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BRIEF

Tax Reality Sets In

By Jim Stergios, Mary Connaughton and Eileen McAnneny

For a decade, progressives have pushed the narrative that a significant increase in taxes on high-income earners will not drive those impacted out of Massachusetts. They have too often advanced policy arguments divorced from reality, such as the fallacy that economic competitive advantage doesn't matter, worsening already foreboding trends for Massachusetts's fiscal outlook, talent retention, and future economic growth.

They're wrong, as the data below unequivocally show.

For the past several years, proponents of the tax hike amendment that was adopted last November have argued that raising taxes on high earners would not encourage them to leave Massachusetts. They cite a dated and narrowly focused study as indisputable evidence of their position. Migration is not about a single tax—such as the tax hike amendment—occuring in a vacuum. It is about the broad set of tax and economic policies considered in the context of very real and dynamic forces: There are dozens of states, as well as a world of countries, competing for businesses, wealth and talent.

Moving out of a state is, of course, not something anyone or any business undertakes lightly, nor is it likely due to one single tax or issue. Leaving your home, where you perhaps raised a family and/or started a business, is a lot like divorce: It rarely happens for a single reason. Such monumental changes are the culmination of a series of events—and a loss of trust. In the case of Massachusetts, the confluence of several recent tax-policy changes, together with unforeseen social phenomena, are leading to a sharp increase in the number of taxpayers leaving the state.

They include:

- **A wildly out-of-the-norm estate tax policy**. Massachusetts and Oregon are the most punitive states, where the estate tax is triggered at the threshold of $1 million. By comparison, the federal threshold is just under $13 million. Thirty-three states have no estate or inheritance tax. Even Connecticut, which until the 2022 adoption of the Massachusetts tax hike amendment to the state Constitution was considered a higher tax state than Massachusetts, sets its estate tax threshold above $9 million.
- **The limitation on the deductibility of state and local taxes to $10,000.** In a high-tax state like Massachusetts, the 2017 limitation in the federal Tax Cuts and Jobs Act (TCJA) laid bare the state's uncompetitive tax policies and the financial benefits of changing one's domicile. Massachusetts legislators have ignored the new national reality and simply charged ahead with anti-growth strategies.

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- **Remote work enables people to live anywhere.** The pandemic accelerated the use of technology that enabled remote working, permanently altering the way business is conducted. Employees are routinely opting to work from home. For many, this has prompted them to relocate to a state different from their place of employment. In Massachusetts, home to many industry sectors that are conducive to remote work, that trend has really taken hold.
- **The waves of states reforming their tax environments became a tsunami**. Forty-three states adopted some kind of tax relief in 2021 and 2022. While Massachusetts contemplated raising income taxes, 21 other states reduced them in those two years. Legislative leaders failed to recognize the dynamic shift in the mobility of the workforce and the need to be competitive.
- **Adoption of the Tax Hike Amendment**, **manipulatively titled the Fair Share Amendment**. The signs for higher earners were and are clear, and many left even before the vote was taken in November. The codependence of the legislature and the public sector unions that bankrolled the amendment was evident. The lackluster engagement from the business community to oppose the amendment was also a clear signal—many simply decided that moving was easier.

One can debate which of these policies and events have played the predominant role in causing a quadrupling of tax filers and near quintupling of wealth leaving Massachusetts over the past decade. But it is indisputable that people are leaving at an accelerated pace, and the state's high taxes have played a role. Lawmakers can no longer ignore the fact that the state's tax burden does cause people to leave Massachusetts. Failing to enact pending proposals to make Massachusetts more competitive, especially for high earners, will further erode the state's economic strength—its human capital and critical industries—and, ironically, undermine its tax base.

Two watershed moments exacerbate the exodus of high-income earners

For three decades following the failed "Massachusetts Miracle," a bipartisan consensus emerged, whereby the state prioritized tax stability and measured approaches to shedding the derisive "Taxachusetts" moniker. By the early 2000s, the Commonwealth joined the broad middle of the pack with regard to state tax policy.

The loss of SALT deductibility and the pandemic laid bare the state's uncompetitive tax environment.

The recent rise of the anti-business and anti-capitalist progressive wing of the Democratic Party has brought an end to that bipartisan consensus. As noted below, Massachusetts is once again among the highest tax states in the nation. As a result, the rate at which higher earners are leaving has grown dramatically.

Two watershed events significantly altered state competition for talent and treasure, exacerbating the impact of anti-growth tax measures and heightening the need for policies that enable Massachusetts to compete.

The 2017 adoption of the Tax Cuts and Jobs Act made sweeping changes to the federal individual and business income tax codes, affecting brackets and rates, benefits, deductions, capital gains and dividends, depreciation, expensing, and more.

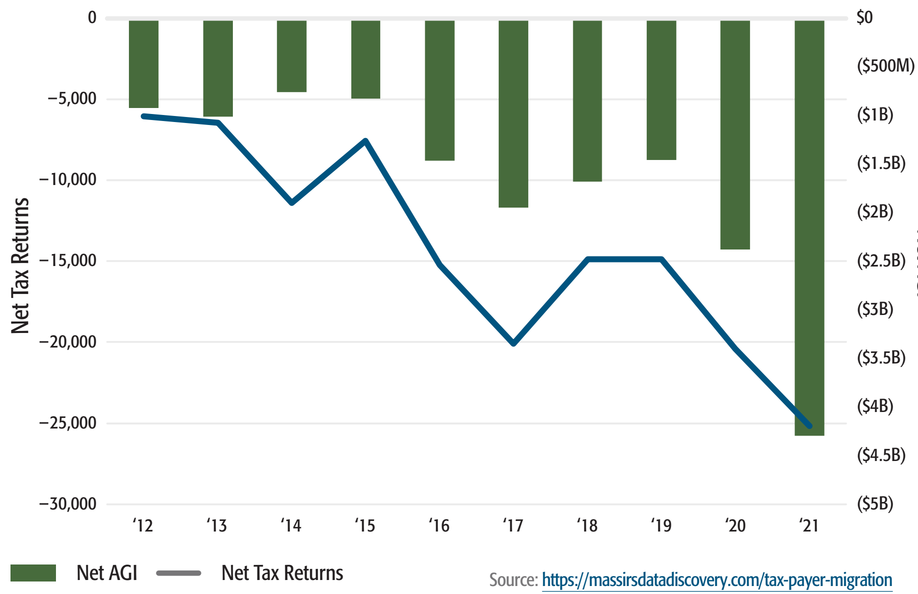
One of the more noteworthy changes in the TCJA was a provision to limit the federal deduction on state and local income taxes (SALT) to $10,000 for joint filers. (While the provision is set to sunset in 2025, there's no assurance that it will actually reverse.) States that are highly reliant on income tax revenues tread rough waters when the TCJA took effect in 2018. Policymakers in high-tax states fought this provision of the TCJA because they knew it would make taxpayers more aware of their state and local tax burden and call attention to the relative differences among the states.

As Figure 1 shows, lawmakers' concerns were justified. In high-tax states across the U.S, the tax base loss, as measured by net out-migration of adjusted gross income (AGI), rose considerably. In Massachusetts, from 2012 to 2018, there was a near doubling in net out-migration of AGI and 250 percent growth in the loss in filers.

After stabilizing in 2019, the amount of AGI and taxpayers leaving Massachusetts have increased significantly. In 2020 came the second seismic economic change — the COVID-19 pandemic.

The pandemic accelerated out-migration of wealth considerably.

Figure 1. Massachusetts net AGI & tax filer out-migration (inflow–outflow), by tax year



Source: https://massirsdatadiscovery.com/tax-payer-migration

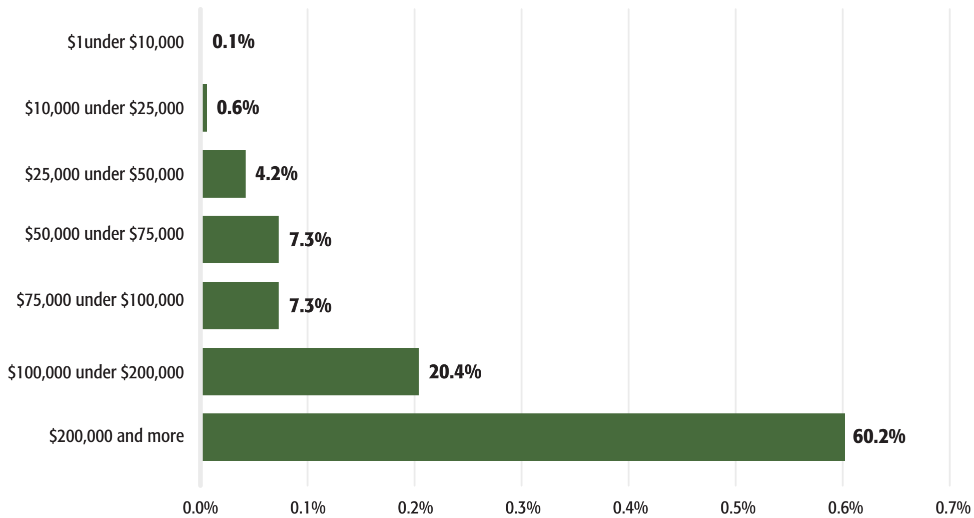
Year	AGI $M	Tax Returns
2012	−$922.8	−6,054
2013	−$1.6	−6,440
2014	−$758.5	−11,417
2015	−$831.1	−7,563
2016	−$1,463.3	−15,228
2017	−$1,947.1	−20,110
2018	−$1,680.3	−14,885
2019	−$1,455.0	−14,893
2020	−$2,378.5	−20,409
2021	−$4,297.2	−25,177
Totals	**−$16,750.3**	**−142,176**

By 2021, out-migration of wealth accelerated dramatically. Over the past decade, net out-migration of AGI in Massachusetts grew almost five-fold, from more than $900 million in 2012 to $4.3 billion in 2021. That translates to a 300 percent increase in the net loss of income tax filers in the Bay State, rising from 6,000-plus filers in 2012 to more than 25,000 in 2021.

Net AGI loss by income category

Figure 2 presents the latest IRS data on wealth categories, ranging from under $10,000 to $200,000 and above. (Note: Average 2021 household income was just under $90,000 in Massachusetts.) As the figure shows, the vast majority of net out-migration from Massachusetts was in the highest income categories — 80.6 percent in categories above $100,000 and a clear majority in the $200,000 or more category. Less than 5 percent of net out-migration was from those with incomes below $50,000.

Figure 2. AGI lost to net out-migration by income category, 2021, by percentage



Source: https://massirsdatadiscovery.com/tax-payer-migration

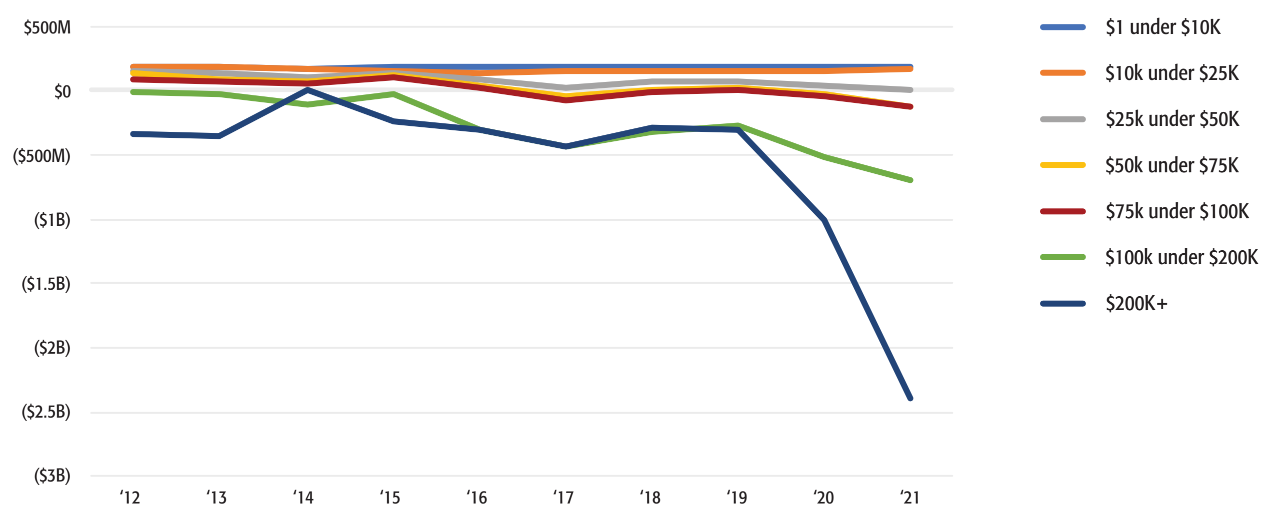
It gets worse.

Figure 3 shows that net out-migration of wealth by income category has gotten worse since the pandemic. There is substantial change in net out-migration of wealth across the board over the 10 years from 2012 to 2021, with a sizable jump in 2020 and 2021. The loss in the five lowest income categories, essentially those with income of $100,000 or below, grew from $192 million in 2012 to $834 million in 2021.

Wealth lost to net out-migration in the $100,000-$200,000 category quadrupled from $202 million to $876 million. Migration is heavily concentrated among earners at $200,000 or above, where there is a five-fold freefall of AGI, from $515 million to $2.6 billion. The massive drop in tax base due to net out-migration of higher earners occurs over the decade, but the hit to the tax base is particularly acute during the 2020 and 2021 tax years.

The 2021 IRS data are clear that higher-earning tax filers are fleeing Massachusetts.

Figure 3. AGI lost to net out-migration, by income class



Source: https://massirsdatadiscovery.com/tax-payer-migration

Net AGI loss by income age group

Figure 4 presents 2021 IRS data on AGI loss from net out-migration (again, taking the sum of out-migration from and migration into Massachusetts), in terms of both income and age group.

A look at the age groups leaving Massachusetts, reveals big—and troubling—surprises. The most significant loss of wealth came from the 55-to-65 age group ($1.2 billion). This may be in part due to attempts to avoid Massachusetts' onerous estate tax. Surprisingly, the second-largest age cohort leaving the state in terms of wealth lost is 26- to 35-year-olds ($930 million). Thereafter, in order of largest loss of wealth, are 45- to 55-year-olds ($765 million), 35- to 45-year-olds ($640 million) and, in another surprise, the retirement cohort of 65 and over, which is only the fifth largest cohort for wealth out-migration ($600M).

Surprisingly, the second-largest age cohort leaving the state in terms of wealth lost is 26- to 35-year-olds

The loss in the 26- to 35-year-old cohort is troubling. In the immediate term, their out-migration diminishes the pool of talent at a time when the state is already experiencing labor shortages. The Commonwealth's young talent also represents future wealth and the foundation of the state's future tax base. Tax revenue, economic contributions, and innovation will be constrained by the departure of younger members of the workforce. Not only will the state forgo these socioeconomic benefits now, but the losses will compound over three decades.

Figure 4. AGI lost due to net out-migration, by age group, 2021

Age Group	<$10K	10K–$25K	$25K–$50K	$50K–$75K	$75K–$100K	$100K–$200K	$200K+	Total
<26	($503K)	($10,351K)	($37,589K)	($35,593K)	($30,311K)	($18,830K)	($16,937K)	($150,114K)
26–34	($1,604K)	($5,032K)	($72,012K)	($139,084K)	($133,281K)	($330,380K)	($247,262K)	($928,655K)
35–44	($107K)	($2,563K)	($25,090K)	($50,681K)	($50,019K)	($169,399K)	($342,662K)	($640,521K)
45–54	$25K	($1,667K)	($18,840K)	($32,095K)	($28,831K)	($102,687K)	($580,964K)	($765,059K)
55–64	($249K)	($2,505K)	($15,715K)	($35,906K)	($42,180K)	($172,738K)	($938,939K)	($1,208,232K)
65+	($1,454K)	($2,398K)	($11,406K)	($19,733K)	($27,040K)	($81,772K)	($459,586K)	($603,389K)
Grand Total	**($3,892K)**	**($24,516K)**	**($180,652K)**	**($313,092K)**	**($311,662K)**	**($875,806K)**	**($2,586,350K)**	**($4,295,970K)**

Source: https://massirsdatadiscovery.com/tax-payer-migration

Florida and New Hampshire are the Commonwealth's biggest threats

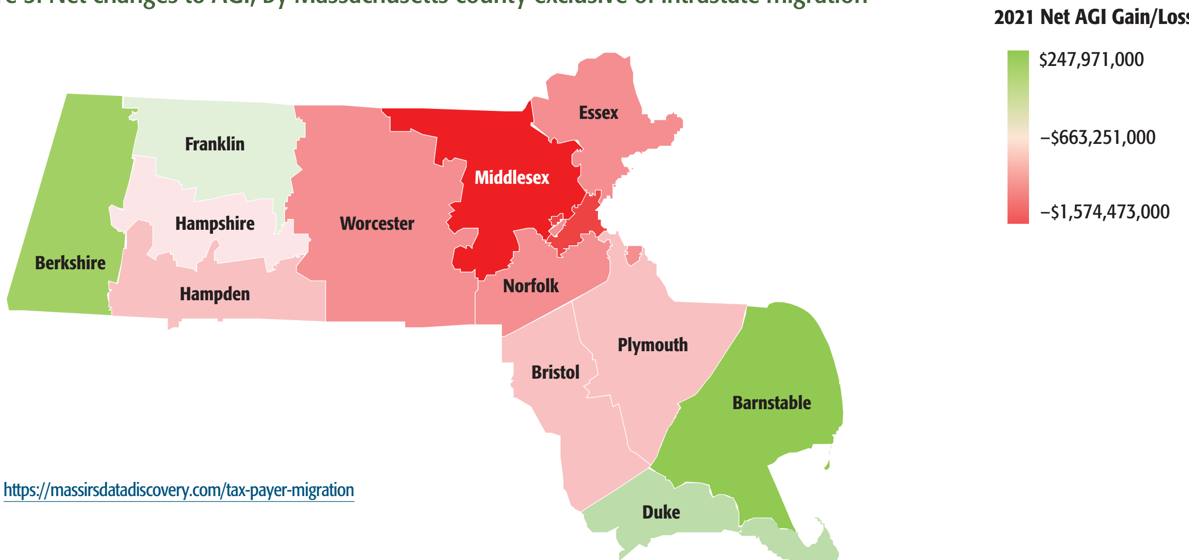
First, the good news: Berkshire and Franklin Counties, as well as the Cape and Islands, which, in total, represent 6.6 percent of the state's population, experienced a net inflow of AGI in 2021. Much of that is due to in-migration after the pandemic from New Yorkers and residents of abutting states, many of whom made their vacation homes into primary residences. For the counties where the remaining 6.5 million people reside, however, there has been net loss of AGI. Middlesex County, which abuts New Hampshire, was the hardest hit, with Norfolk County following closely behind.

New Hampshire has taken a different policy path, and is attracting residents and businesses from Middlesex County.

As previous Pioneer studies have shown, Florida and New Hampshire have long been attractive destinations for Massachusetts filers choosing to relocate. Frequently, the *majority* of the wealth and tax filers leaving the Bay State have moved to these two low-tax, no-income tax states. The tax affordability and stability that New Hampshire provides, while enabling retention of friends, workers, and customers, is attractive to many Middlesex County home and business owners, as the data indicate.

Between 2020 and 2021, the number of Massachusetts tax filers relocating to New Hampshire grew from 5,922 to 6,527, or by 10.2 percent.

Figure 5. Net changes to AGI, by Massachusetts county exclusive of intrastate migration

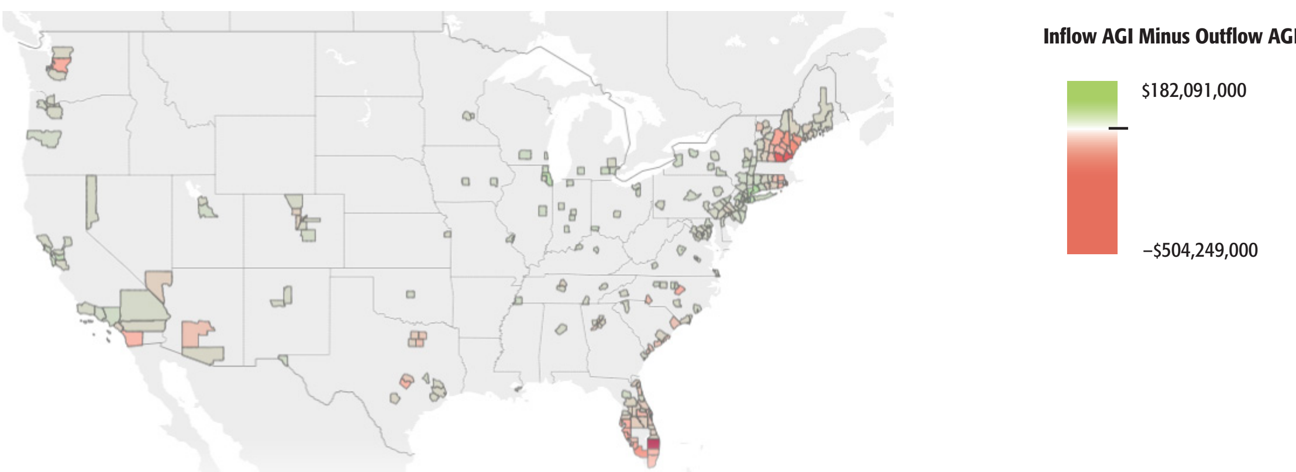


Source: https://massirsdatadiscovery.com/tax-payer-migration

Florida has been another popular destination for those leaving Massachusetts. Between 2020 and 2021, the number of Massachusetts residents relocating to Florida grew from 4,306 to 6,199, up 44 percent year over year.

In total, 67.4 percent of net AGI loss was to New Hampshire and Florida in 2021. In terms of destination by county, as shown in Figure 6, the three counties with the largest in-migration from Massachusetts were Palm Beach County, Florida (net AGI gain of $504 million), Rockingham County, New Hampshire (+$337 million) and Hillsborough County, New Hampshire (+$320 million).

Figure 6. U.S. county AGI net migration to and from Massachusetts



Source: https://massirsdatadiscovery.com/tax-payer-migration

The pandemic and the advent of remote work

As Figure 1 makes clear, net out-migration of wealth and filers from Massachusetts has increased dramatically over the past decade and especially in 2020 and 2021. This was undoubtedly influenced by the pandemic, the advent of remote work, and federal and state tax policy changes. The pandemic hastened adoption of remote work to the point where "WFH" is ubiquitous in many industries.

The McKinsey's 2022 American Opportunity Survey shows, based on a large 8,000-plus nationwide sample, that 35 percent of respondents had the option to work from home the entire week, and 23 percent could work remotely at least three days a week; thus, 58 percent of respondents had substantial remote work options. In Massachusetts, the percentage of workers with the option to work remotely is likely even greater than the national average due to the composition of industries.

Figure 7 is drawn from the McKinsey study and highlights the five industries in which remote work is prevalent across the U.S. All five are sectors of strength for Massachusetts. For each industry, the figure provides the percentage of employees for whom work is 100 percent remote, 60 percent remote (three days or more), or less than three days a week. The right-hand column provides the average days per week that all employees work remotely.

All five sectors where full-time remote work is ubiquitous are areas of importance for Massachusetts.

Figure 7. Remote work by industry, fully, part-time, and other percentage remote

Sector	100%	60%	<60%	Ave. Days/wk
Computer and mathematical	52	37	11	3.0
Business and financial operations	61	25	14	3.2
Architecture/engineering	47	35	18	2.4
Legal	46	30	24	2.7
Life/physical/social science	45	28	27	2.8

Source: McKinsey's 2022 American Opportunity Survey

If, as is likely, these national trends hold for Massachusetts, more than half of the almost four million individuals in the workforce have full- or part-time remote work options, and well over 1 million have full-time options. In a point related to the exodus from Massachusetts of 26- to 35-year-olds observed in the IRS data above, remote work is more prevalent—and preferred—among younger, more educated, and higher-income workers.

Blue state blues — back to Taxachusetts

Massachusetts is not alone in its loss of high-income earners to lower cost jurisdictions. CNBC recently noted that "New York and California lost over $90 billion in income to low-tax states during COVID." Again, the Empire and Golden States saw an acceleration in the trend of high earners relocating to lower-tax states like Florida and Texas. New York lost, on net, about $9 billion in AGI in 2019, growing to $25.1 billion in 2021. California's net loss of AGI grew from $8.7 billion to $29.7 billion over the same period. Common traits of all three states are their high cost of living and heavy tax burdens.

In response to pandemic challenges and the resulting infusion of federal funds, many states chose to reduce taxes. According to the Tax Foundation, 43 states "adopted tax relief in 2021 or 2022—often in both years." Of those, 21 cut income tax rates. The Foundation notes: "It's been a remarkable trend, driven by robust state revenues and an increasingly competitive tax environment." Immediately next door, New Hampshire, already a no-income tax state, moved to eliminate taxes on dividends and interest income.

Most states saw the new opportunities made available by the loss of SALT deductibility and the advent of remote work and acted upon them. Some didn't.

On the Tax Foundation site, they present the tax reforming states in a nice blue color. Massachusetts has through these years remained a stark white. In fact, Massachusetts went in the opposite direction with its adoption of a constitutional amendment placing an additional surtax on high earners. The impact of this policy choice is clear: In 2019, Massachusetts ranked ninth among states in net out-migration of AGI. By 2021, it ranked fourth, behind only California, New York and Illinois. Its fourth-place ranking is deeply troubling, because Massachusetts is ahead of much larger states like New Jersey, Pennsylvania, and Ohio.

Which of the various factors plays the predominant role in the steep losses of wealth in blue states—whether the 2017 federal limitations on SALT deductibility, remote work, or state tax policies—is, again, interesting to debate, but amounts to navel-gazing. The key question for policymakers is about economic reality: What is happening in the other states and in the other countries with whom we are competing for talent and investment? We ignore that reality at our economic peril.

Why this matters

As this analysis makes clear, Massachusetts has a problem with out-migration of wealth. Despite claims from progressives that state taxes do not cause people to move, the IRS has released clear and empirical data that indicate otherwise. This out-migration of wealth will only continue with enactment of the income surtax unless the legislature takes action to address tax issues where Massachusetts is an outlier (capital gains, treatment of S corporation and pass-throughs, and estate taxes). Whether one or another of these taxes was the "straw that broke the camel's back" is less relevant than the fact that people are moving to states with lower taxes.

Massachusetts cannot afford to see a further erosion of high-income earners. As the recent Pioneer piece in Commonwealth Magazine explains, it is in our collective interest to give high earners reason to remain in Massachusetts,as our tax system relies disproportionately on them. In the aftermath of the income surtax, that reliance grows more pronounced.

The state needs to return to the centrist consensus view that a stable tax environment attracts capital investment and talent.

The top 1 percent of taxpayers in Massachusetts paid more than 23 percent of all income taxes in 2019. Income taxes represent about 56 percent of all tax revenues collected by the state, which means 1 percenters were responsible for approximately 14 percent of the annual tax collections, and that percentage is likely to be even higher since the income surtax took effect. These statistics, in addition to dispelling the notion that high income earners don't pay their fair share, lay bare the fact that losing even a small percentage of these taxpayers could result in a significant drop in annual tax collections. It is for that reason that we need to alleviate the burden of our current estate tax and short-term capital gains rates.

The truth is that the tax changes proposed by Governor Maura Healey are modest and minor compared to what needs to be done to retain talent and grow prosperity in Massachusetts. A recent UMass-Amherst/WCVB poll found that a whopping 40 percent of all residents have been considering leaving the state because of the high cost of living, taxes, and other policies.

The state needs to make a course correction and once again foster a stable tax and business environment that will retain and attract capital investment and talent.

About the Authors

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