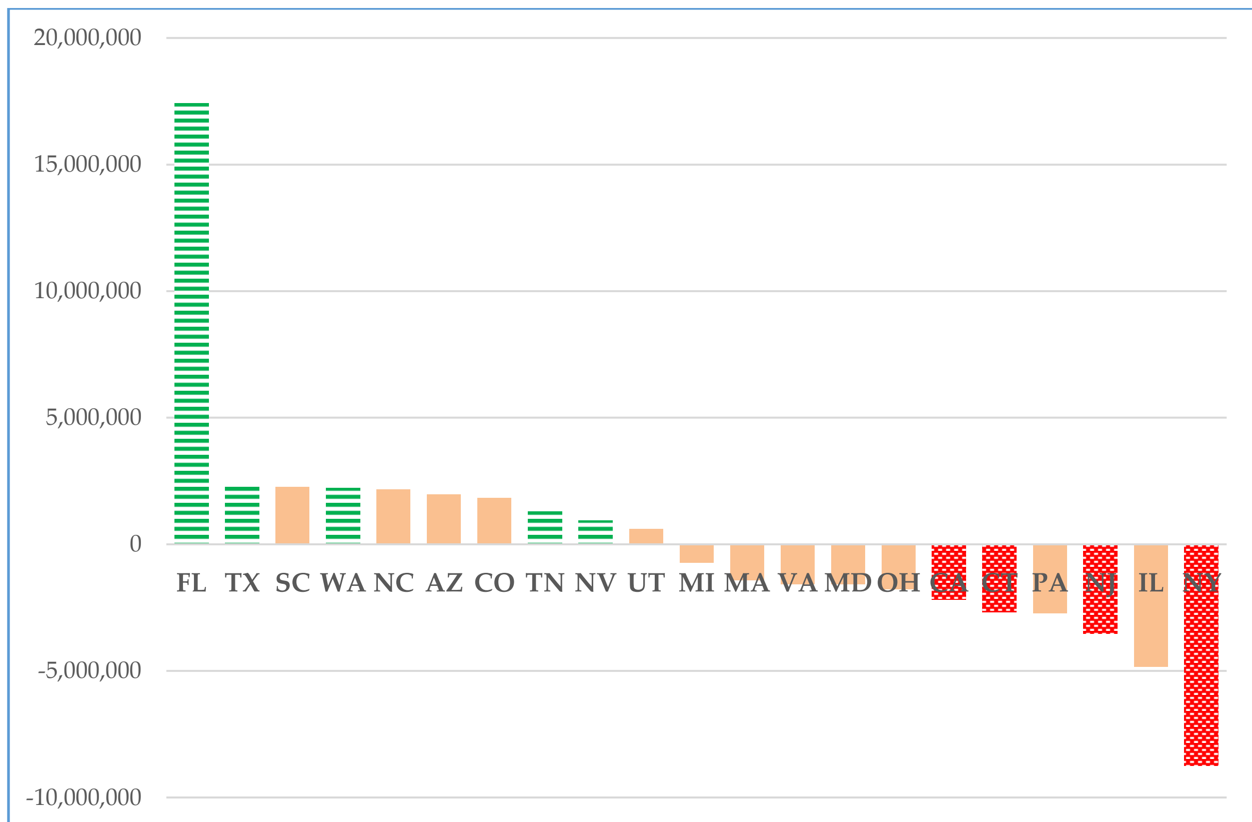
Massachusetts Taxpayers Foundation

On State Tax Policy and Migration

An Analysis of the Impacts of Surtaxes on High-Income Earners



February 12, 2018

ON STATE TAX POLICY AND MIGRATION

Introduction

This paper explores the issue of taxpayer mobility and what it could potentially mean to the Commonwealth should Massachusetts experience an out-migration in light of recent or pending tax law changes. Against the backdrop of the pending ballot initiative that imposes a new surtax on income over a million dollars, the Foundation explores the likelihood of emigration of wealthy taxpayers. We look at the actual experience of two comparable northeast states and the profile of impacted taxpayers to gauge a sense of how real the threat of emigration would be.

Key Findings

Massachusetts already has a migration problem. A net 475,000 people and $18.9 billion in AGI left the state from 1993 - 2016 (see Table 3, pg. 18). This out-migration damages economic growth and state tax revenues. If net migration had been neutral since 1993, that is, if the $18.9 billion in AGI had remained in Massachusetts, the state would have collected nearly $1 billion more in income taxes in 2017 alone, and substantially more over the 20+ year period.[1]

If the surtax passes, Massachusetts would have one of the highest tax rates in the nation on income over $1 million.[2] And that may understate the upcoming shockwave to high-earners. Since SALT deductions are now capped at $10,000, the effective state income tax rate for individuals making more than $1 million would soar to 9 percent from 3 percent – a remarkable 300 percent escalation. Given the state's persistent out-migration issues absent a massive tax hike, the state is rapidly entering uncharted territory with no ability to mitigate the damage for years.

Given the high cost of living along with increased property and income tax costs resulting from the federal limitation on SALT deductions, onerous estate taxes, and a surge in the number of potential retirees, the imposition of the additional 4 percent income surtax will surely drive more Massachusetts taxpayers to change their state of tax residency.

Some have argued that migration due to tax policy is a myth but the data are irrefutable – people routinely move from high-tax states to low tax states (see Figure 1, pg. 5).

[1] Cumulatively, the state would have collected more than $10 billion in tax revenues from 1993 – 2016 had the state's tax base, as measured by out-migration of AGI, not declined.
[2] California (13.3%), Minnesota (9.85%), and Oregon (9.9%) are higher.

This should come as no surprise given that state and federal governments repeatedly use tax policies to influence behavior. Whether it's taxes on cigarettes, sugar, and carbon emissions to reduce consumption or tax incentives for investments in life sciences, "green" technologies, or filming movies, policy makers understand that if you want more of something, tax it less; if you want less of something, tax it more.

Four states that enacted a surtax on income over $1 million – California, Connecticut, New Jersey, and New York – know this to be true, having lost a combined $17.1 billion in adjusted gross income (AGI) in 2016 alone. Following federal tax reform in December 2017, all four states are now re-thinking their income tax policies in order to prevent further out-migration by their highest-earners.

Conversely, Florida, which saw its income tax base increase by $17.4 billion in 2016 as measured by AGI, is using the recent federal tax reforms to recruit wealthy individuals from high-tax states. As the president of New York City Partnership recently commented on the efforts of her Florida counterparts, "Yes they are actively poaching and yes change of residence is easy."[3]

Given the demographic challenges we face – an older and slower growing population – it would certainly benefit the state if it put as much energy into retaining businesses, high-income earners, and college graduates as it does in recruiting new companies, new investors and new talent to fill the shoes of those who have left. The state's competition for talent and wealth – two characteristics that help generate the tax revenues to pay for vital safety net services – would be far easier if residents decided it was in their best interest to make their future here.

[3] *Florida ready to take in New Yorkers seeking tax shelter,* Carl Campanile, The New York Post, February 4, 2018.

ON STATE TAX POLICY AND MIGRATION

INTRODUCTION – IT IS NO MYTH, TAX POLICY CHANGES BEHAVIOR

Although some claim that increasing tax rates on high-income earners does not impact their tax residency, the data are unambiguous – people react to tax law changes. This is especially true for those who have the most to lose, the flexibility to change tax residency, and the advice of tax professionals on how to do so.

This should not come as a surprise. Governments use tax policy to modify behavior routinely and they do so because it works. For example, federal and state governments impose excise taxes on items such as cigarettes, sugar, and carbon emissions to reduce their consumption. Conversely, governments encourage economic growth through a whole array of tax incentives that reduce the cost of investment, whether it is for general research and development, specific investments in the life sciences or "green" technologies, or filming television shows and movies in specified geographical areas. Both practices demonstrate what most policy makers understand to be true – if you want more of something, tax it less; if you want less of something, tax it more.

Taxpayers and consumers are sensitive to changes in tax laws – even small ones. Massachusetts residents voted against indexing the state's gas tax that would have cost the average driver only $5 a year more in additional taxes and have supported sales tax-free holidays for the perceived tax benefit, even if the savings are relatively small.

Perhaps the best recent example of taxpayer sensitivity to tax increases is the concern expressed by taxpayers regarding the limits on state and local tax deductions. Following enactment of the federal income tax reform law on December 22, 2017, thousands of taxpayers in multiple states accelerated prepayments of state property and income taxes due in 2018 in order to maximize their state and local tax deductions before the cap on deductibility took effect. In Massachusetts, non-withholding income tax revenues for December 2017 and January 2018 surged to $1.67 billion, a stunning $650 million more than the previous year, much of which may be attributed to this prepayment of taxes.

This sensitivity to tax increases is not unique to taxpayers, as policymakers also reacted. In response to taxpayer reaction, state officials have begun exploring workarounds out of concern that the cap on SALT deductions may prompt the wealthiest to leave their states.[4,5]

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[4] *Will California outmaneuver a new federal cap on tax deductions*?, Kate Murphy, The Mercury News, January 4, 2018.

[5] See for example New York State Department of Taxation and Finance, *PRELIMINARY REPORT ON THE FEDERAL TAX CUTS AND JOBS ACT*, January 2018.

ON STATE TAX POLICY AND MIGRATION

As this report will demonstrate, the effects of tax policy targeting high-income earners impacts their interstate migration decisions. Those with the greatest amount of wealth to protect do, in fact, change tax residency, and this can result in tens if not hundreds of millions of foregone tax revenues. As the Connecticut Commissioner of Revenues commented, "there are five to seven people who, if they picked up and went, you would see that in the revenue stream."[6] That would include three billionaires who recently left Connecticut for Florida costing the state tens of millions in additional foregone income tax revenues.[7,8]

New Jersey suffered a similar fate when a billionaire moved his company to Florida causing a loss of an estimated $130 million in annual income tax revenues.[9]

This comes as no surprise to tax professionals who routinely provide guidance on tax liability minimization and avoidance. It may come as a revelation to the rest of us, though, that there are a lot of people who are sensitive to higher taxes and take actions to avoid them.

These are the themes that jump from Figure 1, a table displaying the states that either gained or lost adjusted gross income (AGI) in 2016. The data, which use the most recent IRS data available, show a clear and irrefutable shift in the migration of taxpayers from high-tax states to low-tax states.

Four states with surtaxes on incomes in excess of $1 million (CA, CT, NJ, NY) lost a combined $17.1 billion in AGI in 2016 while five of the top nine states that gained AGI (marked in green - FL, TX, WA, TN, NV) have no income taxes. Moreover, none of the states in Figure 1 that gained AGI has an estate tax, in contrast to the five states that lost the most in AGI in 2016 that have either an estate and/or inheritance tax (CT, IL, NJ, NY, PA).

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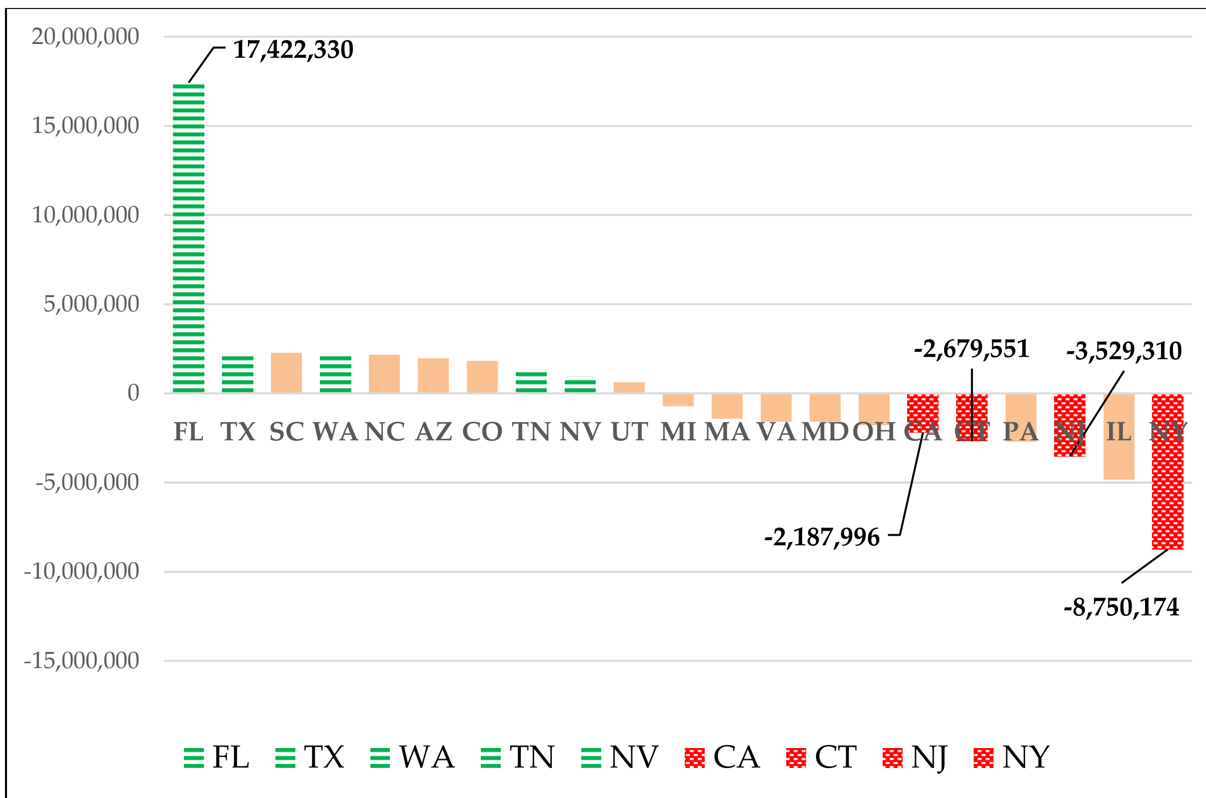
[6] Editorial*: Don't Send CT's wealthy packing by raising their taxes*, The Hartford Courant, March 8, 2016.
[7] *Two billionaires head for Florida, Deepening CT's cash crisis,* Dan Harr, The Hartford Courant, March 3, 2016.
[8] *Connecticut billionaire moves to Florida; could add $30 million to the deficit*, Marc E. Fitch, The Yankee Institute, June 30, 2016.
[9] *One top taxpayer moved, and New Jersey Shuddered*, Robert Frank, The New York Times, April 30, 2016.

Figure 1 - Nationwide Migration of Adjusted Gross Income (AGI) in Tax Year 2016

(Green bars – no income tax; red bars – surtax on income over $1 million tax)



Florida is the clear leader in attracting both people and wealth. The $17.4 billion gain in AGI is more than the next nine states combined. While many attribute Florida's success to its warm weather and retiree-friendly environment – and there is no disputing that those attributes are what initially draw vacationers or partial-year residents – there is substantially more at play than the warm weather in successfully enticing people to permanently relocate to the Sunshine State. And taxes are a prime factor.

For many people, taking advantage of a lower-tax jurisdiction may require them to physically uproot and relocate from one state to another. For many high wealth individuals, particularly those with second homes and passive income, changing one's tax residency can provide the same benefits with less disruption.

According to Massachusetts laws, a tax resident who changes his or her domicile to another state can qualify as a non-resident, for each taxable year after the change, so long as he or she spends no more than 183 days in aggregate in Massachusetts, in each tax year. This is important because residents pay Massachusetts income tax on all income

received regardless of the source while nonresidents pay income tax only on income derived from Massachusetts sources.[10]

If one's income is principally from investments or one's place of work can be changed, there may be considerable flexibility to structure the source of income to another state. Since those Massachusetts residents earning more than $10 million per year derive 85 percent of their income from capital gains, interest, Schedule E, and dividends[11], they are in a position to derive maximum benefit from a decision to move their tax residency to a lower-tax state.

Even if a relatively small number of Massachusetts residents decide to move to lower tax jurisdictions after passage of the income tax, the impacts are likely to be far more damaging in both the short and long-term than some proponents have stated. As shown in states like Connecticut and New Jersey, migration by a small number of the highest earners can have substantial, immediate consequences on state revenues.

Longer term, these tax changes make Massachusetts less competitive with neighboring states and others seeking to gain ground as global innovation hubs, making the state less attractive to those seeking to build the next generation of global enterprises.

Lessons from Connecticut and New Jersey[12]

While income surtaxes targeting higher-earning residents may not be the sole determinant in the decision to change tax residency, IRS data indicate that there is at least a strong correlation. It is likely that a constellation of higher costs from property taxes, estate taxes, and income taxes that target the highest earners, along with housing, energy, health care costs, incents people to reconsider where to establish residency.

When a state has a history of relying on ever increasing tax revenues to solve budgetary challenges, combined with persistent budget woes portending future tax hikes, taxpayers will seek new residency destinations. Given the considerable out-migration of people and AGI over the past two decades in states with high taxes and fiscal woes, Massachusetts policymakers should consider these states' actual experiences with great care.

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[10] For more information on tax residency in Massachusetts see: TIR 95-7: Change in the Definition of "Resident" for Massachusetts Income Tax Purposes, particularly B) Determining Domicile and C) Permanent Place of Abode and Presence in Massachusetts.

[11] Massachusetts Department of Revenue projections of surtax on income over $1 million, 2015.

[12] The Foundation analyzed Connecticut and New Jersey due to the comparable size of economies and the marginal rates on income above $1 million. New York is complicated by a New York City income tax and California's size and graduated income tax structure (10 tax brackets) make comparisons challenging.

CONNECTICUT

Income Tax Rate Hikes

The state of Connecticut passed a series of sweeping tax increases as it grappled with recurring billion dollar budget shortfalls following the 2008 recession. These hikes included changes to income tax rates and tax brackets, along with increases to sales, corporate, and estate taxes.

Before the fiscal crisis, Connecticut had a flat 5.0 percent tax on all income in excess of $20,000 for those filing jointly (Table 1, Column A). In September, 2009, the state introduced a surtax by raising the tax rate to 6.5 percent on income over $1 million (Column B) retroactive to January 1, 2009.

In 2011, Connecticut added three new tax brackets: 1) 5.5 percent on income over $100,000; 2) 6.0 percent on income over $200,000; and 3) 6.7 percent on income over $500,000 while lowering the 6.5 percent rate to income between $400,000 and $500,000. This effectively changed the surtax on higher incomes in two ways – it increased the top tax rate and broadened its applicability to income over $500,000 (Column C).

In 2015, the state went a step further in targeting the highest income earners. The tax rate on income over $500,000 was increased to 6.9 percent from 6.7 percent, and a new top bracket of 6.99 percent was added on income over $1 million (Column D).

Table 1 – Connecticut Income Tax Rates

Tax Rates (filing jointly)	A 2004	B 2009	C 2011	D 2015
3.00%	>$0	>$0	>$0	>$0
5.00%	>$20,000	>$20,000	>$20,000	>$20,000*
5.50%			>$100,000	>$100,000
6.00%			>$200,000	>$200,000
6.50%		> $1,000,000	>$400,000	>$400,000
6.70%			> $500,000	
6.90%				> $500,000
6.99%				> $1,000,000

In addition to these changes, the state cut the benefit of the lowest tax bracket to which the 3 percent tax rate applied by reducing the first $20,000 of income by $2,000 for every $5,000 of adjusted gross income that is in excess of $100,500.[13] Further targeting higher

[13] Department of Revenue Services, IP 2011 – *2011 Connecticut Income Tax Requirements Affecting Withholding Requirements*.

income earners, Connecticut also added a "recapture tax" of $150 for each $10,000 increment of AGI above $400,000, with a maximum recapture amount of $4,500.

Like the 2009 change, both the 2011 and 2015 tax law changes were passed mid-year but made retroactive to the beginning of the respective tax years, so each change would principally have effected taxpayer behavior for subsequent years.

In addition, after raising the estate tax exemption from $2 million to $3.5 million and lowering the top rate from 16 percent to 12 percent in 2009, Connecticut reversed itself and lowered the exemption back to $2 million in 2011.[14]

These cumulative and frequent tax increases prompted the impacted residents to leave, as borne out by the IRS data discussed below.

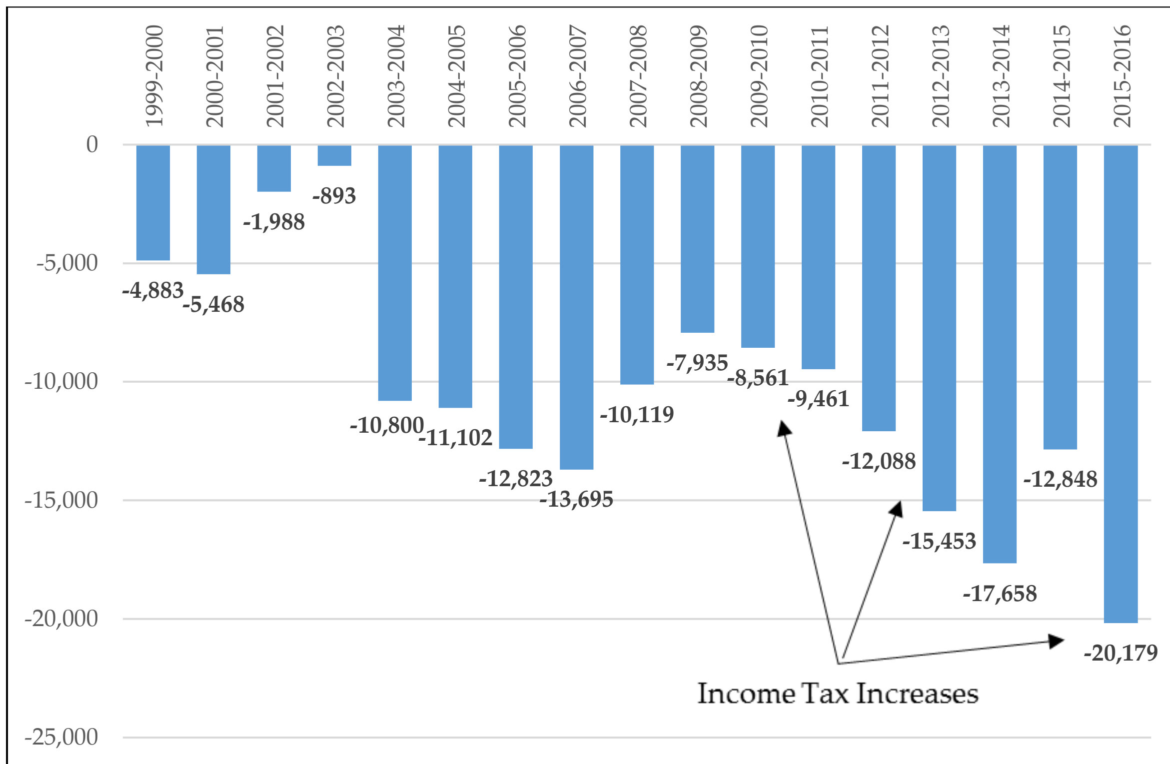
Out-Migration

Connecticut has long experienced an outflow of residents, but the pace rapidly accelerated following the 2008 fiscal crisis and subsequent income tax hikes. From 1999 – 2008, the state averaged a loss of 7,971 people per year. For the five-year period from 2011 – 2016, when the tax increases occurred, net out-migration doubled to 15,645 annually (Figure 2).[15] This uptick in emigration occurred in the midst of the economic recovery.

[14] A Better Place to Die: Reforming Connecticut's Estate Tax, Suzanne Bates, January 22, 2016, The Yankee Institute.

[15] Source: IRS, Statistics of Income Program, U.S. Population Migration Data

Figure 2 – Net Out-Migration of People in Connecticut



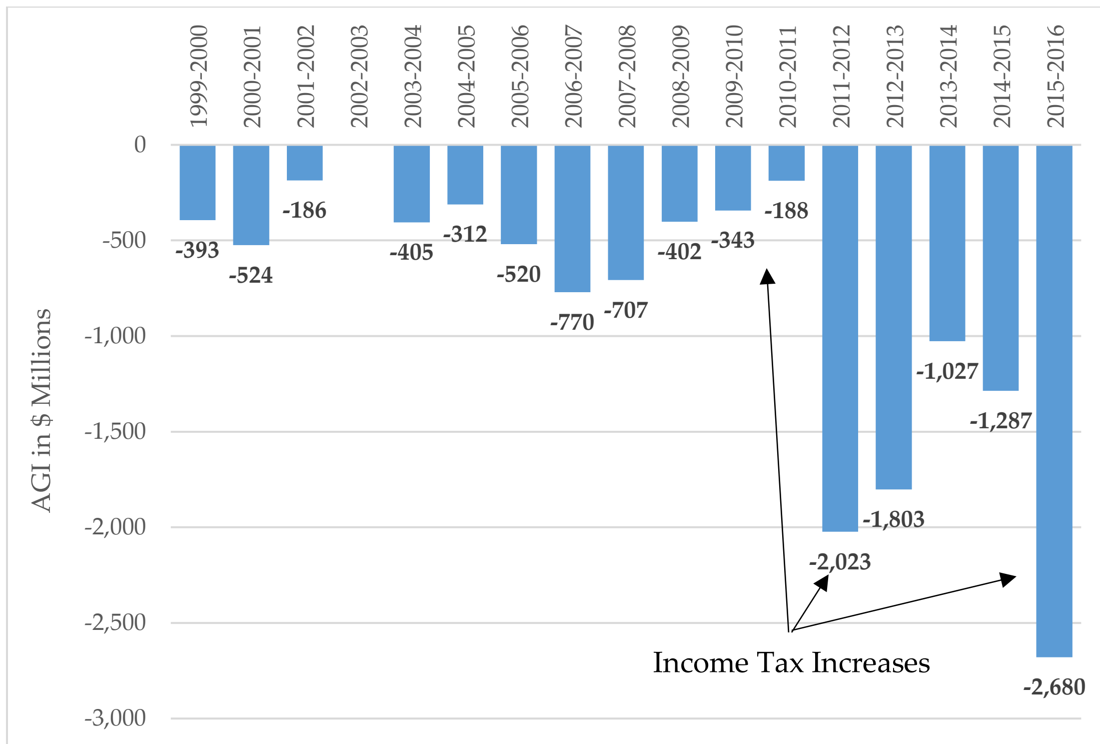
More importantly, the state experienced a staggering reduction of its personal income tax base as illustrated by the declines in AGI shown in Figure 3.

Before passage of the surtax in 2009, the state lost a total of $3.8 billion in AGI over the nine year period from 1999 to 2008, or approximately $423 million per year on average.

In the five year period following the second tax increase (2011 – 2016), Connecticut's losses quadrupled to $8.8 billion of AGI, or $1.76 billion per year.

Prior to the tax hikes, the average loss in AGI per individual who left was $55,000. For the five year period after the tax hikes (2011 – 2016), the average AGI loss per individual more than doubled to $115,000, an indication that wealthier people were the ones choosing to leave the state.

Figure 3 - Net Out-Migration of AGI in Connecticut[16]



In the two years 2011 and 2012, the state experienced a net loss of 27,541 people and $3.8 billion in aggregate AGI. According to the Yankee Institute for Public Policy, over 10,000 of these people and $2.5 billion in taxable income moved to Florida.[17] This is not surprising as Florida is the primary destination for residents leaving the state. As shown in Figure 4, from 1993 – 2016 over 60 percent of the AGI leaving Connecticut went to Florida – a state with no personal income taxes, no estate tax, and attractive weather for retirees. What is noteworthy is the increase in AGI that left Connecticut for Florida in the aftermath of the tax policy changes.

Summary

The tax revenue collected by Connecticut from its top 100 highest-paying taxpayers dropped 45 percent from 2015 to 2016 causing a loss of $200 million to the state. The following year, Governor Malloy attributed a $450 million decline in FY 2017 income tax revenues to a tax system that is "too dependent on our highest-income earners for our revenue".[18] He added, "The reality is that in Connecticut we get most of our money from

[16] Source: IRS, Statistics of Income Program, U.S. Population Migration Data

[17] *$60 a Second: Connecticut's Outmigration Problem*, Suzanne Bates, The Yankee Institute for Public Policy, November 2015, p. 3

[18] *Malloy Says State Too Dependent on Millionaires to Balance Budget*, Christopher Keating, The Hartford Courant, April 28, 2017.

very few people and that can produce some very wild swings."[19] Connecticut's experience highlights the risks of relying on a small subset of taxpayers for revenue who are disproportionately impacted and highly motivated to take action to reduce their tax liability.

The fairest way to raise taxes is to do so broadly, but that also has its challenges. If the proper foundation for why the tax is necessary has not been laid, impacted voters will reject such tax plans. As Governor Malloy acknowledged, "I have made many attempts to broaden the base, but that has not been successful."[20]

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[19] *Income tax revenue collapse; Malloy says taxing the rich doesn't work*, Mark Davis, News8, April 28, 2017.

[20] *Malloy says state too dependent on millionaires to balance budget*, Christopher Keating, The Hartford Courant, April 28, 2017.

NEW JERSEY

Income Tax Rate Hikes

Very similarly to Connecticut, New Jersey also experienced a severe emigration of wealthy taxpayers after enacting targeted tax increases. In 2004, under then-Governor Jim McGreevey, New Jersey added an 8.97 percent tax on income over $500,000 (Table 2, Column B). The higher rate was projected to raise $800 million from 28,000 households. The additional revenue was expected to pay for increased property tax rebates for homeowners, doubling the amount provided to the elderly and households with income below $200,000.

Table 2 – New Jersey Income Tax Rates

Tax Rates (filing jointly)	A 2002	B 2004	C 2009	D 2010	E Vetoed
1.40%	$0	$0	$0	$0	$0
1.75%	$20,000	$20,000	$20,000	$20,000	$20,000
2.45%	$50,000	$50,000	$50,000	$50,000	$50,000
3.50%	$70,000	$70,000	$70,000	$70,000	$70,000
5.52%	$80,000	$80,000	$80,000	$80,000	$80,000
6.37%	$150,000	$150,000	$150,000	$150,000	$150,000
8.00%			$400,000		
8.97%		$500,000		$500,000	$500,000
10.25%			$500,000		
10.75%			$1,000,000		$1,000,000

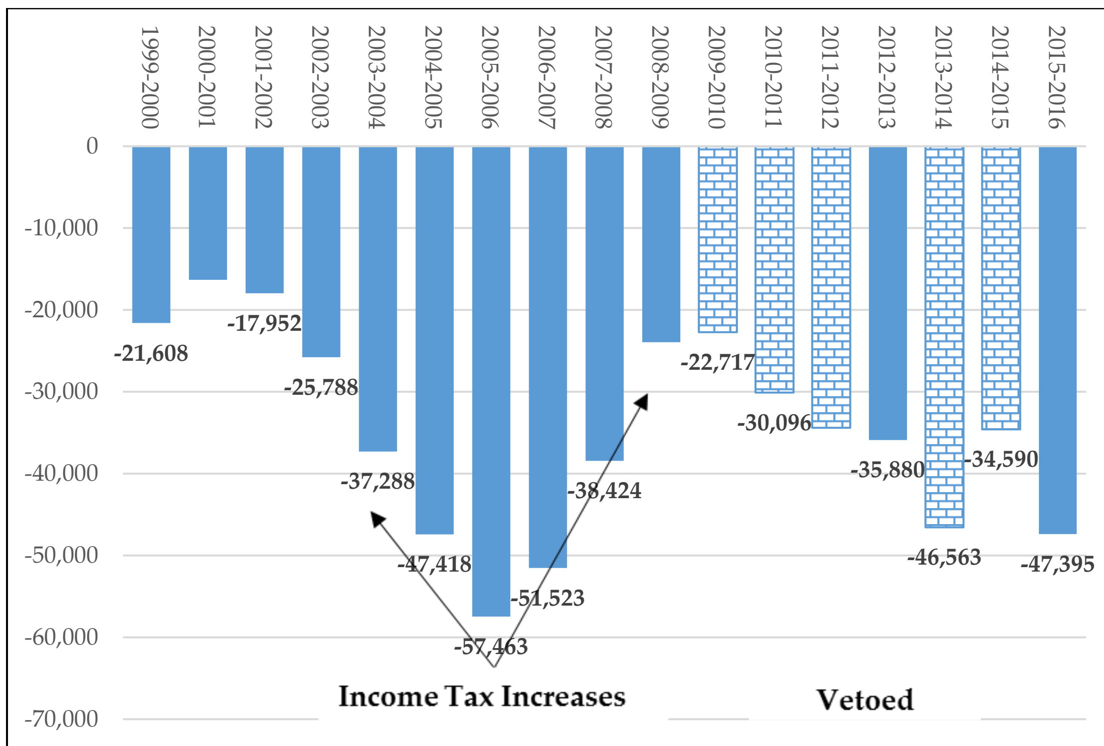
Five years later, in 2009, New Jersey passed a short-term tax increase to help close a $7 billion budget gap during the fiscal crisis (Column C). This change imposed rates of 8.0 percent on income over $400,000, 10.25 percent on income over $500,000, and 10.75 percent on income over $1 million. This temporary tax hike expired in 2010 (Column D).

Subsequently, the state legislature repeatedly tried to pass a permanent 10.75 percent tax on income over $1 million (Column E), but then-Governor Christie vetoed it each time it was put before him (2010, 2011, 2012, 2014, and 2015). The rationale for raising the income tax rate on the highest-earners was to increase payments to the state pension system to help defray a $40 billion unfunded liability.

Out-Migration

Like Connecticut, New Jersey experienced accelerated out-migration following its 2004 income tax rate hike. For the four years preceding the tax hike, net out-migration averaged approximately 20,000 people per year. That figure soared to 48,000 during the five-year period from 2004 – 2008 (Figure 4 and Figure 5 – checked columns). In the six years after the recession, 2011 – 2016, resident net out-migration settled to an average of 38,000 people per year, but the average AGI of emigrating taxpayers increased during that period, indicating that it was the wealthier taxpayers who were leaving the state.

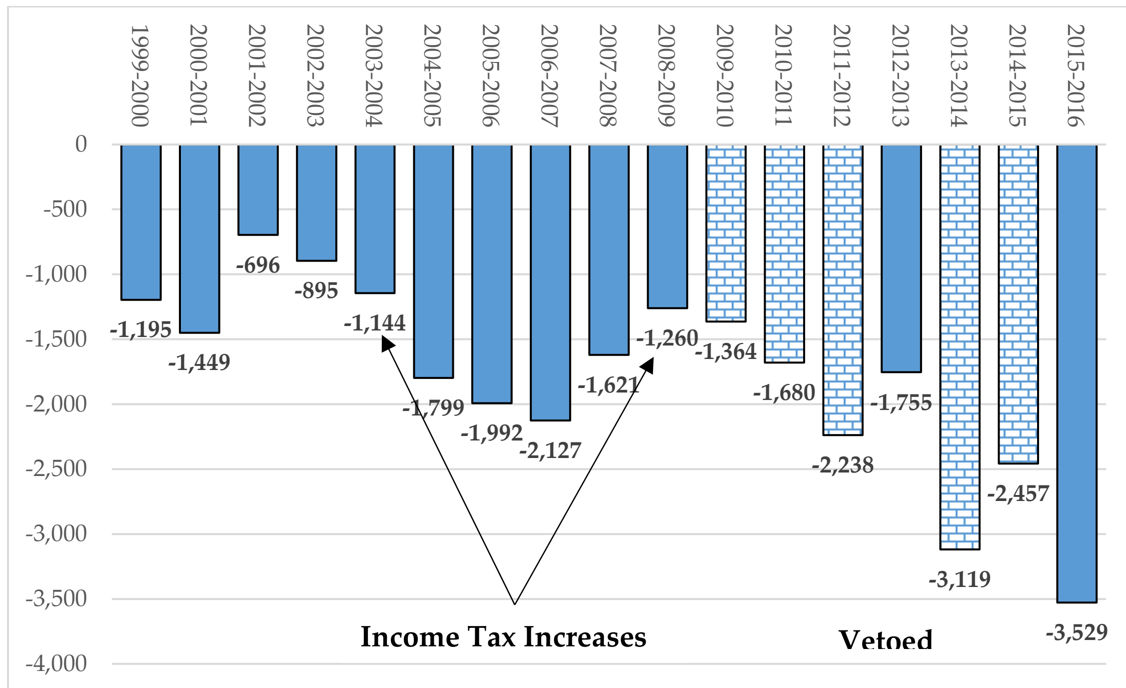
Figure 4 - Net Out-Migration of People in New Jersey[21]
Blue Checked Columns – Income Tax Raised and Subsequently Vetoed



In fact, the personal income tax base declined by an average of $1.1 billion per year for years 2000 – 2004, as measured by AGI, doubling to $2.1 billion annually since. As shown in Figure 6, average out-migration of AGI increased by another 30 percent since 2012, to $2.6 billion each year. On a net basis, 590,000 people have left New Jersey since 2000, shrinking the state's personal income tax base by $30 billion of AGI.

[21] Source: IRS, Statistics of Income Program, U.S. Population Migration Data

Figure 5 - Net Out-Migration of AGI in New Jersey[22]
Blue Checked Columns – Income Tax Raised and Subsequently Vetoed



Three separate analyses of the impact of New Jersey's 2004 tax rate increase demonstrate that out-migration of high-income individuals had a measurable impact on revenues, wealth, and charitable capacity.

In a major study conducted by the State of New Jersey to review the impact of marginal tax rate increases on migration, Roger Cohen (director of revenue and economic analysis at the New Jersey Department of the Treasury), Andrew Lai (policy analyst in the NJ Office of the Chief Economist) and Charles Steindel (chief economist of the NJ Treasury Department) concluded that:

> Our results indicate that variations in differential average marginal tax rates are associated with small but significant effects on net out-migration from a state. Calibrating the model for New Jersey, we estimate that by the end of the last decade the state's cumulative losses from increases in average marginal tax rates

[22] Source: IRS, Statistics of Income Program, U.S. Population Migration Data

> after 2003 (most importantly the 2004 surtax on income over $1 million) totaled roughly 20,000 taxpayers and $2.5 billion in annual income.[23]

In 2010, John Havens, Senior Associate Director of the Center on Wealth and Philanthropy at Boston College, conducted a study of the impact of higher tax rates on migration from New Jersey. The report found that from 1999 – 2003, New Jersey experienced a net influx of $98 billion in household wealth and a net increase of $881 million in charitable capacity, with the largest share of wealthy in-migrants coming from New York and Pennsylvania. Following New Jersey's income tax rate hike, those flows reversed. From 2004 – 2008, wealth tumbled due to a net *outflow* of $70 billion coupled with a $1.1 billion net *outflow* of charitable capacity.[24]

Havens found that wealthy heads-of-households moving into New Jersey after the tax hike were younger and less educated than those leaving. Additionally, in-migrants were concentrated in management or manufacturing while those leaving tended to be self-employed or working in finance or professional services.

Further, Havens found that many wealthy filers own at least two residences, with one often located in the south. "In the past five years, Florida was the destination of 17% of households, 20% of the wealth, and 37% of the charitable capacity leaving New Jersey."[25]

In another study of migration patterns, Antony Davies and John Pulito of the Mercatus Center at George Mason University analyzed the findings of a 2011 Young and Varner report on high-income migration from New Jersey following the income tax rate hike in 2004. They concluded:

> Controlling for property-tax rates, sales-tax rates, high-income tax brackets, unemployment, and state/county-specific and time-specific effects, we find that higher state income-tax rates cause a net out-migration not only of higher-income residents, but of residents in general.[26]

In July 2011, the New Jersey Department of the Treasury's Office of Revenue and Economic Analysis surveyed a group of accountants and financial advisers about the

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[23] *The Effects of Marginal Tax Rates on Interstate Migration in the U.S.*, Roger Cohen, Andrew Lai, and Charles Steindel, New Jersey Department of the Treasury, Office of the Chief Economist, Office of Revenue and Economic Analysis, October 2011.

[24] *Migration of Wealth in New Jersey and the Impact on Wealth and Philanthropy*, John Havens, Center on Wealth and Philanthropy, Boston College, January 22, 2010.

[25] Ibid. p. 9.

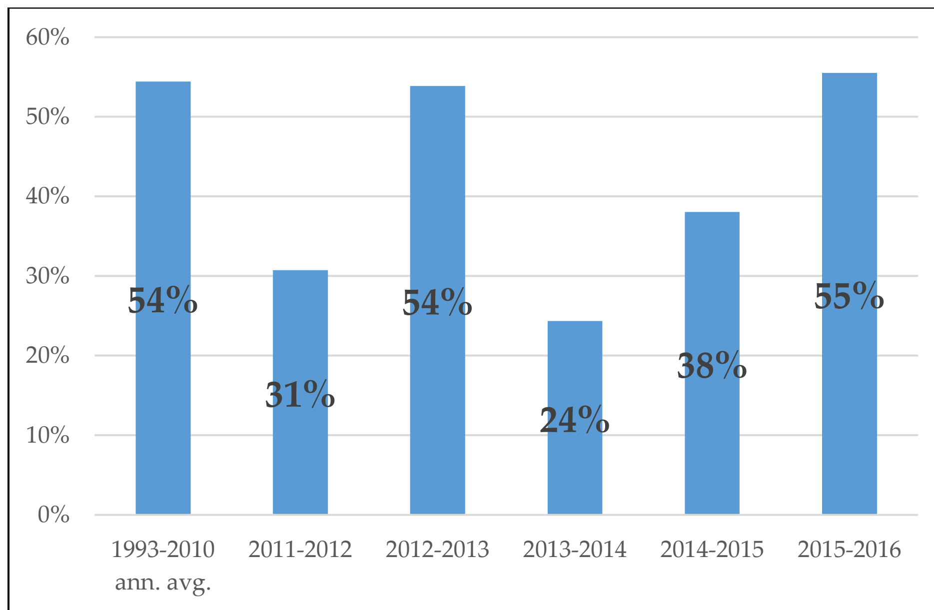
[26] *Tax Rates and Migration,* Antony Davies and John Pulito, Mercatus Center, George Mason University, p. 22.

migration patterns of their clients.[27] They received 200 responses. *More than half replied that one or more clients had either recently left or expressed interest in leaving the state*. Of the 11 reasons offered to explain why wealthy residents were leaving or contemplating leaving the state, the top five responses were:

1. State income taxes – (85.4%)
2. State property taxes – (77.7%)
3. State estate taxes – (67.0%)
4. Retirement – (47.6%)
5. Housing costs – (43.7%)

These five reasons help explain why a significant portion of New Jersey's personal income tax base disappeared to Florida. As shown in Figure 6, from 1993 – 2019, 50 percent of the AGI leaving New Jersey went to Florida – a state with no income taxes, no estate taxes, lower housing and property tax costs, and an attractive climate for retirees.

Figure 6 - Percent of New Jersey AGI Out-Migration to Florida[28]



Summary

Like Connecticut, New Jersey has experienced a continuous out-migration of residents – nearly 600,000 – and a $30 billion decline in the tax base as measured by net AGI since

[27] The New Jersey Department of the Treasury's Office of Revenue and Economic Analysis surveyed subscribers to the NJ Division of Taxation's Tax E-Notes comprised largely of accountants and financial advisers.

[28] Source: IRS, Statistics of Income Program, U.S. Population Migration Data

2000. The cause can be partially attributed to two income tax increases. But the state's perpetual fiscal woes also play a significant role. The near-yearly efforts to raise taxes on the wealthiest residents, including a 2017 campaign pledge by the newly elected Governor, suggest that the state's fiscal volatility and tax uncertainties have a chilling effect on the wealthiest taxpayers. It is this combination of actual and potential tax increases that drives taxpayers to seek lower tax jurisdictions.

The recent federal tax law change may put a stop to New Jersey lawmakers' support of a permanent 10.75 percent rate on income over $1 million. The combination of the state income tax increase from 8.97 percent to 10.75 percent and the $10,000 cap on SALT deductions translates into an estimated 5.5 percent tax hike for those with incomes over $1 million.

Both the New Jersey Senate President and the incoming speaker, past proponents of a surtax on income over $1 million, have questioned whether that tax increase may now be too burdensome on residents given the federal tax law changes.[29] Senate President Sweeney said that he is re-evaluating the surtax: "I hit the pause button for one reason: If this [tax reform] actually does happen, I am very concerned about the exodus of wealthy people out of these states that pay a large portion of our tax base."[30]

[29] *Democrats in High-Tax States Plot to Blunt Impact of New Tax Law*, Ben Casselman, The New York Times, December 31, 2017.

[30] *NJ Senate president 'worried' about exodus of top earners if tax reform happens*, Fox Business, November 21, 2017.

MASSACHUSETTS HAS A HISTORY OF LOSING RESIDENTS AND WEALTH

Massachusetts already has a migration problem. Residents have been leaving the Bay State for decades with a net loss of 476,000 people and $19 billion in AGI since 1993 (Table 3).[31] This out-migration damages state economic growth and tax revenues. If net migration had been neutral since 1993, that is, if the $19 billion in AGI had remained in Massachusetts, the state would have collected nearly $1 billion more in personal income taxes in 2017 alone and substantially more over the 20+ years.[32]

Table 3 – Net Out-Migration of Residents and AGI[33]

Years	Net People - To All States	Net AGI - To All States	Net AGI To FL	Net AGI to NH
1993-2010	(382,833)	($13,388)	($6,108)	($4,199)
2010-2011	(10,723)	($536)	($239)	($83)
2011-2012	(10,317)	($918)	($483)	($46)
2012-2013	(11,915)	($1,012)	($650)	($189)
2013-2014	(19,478)	($761)	($425)	($186)
2014-2015	(13,556)	($848)	($498)	($207)
2015-2016	(27,889)	($1,419)	($660)	($247)
Total	**(476,711)**	**($18,883)**	**($9,064)**	**($5,156)**
Percent			**48.0%**	**27.3%**

Where have these residents moved? Mostly to New Hampshire and Florida – two states with completely different weather but similar tax environments, specifically no income tax[34] and no estate tax. Nearly 50 percent of lost AGI, or $9 billion, moved to Florida and $5.2 billion or 27 percent to New Hampshire since 1993. Roughly 300,000 of the 476,000 residents that left Massachusetts chose either Florida or New Hampshire as their state of primary residency.

Massachusetts has many of the attributes of New Jersey and Connecticut that encourage out-migration – high housing costs and property taxes, exceedingly onerous estate taxes, and an aging demographic approaching retirement age. Lawmakers have successfully moderated the tax burden on residents over the past two decades, finally

[31] The number of Massachusetts residents moving out of state has been offset by international in migration from 1993 to 2016. Given current federal policies on immigration, that offset could change.

[32] Cumulatively, the state would have collected more than $10 billion in tax revenues for 1993 – 2016 had the state's tax base, as measured by out-migration of AGI, not declined.

[33] Source: 1993 – 2010, Tax Foundation, State to State Migration Data; 2010 – 2016, IRS, Statistics of Income Program, U.S. Population Migration Data.

[34] New Hampshire has a 5 percent tax that applies to interest and dividends income only.

shedding the state's historic reputation as a state with one of the highest tax burdens in the nation, but this could be jeopardized by the cumulative impact of recent or pending tax policies.

Impacts of the Ballot Question to Impose a Surtax on Income over $1 Million

Should the ballot question pass, those reputational gains could be quickly lost.[35] Massachusetts would have one of the highest tax rates in the nation on income over $1 million.[36] The income tax surcharge would raise the top tax rate in Massachusetts for the highest earners by 4 percentage points, from 5.1 percent to 9.1 percent. This increase is substantially larger than Connecticut's 2 percentage point increase (5.0 percent to 6.99 percent) and New Jersey's 2.6 percentage point rate hike (6.37 percent to 8.97 percent).[37]

The 80 percent increase in the state income tax rate would add a projected average increase of $96,000 in tax liability for those making more than $1 million.[38] Further, the tax rate on short-term capital gains would jump to 16 percent from 12 percent.

Estate Taxes

The Massachusetts income surtax hike would be in addition to the onerous estate tax that impacts many of the same taxpayers. Massachusetts is one of only 16 states with either an estate or inheritance tax[39] and the calculation as to how much is owed can be quite complex. Tax rates are graduated from 0.8 percent on estates valued at more than $40,000 but less than $90,000 to 16 percent on estate valued in excess of $10.4 million (see Appendix).

Massachusetts does not tax estates with a value of less than $1 million. However, the $1 million threshold is not an exemption, meaning that if the value of the estate exceeds $1

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[35] On five occasions Massachusetts voters rejected the adoption of a graduated income tax (1962, 1968, 1972, 1976, and 1994). The results were overwhelming – of 10.2 million votes cast cumulatively, 72 percent opposed the change to a graduated income tax, MA Secretary of State's Office, Statewide Ballot Questions — Statistics by Year: 1919 – 2016

[36] California (13.3%), Minnesota (9.85%), and Oregon (9.9%) are higher.

[37] New Jersey's temporary rate hike in 2009 and subsequent efforts to permanently raise the millionaires' tax would be an overall increase of 4.38 percentage points (from 6.37 to 10.75) – slightly higher than the 4 percent surcharge in the Massachusetts ballot question.

[38] Massachusetts Department of Revenue estimates, 2015: $1.9 billion in new revenues affecting 19,650 tax filers.

[39] In 2017, 12 states (Connecticut, Delaware, Hawaii, Illinois, Maine, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia impose only estate taxes. Four states (Iowa, Kentucky, Nebraska, and Pennsylvania) impose only inheritance taxes.

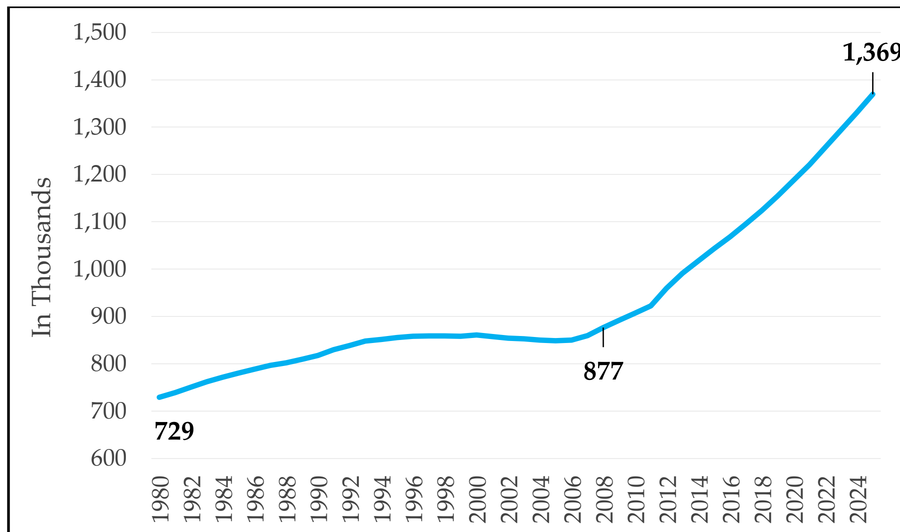
million, the tax applies to the full value of the estate and not just the amount over $1 million.

Because Massachusetts does not conform to the current version of the Internal Revenue Code with respect to the estate tax, the $1 million estate value tax threshold was significantly lower than the federal exemption of $5.49 million in effect prior to the recent federal tax law changes. Now that federal tax reform has doubled the exemption to $11.2 million, Massachusetts is even a greater outlier to older, high-net worth residents.

Demographics

A growing subset of Massachusetts taxpayers will be highly sensitive to the recently enacted or pending tax changes. One such group is the surging number of retirees in the Commonwealth. As shown in Figure 7 below, the number of Massachusetts residents over the age of 65 hit an inflection point in 2011 as the first wave of baby boomers turned 65. By 2025, those over 65 years old grow by approximately 500,000, leading to a surge in retirement.

Figure 7 – MA Population Aged 65+[40]



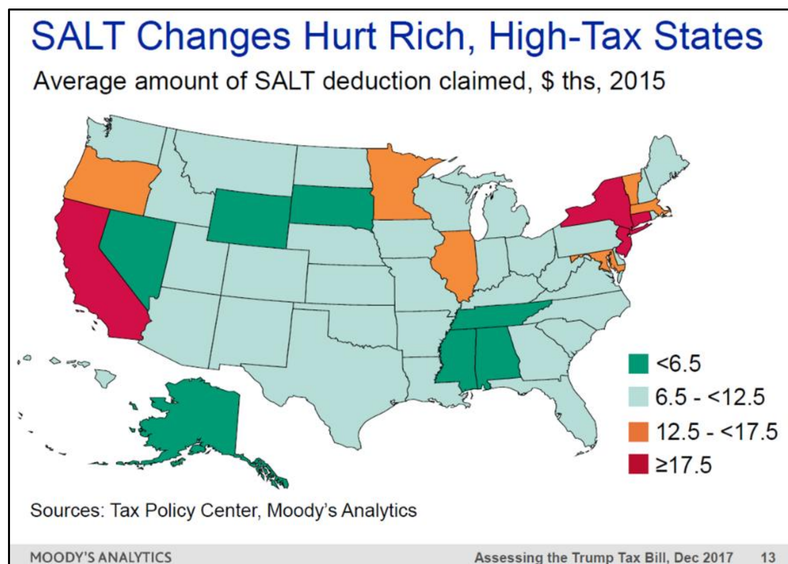
Given the already high cost of living, along with increased property and income tax costs resulting from the federal limitation on the state and local tax deduction, and burdensome estate taxes, the imposition of the income surtax will likely drive more residents out of Massachusetts exacerbating the state's migration problem.

[40] Source: Moody's Analytics, January 3, 2018.

Federal Tax Law's SALT Cap Exacerbates the Surtax Impact

Another highly impacted group of taxpayers is the 1.15 million, or one-third of all Massachusetts tax filers, who itemized deductions in 2015. Their average state and local tax deduction (SALT) per filer was $17,000. According to Moody's Analytics that places Massachusetts just behind California, New York, Connecticut, and New Jersey, (with more than $17,500 in SALT deductions per filer), among those states most adversely affected by the federal tax law (Figure 8). For individual taxpayers with above average tax liability, that additional burden is quite substantial.

Figure 8 – Massachusetts Will Be Hit Hard by SALT Cap



Of these 1.15 million people who itemized, 15,485 Massachusetts tax filers had incomes over $1 million with an aggregate AGI of $56 billion and total SALT deductions of $3.87 billion (Table 4). These filers averaged $250,000 in itemized SALT deductions in their 2015 tax returns. Although many Massachusetts taxpayers will benefit from the doubling of the standard deduction ($24,000 for joint filers), including some who have itemized in the past, those with incomes over $1 million will lose on average $240,000 in deductions starting in 2018.

Table 4 – Tax Year 2015[41]

(in $ thousands)

Federal SALT Cap Impact	Income > $1 Million
AGI	56,213,016
Tax Returns	15,485
Total Itemized Deductions	6,117,272
Income Tax	3,427,258
Property Tax	445,536
Charitable contributions	2,568,813
Total SALT Deductions	3,872,794
Average SALT Deduction	250
SALT Cap	10
Average SALT Exposure	240

At a 37 percent marginal tax rate on income over $600,000 (filing jointly), the loss of $240,000 in deductions translates into approximately $90,000 in additional federal tax liability on average (on top of the $96,000 impact per filer from the 4 percent surtax[42]).

Put another way, in the past, federal SALT deductions reduced the effective state income tax rate to approximately 3 percent for those making more than $1 million. The combination of the $10,000 cap on SALT deductions and the 4 percent state surtax would mean that the effective state income tax rate for these individuals would jump from 3 percent to 9 percent – a remarkable 300 percent escalation.

While the individual impacts cannot be known given the multitude of federal tax law changes and differences in circumstances, the SALT cap does place the increased tax burden in context. Should the surtax pass, its impact, combined with fed tax law changes, could drive out a significant number of the state's highest earners. These tax filers have considerable flexibility to change their tax residency as the preponderance of their income – over 85 percent – derives from passive investments rather than wages.

As we see from the actual experience of other northeastern states, the impact of outward migration by wealthy taxpayers can make a material difference to the state's revenue collections. New Jersey changed tax brackets and increased tax rates twice in five years and attempted to pass a higher rate on income over $1 million five additional times in the six years after the tax increases. Those actions resulted in a doubling of the average annual

[41] Source: IRS, Statistics of Income Stats – Historic Table 2.

[42] Massachusetts Department of Revenue estimates, 2015: $1.9 billion in new revenues from 19,650 tax filers equals $96,000 in additional income taxes per filer from the surtax.

AGI that migrated from New Jersey. Connecticut passed three bracket changes and rate hikes in six years and its average out-migration of AGI quadrupled.

Both states resorted to tax increases on their highest earners to cope with slowing revenues and increased spending obligations, and both states experienced substantial lower revenues than predicted. Because of these experiences, and the potential aftershock of the federal SALT limitation, lawmakers in Connecticut, New Jersey and New York are re-thinking proposals to raise state income taxes on the highest earners.

That is also why high-tax states are reviewing provisions[43] – and passing legislation[44] – to mitigate the impacts of the loss of SALT deductions to keep high-income residents from leaving their states. The resulting revenue risks are stark.

The ballot question pending in Massachusetts, however, is quite different and far more dangerous to the economic health of our state. The ballot question embeds the high tax rate into the state's Constitution, thereby effectively enshrining the surtax. As the Foundation noted in its earlier analysis[45], should the ballot question pass, the legislature is powerless to amend it without voter approval, a process that takes years to complete. Unlike other states that have enacted similar proposals and had the power to subsequently revise or reconsider their policies, Massachusetts could not quickly shield or mitigate the surtax's impact on residents and the state's economy.

While lawmakers in Connecticut, New Jersey, and New York back away from taxes that target their highest earners, Massachusetts would have no such flexibility. In order to fix the surtax, the legislature must approve a constitutional amendment by a majority of the 200 members in two successive Constitutional Conventions. Then the initiative must be placed before the voters on the next general election ballot and a majority must approve to make the change. That means the surtax and its impact on the state's economy cannot be adjusted or repealed until January 1, 2023 at the earliest.

By then the damage could be irreparable. That fact, in and of itself, may be enough to cause those with the most to lose to leave, compounding the state's historic migration woes. The voters of the Commonwealth should stop this well-intentioned but ill-conceived proposal from becoming law before it is too late.

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[43] *How these states are rebelling against the GOP tax code*, Annie Nova and Darla Mercado, CNBC News, January 23, 2018.

[44] *State Senate approves bill to tweak income tax rules*, Kirstan Conley, The New York Post, January 23, 2018.

[45] Changing the Constitution: 5 Questions to Consider, Massachusetts Taxpayers Foundation, June 12, 2017.

APPENDIX

Table 5 – Massachusetts Estate Tax Schedule

There is No Massachusetts Tax on Estate Values of Less than $1 million;
Massachusetts Taxes the Full Value of Estates with Values over $1 Million

From	To	Credit	+ % of	Excess over
$0	$40,000	0	0.0	$0
40,000	90,000	0	0.8	40,000
90,000	140,000	400	1.6	90,000
140,000	240,000	1,200	2.4	140,000
240,000	440,000	3,600	3.2	240,000
440,000	640,000	10,000	4.0	440,000
640,000	840,000	18,000	4.8	640,000
840,000	1,040,000	27,600	5.6	840,000
1,040,000	1,540,000	38,800	6.4	1,040,000
1,540,000	2,040,000	70,800	7.2	1,540,000
2,040,000	2,540,000	106,800	8.0	2,040,000
2,540,000	3,040,000	146,800	8.8	2,540,000
3,040,000	3,540,000	190,800	9.6	3,040,000
3,540,000	4,040,000	238,800	10.4	3,540,000
4,040,000	5,040,000	290,800	11.2	4,040,000
5,040,000	6,040,000	402,800	12.0	5,040,000
6,040,000	7,040,000	522,800	12.8	6,040,000
7,040,000	8,040,000	650,800	13.6	7,040,000
8,040,000	9,040,000	786,800	14.4	8,040,000
9,040,000	10,040,000	930,800	15.2	9,040,000
10,040,000	----	1,082,800	16.0	10,040,000