

Back to Taxachusetts Series: Capital Gains

By Gregory Sullivan

Proposition 80 is an initiative petition measure, scheduled to appear on the state ballot in November 2018, that would create an additional 4 percent tax (“surtax”) on any annual income above \$1 million.¹ As of 2017, the state income tax is 5.1 percent for all earners with taxable income. The ballot measure would make the tax 9.1 percent on the portion of an income above \$1 million (certain short-term capital gains currently taxed at 12 percent would be taxed at 16 percent). The portion of income below \$1 million would continue to be taxed at 5.1 percent. The \$1 million tax bracket would be adjusted each year to reflect increases in the cost of living and the tax would go into effect for the tax years beginning on/after January 1, 2019.

The measure would dedicate revenue from the new tax to public education (including public colleges and universities) and public transportation (including road and bridge projects). Proposition 80 is a state petition measure and therefore the increase in the state tax rate for top earners is independent of any forthcoming changes in federal tax law. The impact of Proposition 80 could, however, be amplified by changes in the federal tax code, such as the elimination of state income tax deductibility, as is currently under consideration by the Trump administration and Congress.

The organizations behind Proposition 80 are led by major public and private sector unions, such as the Massachusetts Teachers’ Association, American Federation of Teachers Massachusetts, the Boston Teacher’s Union, AFL-CIO, SEIU, American Federation of State, County and Municipal Employees and other progressive unions, groups, councils and associations. In addition to Proposition 80, Raise Up seeks to provide paid leave for up to half a year, an increase in the minimum wage to \$15 an hour. The members of Raise Up are largely similar to those that constituted two previous progressive coalitions, the Tax Equity Alliance for Massachusetts and Mass. Fair Share, which brought initiatives to create a graduated income tax to the ballot five times between 1962 and 1994. On each of those occasions, the pro-tax coalition lost, never gaining more than 28 percent of the vote.

Impact on Capital Gains

If approved, the initiative would have an outsized impact on capital gains taxes, hiking the state’s top marginal rate from 30th highest in the country to the fourth highest. When both state and federal capital gains taxes are included, Massachusetts’ combined top marginal rate would jump from 25th to the nation’s second highest. Looking globally, the commonwealth’s top marginal capital gains tax rate would become the sixth highest in the world.²

Most economists agree that keeping taxes low on investment is critical to economic growth, job creation and rising wages. A study by Nobel laureate Robert Lucas estimates that if the U.S. eliminated



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its capital gains and dividend taxes, the capital stock of American plant and equipment would be twice as large.

The highest federal tax bracket for capital gains is 23.8 percent, and Massachusetts taxes them at a 5.1 percent rate. But Proposition 80 would introduce an important difference between how the federal government and Massachusetts treat capital gains. The Internal Revenue Service essentially treats capital gains as separate from income taxes in that capital gains income cannot push a taxpayer into a higher income tax bracket.

Proposition 80 introduces a very different approach. Under the proposal, a 4 percent surtax applies to annual income over \$1 million, including income from capital gains. For this reason, capital gains can push a taxpayer into the higher Massachusetts tax bracket. This includes capital gains from the sale of a principal residence, after exclusion of \$250,000 for a single filer and \$500,000 for a married couple.

When state and federal capital gains taxes are combined, the Tax Foundation calculates that the highest marginal rate is 28.1 percent. Since states use various methodologies for capital gains taxes, with some, for example, providing deductions for federal capital gains taxes paid, the combined state and federal rate can't always be determined simply by adding the rates.

At 5.2 percent, Massachusetts' top marginal capital gains tax rate ranked 30th in the country in 2015, according to the Tax Foundation. The rate has since been reduced to 5.1 percent, but the 4 percent increase would move the commonwealth up to fourth (see Figure 1).

Similarly, the 4 percent surtax would move the commonwealth's combined top marginal capital gains rate from 28.1 percent in 2015 to 32.0 percent. This change would jump Massachusetts from 25th highest to second in the nation, behind only California (see Figure 2).

If Proposition 80 passes, Massachusetts would have the sixth highest capital gains tax rate in the world. At 32.0 percent, the commonwealth's highest marginal combined rate would rank behind only four European countries and California (see Figure 3).

Government by initiative petition often amounts in using a machete where a scalpel is needed. By imposing a 4 percent income on *all* annual income over \$1 million, including capital gains, Proposition 80 would penalize the capital formation that is the key to long-term growth and higher living standards.

Source: Tax Foundation Commerce Clearing House, and Author's Calculation

* States either allow a taxpayer to deduct their federal taxes from your state taxable income, have local income taxes, or have special tax treatment of capital gains income.

Figure 1. Top Marginal Tax Rate on Capital Gains by U.S. States, State Only & Combined Rate, 2015

Rank	State	State Rate	Combined Rate
1	California	13.3%	33.0%
2	New York	8.8%	31.5%
3	Oregon	9.9%	31.0%
4	Minnesota	9.9%	30.9%
5	New Jersey	9.0%	30.4%
6	Vermont	9.0%	30.4%
7	Maryland	5.8%	30.3%
8	Maine	8.0%	29.8%
9	Iowa	9.0%	29.6%
10	Idaho	7.4%	29.4%
11	Hawaii	7.3%	29.4%
12	Nebraska	6.8%	29.1%
13	Connecticut	6.7%	29.0%
14	Delaware	6.6%	29.0%
15	West Virginia	6.5%	28.9%
16	Georgia	6.0%	28.6%
16	Kentucky	6.0%	28.6%
16	Missouri	6.0%	28.6%
19	Rhode Island	6.0%	28.6%
20	North Carolina	5.8%	28.5%
20	Virginia	5.8%	28.5%
22	Ohio	5.3%	28.3%
23	Wisconsin	7.7%	28.2%
24	Oklahoma	5.3%	28.2%
25	Massachusetts	5.2%	28.1%
26	Mississippi	5.0%	28.0%
26	Utah	5.0%	28.0%
28	Arkansas	7.0%	27.9%
28	Montana	6.9%	27.9%
30	Louisiana	6.0%	27.9%
31	Kansas	4.8%	27.9%
32	Colorado	4.6%	27.8%
33	Indiana	3.3%	27.8%
34	Michigan	4.3%	27.7%
35	Arizona	4.5%	27.7%
36	Alabama	5.0%	27.4%
37	South Carolina	7.0%	27.3%
38	Illinois	3.8%	27.2%
39	Pennsylvania	3.1%	26.8%
40	New Mexico	4.9%	26.5%
41	North Dakota	3.2%	26.3%
42	Alaska	0.0%	25.0%
42	Florida	0.0%	25.0%
42	Nevada	0.0%	25.0%
42	New Hampshire	0.0%	25.0%
42	South Dakota	0.0%	25.0%
42	Tennessee	0.0%	25.0%
42	Texas	0.0%	25.0%
42	Washington	0.0%	25.0%
42	Wyoming	0.0%	25.0%
	D.C.	9.0%	30.4%
	U.S. Average	6.1%	28.6%

Figure 2. Top Marginal Tax Rate on Capital Gains by U.S. States, State and Federal Combined, after 2018 increase

Rank	State	State Rate	Combined Rate
1	California	13.3%	33.0%
2	Massachusetts	5.1%	32.0%
3	New York	8.8%	31.5%
4	Oregon	9.9%	31.0%
5	Minnesota	9.9%	30.9%
6	New Jersey	9.0%	30.4%
7	Vermont	9.0%	30.4%
8	Maryland	5.8%	30.3%
9	Maine	8.0%	29.8%
10	Iowa	9.0%	29.6%
11	Idaho	7.4%	29.4%
12	Hawaii	7.3%	29.4%
13	Nebraska	6.8%	29.1%
14	Connecticut	6.7%	29.0%
15	Delaware	6.6%	29.0%
16	West Virginia	6.5%	28.9%
16	Georgia	6.0%	28.6%
16	Kentucky	6.0%	28.6%
19	Missouri	6.0%	28.6%
20	Rhode Island	6.0%	28.6%
20	North Carolina	5.8%	28.5%
22	Virginia	5.8%	28.5%
23	Ohio	5.3%	28.3%
24	Wisconsin	7.7%	28.2%
25	Oklahoma	5.3%	28.2%
26	Mississippi	5.0%	28.0%
26	Utah	5.0%	28.0%
28	Arkansas	7.0%	27.9%
28	Montana	6.9%	27.9%
30	Louisiana	6.0%	27.9%
31	Kansas	4.8%	27.9%
32	Colorado	4.6%	27.8%
33	Indiana	3.3%	27.8%
34	Michigan	4.3%	27.7%
35	Arizona	4.5%	27.7%
36	Alabama	5.0%	27.4%
37	South Carolina	7.0%	27.3%
38	Illinois	3.8%	27.2%
39	Pennsylvania	3.1%	26.8%
40	New Mexico	4.9%	26.5%
41	North Dakota	3.2%	26.3%
42	Alaska	0.0%	25.0%
42	Florida	0.0%	25.0%
42	Nevada	0.0%	25.0%
42	New Hampshire	0.0%	25.0%
42	South Dakota	0.0%	25.0%
42	Tennessee	0.0%	25.0%
42	Texas	0.0%	25.0%
42	Washington	0.0%	25.0%
42	Wyoming	0.0%	25.0%
	D.C.	9.0%	30.4%
	U.S. Average	6.1%	28.6%

Source: Tax Foundation Commerce Clearing House, and Author's Calculation

Figure 3. Top Marginal Tax Rate on Capital Gains, by OECD

Rank	Country/State	Rate
1	Denmark	42.0%
2	France	34.4%
3	Finland	33.0%
3	Ireland	33.0%
3	California	33.0%
6	Massachusetts	32.0%
7	Sweden	30.0%
8	U.S. (avg state)	28.6%
9	Portugal	28.0%
9	United Kingdom	28.0%
11	Norway	27.0%
11	Spain	27.0%
13	Italy	26.0%
14	Austria	25.0%
14	Germany	25.0%
14	Israel	25.0%
14	Slovak Republic	25.0%
18	Australia	24.5%
19	Canada	22.6%
20	Estonia	21.0%
21	Japan	20.3%
22	Chile	20.0%
22	Iceland	20.0%
24	Poland	19.0%
25	Hungary	16.0%
26	Greece	15.0%
27	Mexico	10.0%
28	Belgium	0.0%
28	Czech Republic	0.0%
28	Korea	0.0%
28	Luxembourg	0.0%
28	Netherlands	0.0%
28	New Zealand	0.0%
28	Slovenia	0.0%
28	Switzerland	0.0%
28	Turkey	0.0%

Source: Ernst and Young and Deloitte Tax Foundation

* States either allow a taxpayer to deduct their federal taxes from your state taxable income, have local income taxes, or have special tax treatment of capital gains income.

Endnotes

1. Actual text of constitutional amendment: “To provide the resources for quality public education and affordable public colleges and universities, and for the repair and maintenance of roads, bridges and public transportation, all revenues received in accordance with this paragraph shall be expended, subject to appropriation, only for these purposes. In addition to the taxes on income otherwise authorized under this Article, there shall be an additional tax of 4 percent on that portion of annual taxable income in excess of \$1,000,000 (one million dollars) reported on any return related to those taxes. To ensure that this additional tax continues to apply only to the commonwealth’s highest income residents, this \$1,000,000 (one million dollar) income level shall be adjusted annually to reflect any increases in the cost of living by the same method used for federal income tax brackets. This paragraph shall apply to all tax years beginning on or after January 1, 2019.”
2. “The High Burden of State and Federal Capital Gains Tax Rates in the United States,” by Kyle Pomerleau. Tax Foundation, May 2015 (https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF460.pdf). At the time, the Tax Foundation published its study, Massachusetts’ income tax rate and capital gains tax rate was 5.2 percent. It was reduced to 5.1 percent effective 2016.

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