

The Great Understatement: Far more taxpayers and businesses than previously estimated will be affected by the proposed surtax

By Greg Sullivan

Internal Revenue Service data indicate that far more Massachusetts taxpayers and businesses are likely to be impacted by the proposed surtax on income above \$1 million than has been previously reported. The Massachusetts Department of Revenue estimated in 2016 that the millionaire's tax, if enacted, will apply to 19,565 individual taxpayers in the first year it takes effect. Data interpreted from the Tax Foundation suggests that the new tax will not impact the same 19,565 taxpayers year after year, but will likely affect a total of almost 65,000 unique individual taxpayers over the nine-year period following enactment of the proposed surtax.

A review of Tax Foundation data strongly suggests that those who would be subject to the surtax amendment to the Massachusetts Constitution would likely be a changing cohort of taxpayers composed mainly of “one-time millionaires”—that is households and businesses whose annual income exceeds \$1 million due to one-time business events or a one-time sale of long-held property. According to a report published by the Tax Foundation in 2010 entitled “Income Mobility and the Persistence of Millionaires, 1999 to 2007”, more than half of taxpayers reporting gross annual income of more than \$1 million in any year from 1999–2007 did so only once during the nine-year period.¹ The report also found that only 5.6 percent of those taxpayers reported gross income over \$1 million in all nine years. Fewer than 20 percent reported this income more than four times.

If the same persistence rate of millionaires reported by the Tax Foundation bears out in Massachusetts, 64,843 unique individual taxpayers would be affected over the nine-year period following enactment. Of these, almost 65,000 unique taxpaying households and businesses, 32,470 (50.1 percent) are predicted to have annual incomes in excess of \$1 million just once over the nine-year period. Only 3,650 (5.6 percent) are predicted to have income exceeding \$1 million in all nine years.

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Federal Analysis

The 2010 Tax Foundation report indicates that over the nine years from 1999–2007 the U.S. IRS received a total of 1,833,000 individual tax returns with gross income of \$1 million or more—an average of 203,667 per year. See Figure 1 below.



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Figure 1. Average and total number of returns with gross earnings exceeding \$1M, 1999–2007

Average # of returns per year with >\$1M gross income	203,667
Total # of returns over 9-years with >\$1M gross income	1,833,000

The Tax Foundation report also calculated how frequently individual taxpayers meet or exceed the \$1 million income level over the nine-year period studied. The results are shown in Figure 2.

Figure 2. I.R.S. Frequency of times a taxpayer's gross earnings exceed \$1M, 1999–2007

Times reporting >\$1M gross income	1	2	3	4	5	6	7	8	9	Total
# of unique taxpayers over 9-years with >\$1M gross income	338k	102k	54k	50k	29k	23k	24k	17k	38k	675k
% of unique taxpayers over 9-years with >\$1M gross income	50.1%	15.1%	8.0%	7.4%	4.3%	3.4%	3.6%	2.5%	5.6%	100.0%

The data in Figure 1 show that the average annual number of federal tax returns with gross income of \$1 million or more over the nine-year period was 203,667; as Figure 2 shows, these returns were filed by a total of 675,000 unique individual taxpayers over the same period. This means that the number of returns reporting gross income of \$1 million or more at least once over the nine-year period (675,000) was 3.3 times the average number of annual returns (203,667).

More than three times the number of unique individual Massachusetts taxpayers could be affected by the proposed surtax over a nine-year period than in a single year.

Massachusetts Analysis

The MA DOR estimated that using 2019 as an example, in a single year there will likely be 19,565 households and businesses affected by the surtax amendment to the Massachusetts Constitution—that is, taxpayers with incomes exceeding \$1 million in a single year. Over a nine-year period, based on federal data, we would expect then that the total number of returns with annual earnings of more than \$1 million filed in Massachusetts to be over 176,000. See Figure 3.

Figure 3. MA DOR's 2019 number of returns with gross earnings exceeding \$1M versus extrapolated 9-year total

Number of returns in 2019 with >\$1M gross income	19,565
Extrapolated 9-year total number of returns with >\$1M gross income	176,085

If the same 3.3 to 1 ratio observed federally holds in Massachusetts, should the constitutional amendment be passed by voters and enacted by the legislature, 64,843 unique taxpayers can be expected to be affected by the surtax over a nine-year period. We arrive at that calculation by multiplying MA DOR's estimation for incomes exceeding \$1 million in a single year (19,565) by the 3.3 ratio.

Figure 4 below provides a detailed view into the effect of the infrequency with which taxpayers achieve incomes of \$1 million or more over a nine-year period. By applying of the ratio established in Tax Foundation report, we can see that 32,470 (50.1 percent) of the 64,843 unique Massachusetts taxpayers will be one-year millionaires over a nine-year period; 65.2 percent would be subject to the surtax two or fewer times; fewer than 20 percent would be subject to it more than four times; and 5.6 percent would be subject to it in all nine years.

Over a nine-year period, based on federal data, we would expect then that the total number of returns with annual earnings of more than \$1 million filed in Massachusetts to be over 176,000.

Figure 4. Frequency of times a taxpayer's gross earnings exceed \$1M, 1999–2007

Times reporting >\$1M gross income	1	2	3	4	5	6	7	8	9	Total
# of unique taxpayers over 9 years	32,470	9,799	5,187	4,803	2,786	2,209	2,306	1,633	3,650	64,843
% of unique taxpayers over 9 years	50.1%	15.1%	8.0%	7.4%	4.3%	3.4%	3.6%	2.5%	5.6%	100.0%

What is the impact on businesses?

An April 2020 Pioneer Institute report demonstrated that the constitutional surtax amendment also applies to pass-through businesses such as sole proprietorships, partnerships, limited liability corporations, and S corporations that are taxed at the individual rather than corporate level.²

Publicly available data suggest that income from pass-through corporations represents a large component of the income that would be subject to the proposed surtax. In 2018, 13,430 of the 20,040 Massachusetts taxpayers with adjusted gross income of \$1 million or more reported Partnership/S-corporation income of \$1,026,774 on average.³ According to IRS data, taxpayers with adjusted gross income of more than \$1 million derive more than a third of such income from ownership interest to pass-through businesses. These 13,430 pass-through businesses in Massachusetts represent 7.16 percent of the Commonwealth's total partnerships and S corporations.

The number of pass-through businesses affected over a decade is harder to parse. On the one hand, the persistence of the “millionaires’ phenomenon” identified by the Tax Foundation also applies to the proposed millionaire’s tax effect on Massachusetts businesses. So a reasonable argument can be made that the number of pass-through returns reporting gross income of \$1 million or more at least once over the nine-year period may reach 40,000, or 3.3 times the annual number, just as is the case with household and individual filers.

From a research perspective, however, it is difficult to *pinpoint* exactly how many of the 13,430 businesses might ultimately be affected by the surtax without having access to individual tax returns of partnerships and S-corps. The Massachusetts Department of Revenue could, of course, analyze and report on this subject.

Conclusion

Public discussion of the proposed surtax has focused on an estimate by the Massachusetts Department of Revenue that fewer than 20,000 individual taxpayers would be affected by it in the first year after enactment. But taxes are not just for a single year, and this specific tax is one that mainly lands on people and businesses selling an asset or going into retirement rather than the image most people have of millionaires as individuals making \$1 million or more on a consistent basis. Making the reasonable assumption that Massachusetts’ trends largely match up with those in the rest of the country, the surtax could potentially affect around 65,000 unique taxpaying households and businesses over the nine-year period following enactment of the proposed surtax.

This conclusion is based upon the analysis conducted by the Tax Foundation in 2010 about the frequency with which federal taxpayers who report gross income of \$1 million or more in at least one year over a nine-year period do so over the entire nine-year period. As indicated by the report, the ratio of the number of unique taxpayers with gross income of \$1million or more over nine years to the average number of returns per year was 3.3 to 1. If the same ratio applies in Massachusetts, it will not be the same 19,565 Massachusetts taxpayers year after year who will pay the proposed surtax but rather a changing group of approximately 19,565 taxpayers per year. Over a nine-year period, an estimated 64,483 unique individual taxpayers will become subject to the

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surtax, comprised mostly of one-time millionaires whose income exceeds \$1 million due to one-time business events or one-time sale of long-held property.

If the same 3.3 to 1 ratio applied to the number of pass-through businesses that would become subject to the surtax over a nine-year period, the reach of the surtax would be greatly expanded, potentially even reaching up to 40,000 pass-through businesses. Based on 2018 IRS data, a total of 13,430 pass-through businesses in Massachusetts had adjusted gross income of \$1 million or more, representing 7.16 percent of total partnerships and S corporations in Massachusetts. These are the entities that could potentially be subject to the proposed surtax, depending on the number of owners to which each entity allocates profit. Only the Massachusetts Department of Revenue or the Internal Revenue Service could determine how many of these 13,430 pass-through entities will become subject to the surtax per year and how many over nine years. The state legislature should direct the Massachusetts Department of Revenue to produce such an estimate.

Endnotes

1. Tax Foundation. *Income Mobility and the Persistence of Millionaires*, 1999 to 2007. <https://files.taxfoundation.org/legacy/docs/sr180.pdf>
2. Nina Weiss and Gregory Sullivan, Pioneer Institute, “The Graduated Income Tax Trap: A Tax on Small Businesses.” April 20, 2021. <https://pioneerinstitute.org/download/the-graduated-income-tax-trap-a-tax-on-small-businesses/>
3. <https://www.irs.gov/statistics/soi-tax-stats-historic-table-2>

