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Retirees Who Move to Lower-Tax States May Not Save as Much as They Think

As other costs rise, retirees need to think about total spending

BY DEBBIE CARLSON

RETIREES move to new states for all sorts of reasons. For some it's the weather, or to be near family, or to be closer to medical care. But for those moving in search of lower income taxes—and that's a lot of people—it might pay to get out the calculator.

When clients of investment adviser Brad Clark left the Indianapolis area in 2024 to be closer to their adult children who live near St. Petersburg, Fla., they thought moving to the no-income-tax state would be a financial fringe benefit.

The couple, who are in their mid-60s, quickly discovered that buying a new home and paying for the insurance offset any tax savings, says Clark, founder of Solomon Financial in Carmel, Ind. Home repairs after Hurricane Helene hit were an added expense. The husband, who had retired, went back to work, and it is likely the couple will have to work many more years than they initially expected.

" They were in a pretty good position up here, and [now] it's just not a pretty picture. It's fine as long as they're going to work," Clark says.

The lesson for retirees: Don't let the income-tax tail wag the totalspending dog.

Beyond income tax

The impact of state income taxes depends in part on the tax bracket. For instance, the state income tax may be a significant factor for wealthier retirees relying on investment returns, but for many middleincome retirees, income taxes become less important since they are typically drawing down and not earning so much, says Jared Walczak, vice president of state projects at the Tax Foundation in Washing--ton, D.C., a tax-policy research organization.

For middle-income retirees, sales taxes and property taxes often take precedent, Walczak says, since states with little to no income taxes often rely on these two categories. For example, Tennessee has no income tax, but its combined state and average local sales-tax rate of 9.56% is the second-highest nationally, according to the Tax Foundation. *

As for property taxes, "you may have declining income, but not necessarily a smaller home," Walczak says, "and that can be significant in some states."

Consider Texas, a state popular with retirees, which has the seventh- highest property-tax rate, with the state average for homeowners at 1.58%, more than double Florida's 0.71%.

Caitlin Frederick, director of financial planning at Ullmann Wealth Partners in Jacksonville Beach, Fla., says higher property taxes and home prices might surprise someone who hasn't moved recently. She says many states have homestead exemptions, which limit annual rises in property-tax assessed value—until a property is sold. As such, estimated property-tax figures for homes listed on online real-estate websites might not reflect increases that often result from a new purchase.

Frederick says that real-estate agents can estimate a potential property tax increase, but the updated assessed value often isn't reflected until the second year's tax bill, coming as an unwelcome surprise. *

Home and insurance costs

Mark Hammrick, senior economic analyst at Bankrate in Washington, D.C., says the firm's research shows rising shelter costs may make relocating difficult, and retirees "could run the risk of totally mitigating any tax savings with respect to exposure to state taxes."

Hammrick says retirees buying property in other states must also consider the availability and cost of home insurance before choosing a house.

"It is absolutely an issue in more communities than people know across the country, and that is largely because of these extreme weather events," he says.

Andrew Connors, managing director at Fairport Wealth in Cleveland, says he recently met with clients who moved to Sarasota, Fla., from Michigan and are rethinking their retirement in Florida as they're paying $35,000 annually in homeowners insurance, property taxes and homeowners-association fees on their condo. *

Bankrate estimates that average cost of home insurance is $2,242 annually for a policy with a $300,000 maximum insurance payout, with Florida the secondhighest at $5,340, after Nebraska's $5,640.

Tax and estate planning

No matter where retirees want to live, financial advisers emphasize that preretirement planning, such as doing Roth conversions of tax-deferred accounts, can limit tax liability on the state level. They should also see how states tax retirement income, as retirees might be in for a surprise. Illinois, for example, which charges a flat income-tax rate of 4.95% for individuals, doesn't tax the federally taxed portions of 401(k)s, IRAs or pensions, while some states such as Colorado and New Mexico tax Social Security payments above certain income thresholds.

Financial advisers encourage retirees to not limit their thinking to what the tax burden might be in a new location but also to think about how far their dollars will go in general terms. Both Bankrate and the Tax Foundation offer calculators that allow one to compare cost of living and purchasing power in different metropolitan areas.

Tony Owens, wealth planner at AlphaCore in San Diego, says retirees who plan to be generous to heirs should be aware of estate and inheritance taxes in whatever new state they are considering. A handful of states have an estate or an inheritance tax threshold much lower than the current federal tax of about $14 million for a single filer. Oregon, for example, taxes estates above $1 million.

In the end, says Owens, even in California, there's usually little cost savings for someone looking to move to a low-tax state, unless a client is in California's top state-tax bracket, which is 13.3%. The key is for retirees to know their marginal tax bracket for each state.

Says Owens, "I think oftentimes clients are surprised that…other states' tax brackets are actually probably pretty similar to California."

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