---------------------------|-------------------------|------------------|---------------------------------|---|
| | <u>timing</u> | <u>generosity</u> | <u>start</u> | <u>eliminate</u> | <u>1940</u> | <u>1950</u> |
| Minnesota | early | average | before 1900 \$33,200 | 1986 | benefit amount reciency rate | 1934 (m) 258 301 29.6 20.7 |
| Mississippi | late early | less more (since 1973) | 1918 \$36,000 | 2000 | benefit amount reciency rate | no date available 100 121 18.6 42.9 |
| Missouri | late | less to average | before 1900 \$34,600 | 1981 | benefit amount reciency rate | no date available 193 283 28.3 32.3 |
| Montana | early | less to average | before 1900 \$61,990 | 2001 | benefit amount reciency rate | 1923 217 341 33.6 23.2 |
| Nebraska | follows federal gov't for most years | | 1921 \$33,200 | still in place | benefit amount reciency rate | 1933 198 291 26.3 18.3 |
| Nevada | NONE | | never | | benefit amount reciency rate | 1923 317 347 33.4 24.2 |
| New Hampshire | NONE | | 1905 \$33,200 | 2003 | benefit amount reciency rate | 1931 257 285 11.9 12.9 |
| New Jersey | early | more | before 1900 \$33,200 | still in place | benefit amount reciency rate | 1931 249 316 11.2 6.2 |
| New Mexico | early | average to more | 1919 N/A | 1976 | benefit amount reciency rate | no date available 174 232 19.3 30.2 |
| New York | early to average | average to more | before 1900 \$42,500 | 2000 | benefit amount reciency rate | 1930 307 351 12.9 9.6 |
| North Carolina | average to late | average | before 1900 \$41,150 | 1999 | benefit amount reciency rate | no date available 122 139 22.8 27.3 |

TABLE 3A (continued)--State Behavior in Elderly Programs

| State | Income Tax Preferences | | EIG | | OAA | |
|----------------|----------------------------|-------------------|-------------------------|---|----------------------------------|-------------|
| | <u>timing</u> | <u>generosity</u> | <u>start</u> | <u>eliminate</u> | <u>1940</u> | <u>1950</u> |
| North Dakota | early | less to average | 1903 \$111,700 | 1979 benefit amount reciency rate | 1933 201 22.4 | 315 18.3 |
| Ohio | average | average | before 1900 \$33,200 | still in place benefit amount reciency rate | 1933 280 22.8 | 310 17.7 |
| Oklahoma | late | average to more | 1907 \$52,100 | still in place benefit amount reciency rate | no date available 213 50.2 | 335 52 |
| Oregon | early to average | average to more | 1903 \$75,775 | 1987 benefit amount reciency rate | 1933 257 20.7 | 341 17.9 |
| Pennsylvania | early to average | more | before 1900 \$33,200 | still in place benefit amount reciency rate | 1923*, 1933 265 14.5 | 258 10.4 |
| Rhode Island | follows federal government | | 1916 \$33,200 | 1991 benefit amount reciency rate | no date available 234 12.5 | 301 14.7 |
| South Carolina | average | more | 1922 \$37,100 | 1992 benefit amount reciency rate | no date available 99 24.3 | 147 36.6 |
| South Dakota | NONE | | 1905 \$48,250 | 2001 benefit amount reciency rate | no date available 237 33.2 | 259 22 |
| Tennessee | NONE | | before 1900 \$38,525 | still in place benefit amount reciency rate | no date available 121 23.5 | 198 27.9 |
| Texas | NONE | | 1907 N/A | 1983 benefit amount reciency rate | no date available 124 34.1 | 223 43.8 |
| Utah | average | average | 1901 \$49,200 | 1977 benefit amount reciency rate | no date available 254 45.1 | 308 23.9 |

TABLE 3A (continued)--State Behavior in Elderly Programs

| State | Income Tax Preferences | | EIG | | OAA | |
|------------------|------------------------|-------------------|-------------------------|------------------|--|-------------|
| | <u>timing</u> | <u>generosity</u> | <u>start</u> | <u>eliminate</u> | <u>1940</u> | <u>1950</u> |
| Vermont | early | average | before 1900 \$34,750 | 1980 | no date available benefit amount 192 15.8 | 228 17.3 |
| Virginia | average | more | before 1900 \$33,200 | 1980 | no date available benefit amount 118 11.3 | 135 9.2 |
| Washington | NONE | | 1901 N/A | 1982 | 1933, 1934 (m) benefit amount 266 27.2 | 429 34.9 |
| West Virginia | early to average | less to average | before 1900 \$52,000 | 1985 | 1931 benefit amount 166 17.6 | 164 19.3 |
| Wisconsin | average to late | less | 1903 \$61,000 | 1992 | 1925-26, 1929 (m) benefit amount 269 21.3 | 277 17 |
| Wyoming | NONE | | 1903 N/A | 1983 | no date available benefit amount 286 27.1 | 365 23.3 |
| National Average | | | | | benefit amount 241 21.8 | 298 22.7 |

NOTES on EIG

EIG start dates from ACIR; elimination dates from Conway and Rork (2004)

Dollar amount are the EIG taxes imposed on a \$1 million estate in 1935 from Cooper (2006)

Note that \$33,200 is the exact amount of the federal credit in 1935. Only amounts above that level add tax liability to the estate

N/A indicates Cooper (2006) does not list liability on \$1 million estate in 1935, since those states are community tax states.

NOTES ON OAA

*means the original program was found unconstitutional

m means the program was mandatory statewide in that year

OAA amounts from Friedberg (1999)

OAA enactment dates from Costa (1998) listed above benefit amounts

TABLE 3B -- State Ranking in Policy Innovativeness (Walker, 1969)

| Rank | State | Income Tax Timing | Income Tax Generosity |
|------|----------------|---|---------------------------------|
| 1 | New York | early to average | average to more |
| 2 | Massachusetts | late | less |
| 3 | California | average | average |
| 4 | New Jersey | early | more |
| 5 | Michigan | early | more |
| 6 | Connecticut | late | less |
| 7 | Pennsylvania | early to average | more |
| 8 | Oregon | early to average | average to more |
| 9 | Colorado | early | average |
| 10 | Wisconsin | average to late | less |
| 11 | Ohio | average | average |
| 12 | Minnesota | early | average |
| 13 | Illinois | early | more |
| 14 | Washington | NONE | NONE |
| 15 | Rhode Island | follows the federal government | |
| 16 | Maryland | early | average to more |
| 17 | New Hampshire | NONE | NONE |
| 18 | Indiana | average | average |
| 19 | Louisiana | late to average | average |
| 20 | Maine | late | average to more |
| 21 | Virginia | average | more |
| 22 | Utah | average | average |
| 23 | North Dakota | early | less to average |
| 24 | North Carolina | average to late | average |
| 25 | Kansas | early | less to average |
| 26 | Nebraska | followed the federal gov't for most years | |
| 27 | Kentucky | early | less (switched to late/more) |
| 28 | Vermont | early | average |
| 29 | Iowa | late | average |
| 30 | Alabama | late | less |
| 31 | Florida | NONE | |
| 32 | Arkansas | late | more |
| 33 | Idaho | average | average |
| 34 | Tennessee | NONE | |
| 35 | West Virginia | early | less (switched to average/more) |
| 36 | Arizona | average | average |
| 37 | Georgia | early | more |
| 38 | Montana | early | less to average |
| 39 | Missouri | late | less to average |
| 40 | Delaware | early | more |
| 41 | New Mexico | early | average to more |
| 42 | Oklahoma | late | average to more |
| 43 | South Dakota | NONE | |
| 44 | Texas | NONE | |
| 45 | South Carolina | average | more |
| 46 | Wyoming | NONE | |
| 47 | Nevada | NONE | |
| 48 | Mississippi | late | less (switched to early/more) |

TABLE 3C--State Ranking Based on Year of 10% Tractor Adoption (Staiger and Skinner, 2005)

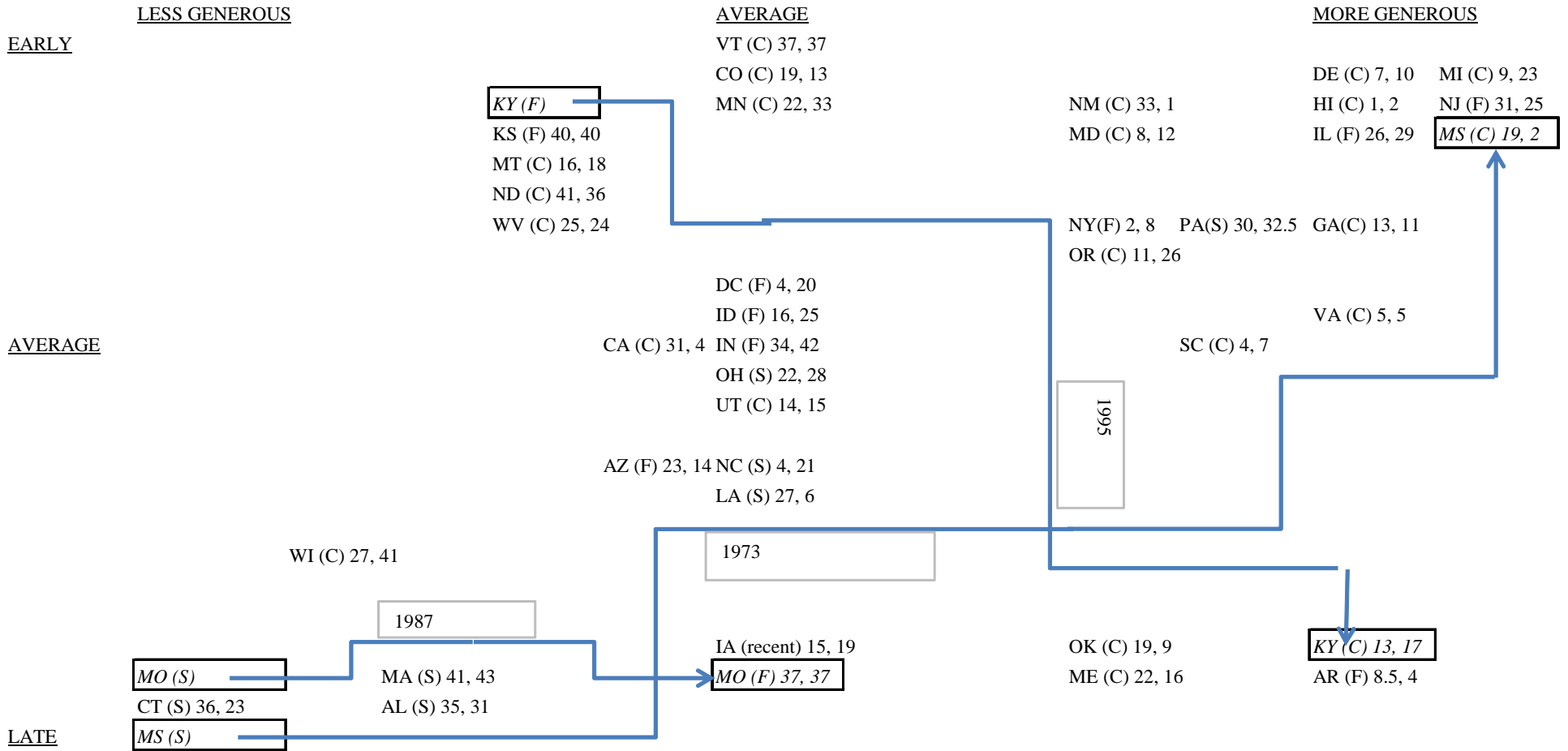
| <u>Rank</u> | | <u>Year</u> | <u>Income Tax Timing</u> | <u>Income Tax Generosity</u> |
|-------------|----------------|-------------|---|-------------------------------|
| 1 | South Dakota | 1916 | NONE | |
| 2 | North Dakota | 1917 | early | less to average |
| 3 | California | 1917 | average | average |
| 4 | Kansas | 1918 | early | less to average |
| 5 | Illinois | 1919 | early | more |
| 6 | Montana | 1919 | early | less to average |
| 7 | Iowa | 1920 | late | average |
| 8 | Nebraska | 1921 | followed the federal gov't for most years | |
| 9 | Minnesota | 1922 | early | average |
| 10 | Colorado | 1924 | early | average |
| 11 | Wisconsin | 1924 | average to late | less |
| 12 | New Jersey | 1924 | early | more |
| 13 | Wyoming | 1925 | NONE | |
| 14 | Indiana | 1925 | average | average |
| 15 | Ohio | 1925 | average | average |
| 16 | New York | 1925 | early to average | average to more |
| 17 | Arizona | 1926 | average | average |
| 18 | Oregon | 1926 | early to average | average to more |
| 19 | Michigan | 1927 | early | more |
| 20 | Pennsylvania | 1928 | early to average | more |
| 21 | Maryland | 1929 | early | average to more |
| 22 | Nevada | 1930 | NONE | |
| 23 | Delaware | 1930 | early | more |
| 24 | Idaho | 1930 | average | average |
| 25 | Rhode Island | 1930 | follows the federal government | |
| 26 | Washington | 1930 | NONE | |
| 27 | Oklahoma | 1931 | late | average to more |
| 28 | Connecticut | 1931 | late | less |
| 29 | Massachusetts | 1932 | late | less |
| 30 | Missouri | 1932 | late | less to average |
| 31 | Vermont | 1933 | early | average |
| 32 | Texas | 1934 | NONE | |
| 33 | Maine | 1934 | late | average to more |
| 34 | Utah | 1934 | average | average |
| 35 | New Mexico | 1935 | early | average to more |
| 36 | New Hampshire | 1936 | NONE | |
| 37 | Florida | 1938 | NONE | |
| 38 | Virginia | 1939 | average | more |
| 39 | North Carolina | 1941 | average to late | average |
| 40 | Kentucky | 1942 | early | less (switches to late/more) |
| 41 | Georgia | 1942 | early | more |
| 42 | Tennessee | 1942 | NONE | |
| 43 | Louisiana | 1943 | late to average | average |
| 44 | Arkansas | 1943 | late | more |
| 45 | West Virginia | 1944 | early | less (switches to ave/more) |
| 46 | South Carolina | 1945 | average | more |
| 47 | Alabama | 1945 | late | less |
| 48 | Mississippi | 1947 | late | less (switches to early/more) |

TABLE 3D--State Ranking Based on Townsend Clubs (Amenta and Zylan, 1991)

| <u>Rank</u> | <u>State</u> | <u>Clubs per 100,000 people</u> | <u>Income Tax Timing</u> | <u>Income Tax Generosity</u> |
|-------------|----------------|-------------------------------------|---|-------------------------------|
| 1 | Oregon | 37.99 | early to average | average to more |
| 2 | Wyoming | 31.11 | NONE | |
| 3 | Colorado | 29.91 | early | average |
| 4 | Washington | 26.15 | NONE | |
| 5 | South Dakota | 23.8 | NONE | |
| 6 | Montana | 22.88 | early | less to average |
| 7 | Maine | 22.07 | late | average to more |
| 8 | Idaho | 21.91 | average | average |
| 9 | Florida | 21.61 | NONE | |
| 10 | New Hampshire | 19.74 | NONE | |
| 11 | Minnesota | 19.16 | early | average |
| 12 | Indiana | 17.62 | average | average |
| 13 | Kansas | 17.32 | early | less to average |
| 14 | Vermont | 16.7 | early | average |
| 15 | Michigan | 16.44 | early | more |
| 16 | North Dakota | 16.36 | early | less to average |
| 17 | Arizona | 16.02 | average | average |
| 18 | California | 15.53 | average | average |
| 19 | Wisconsin | 15.52 | average to late | less |
| 20 | Iowa | 14.61 | late | average |
| 21 | Nebraska | 14.52 | followed the federal gov't for most years | |
| 22 | New Mexico | 12.79 | early | average to more |
| 23 | Ohio | 12.19 | average | average |
| 24 | Nevada | 9.98 | NONE | |
| 25 | Pennsylvania | 9.56 | early to average | more |
| 26 | Missouri | 8.83 | late | less to average |
| 27 | Utah | 7.45 | average | average |
| 28 | West Virginia | 7.31 | early | less (switched to average/mor |
| 29 | Illinois | 6.93 | early | more |
| 30 | Massachusetts | 6.88 | late | less |
| 31 | Oklahoma | 6.81 | late | average to more |
| 32 | New York | 6.17 | early to average | average to more |
| 33 | Arkansas | 5.95 | late | more |
| 34 | Maryland | 5.05 | early | average to more |
| 35 | Connecticut | 4.2 | late | less |
| 36 | Delaware | 4.13 | early | more |
| 37 | Kentucky | 3.83 | early | less (switched to late/more) |
| 38 | New Jersey | 3.77 | early | more |
| 39 | Texas | 2.96 | NONE | |
| 40 | Alabama | 1.98 | late | less |
| 41 | Georgia | 1.95 | early | more |
| 42 | Tennessee | 1.92 | NONE | |
| 43 | Louisiana | 1.1 | late to average | average |
| 44 | Mississippi | 1.05 | late | less (switched to early/more) |
| 45 | North Carolina | 0.95 | average to late | average |
| 46 | Rhode Island | 0.84 | follows the federal government | |
| 47 | Virginia | 0.78 | average | more |
| 48 | South Carolina | 0.58 | average | more |

FIGURE 1-- Generosity and Timing of State Elderly Tax Preferences

Timing\Generosity



C indicates a state makes major changes to its elderly tax preferences
 F indicates a state is a fiddler, making numerous minor adjustments
 S indicates a state is stable, making few, if any changes.

NE, RI and VT have income tax systems tied to federal liability for majority of time
 AK, FL, NV, NH, SD, TN, TX, WA, WY currently do not have broad based income tax systems and are excluded from the figure
 CO, ID, ME, MD, MN, MO, NE, ND, SC, UT enact a maximum elderly deduction in 1987 and annually adjust to inflation in lockstep

APPENDIX 1--State Rankings on Other Private Innovativeness Measures from Staiger and Skinner (2005)

| % of Homes with Personal Computer in 1993 | | % of 2001 Heart Attacks Treated w/ Beta Blockers w/in 24 hrs | |
|---|------|--|----|
| Alaska | 43.6 | New Hampshire | 86 |
| Utah | 43.1 | Maine | 82 |
| Colorado | 40.4 | Massachusetts | 82 |
| New Hampshire | 39.2 | Vermont | 82 |
| Washington | 36.8 | New York | 81 |
| Connecticut | 36.0 | Rhode Island | 81 |
| Massachusetts | 34.1 | Minnesota | 80 |
| Vermont | 33.5 | Oregon | 79 |
| Wyoming | 32.4 | Alaska | 78 |
| California | 32.1 | Connecticut | 78 |
| Oregon | 31.9 | Iowa | 78 |
| Maryland | 31.9 | Colorado | 75 |
| Idaho | 30.9 | Utah | 75 |
| Virginia | 30.6 | North Dakota | 75 |
| Iowa | 30.3 | Nebraska | 74 |
| Hawaii | 29.5 | Wisconsin | 74 |
| Kansas | 29.2 | Ohio | 72 |
| Arizona | 29.1 | Wyoming | 71 |
| North Dakota | 29.0 | Washington | 71 |
| Delaware | 28.8 | Maryland | 71 |
| Missouri | 28.3 | Montana | 70 |
| Maine | 28.2 | South Dakota | 70 |
| Illinois | 27.9 | South Carolina | 70 |
| New Jersey | 27.9 | Michigan | 70 |
| Nevada | 27.5 | North Carolina | 69 |
| Montana | 27.0 | Indiana | 69 |
| Ohio | 26.4 | Delaware | 69 |
| Wisconsin | 26.4 | Kansas | 68 |
| Michigan | 26.2 | Pennsylvania | 68 |
| Nebraska | 25.9 | Missouri | 67 |
| Rhode Island | 25.9 | Illinois | 67 |
| Texas | 25.9 | Virginia | 67 |
| Georgia | 25.5 | Idaho | 66 |
| Pennsylvania | 25.2 | California | 66 |
| Minnesota | 25.1 | Arizona | 65 |
| New Mexico | 25.1 | Texas | 65 |
| Florida | 24.9 | Florida | 65 |
| New York | 24.8 | West Virginia | 65 |
| Indiana | 24.7 | Kentucky | 65 |
| South Dakota | 23.5 | Louisiana | 65 |
| Oklahoma | 22.5 | New Mexico | 65 |
| South Carolina | 21.1 | Tennessee | 63 |
| Arkansas | 20.2 | Hawaii | 62 |
| West Virginia | 20.0 | New Jersey | 61 |
| North Carolina | 19.2 | Mississippi | 60 |
| Tennessee | 18.7 | Nevada | 59 |
| Louisiana | 18.1 | Alabama | 58 |
| Kentucky | 16.9 | Georgia | 58 |
| Alabama | 15.3 | Oklahoma | 57 |
| Mississippi | 13.9 | Arkansas | 50 |

FIGURE 2: Timeline of Elderly Policies

