Debunking Tax Migration Myths

The truth: Tax them and they *will* leave

By Eileen McAnneny

The legislature held a public hearing to hear testimony on H.42, An Act Creating Tax Relief for Affordability, Competitiveness and Equity. This bill is the Healey-Driscoll tax package that proposes $876 million in annual tax relief to a variety of taxpayers. Of the participating legislators and those who testified, there seemed to be near universal support for the provisions aimed at helping people of low or modest means—a family and child dependent deduction, an increase in the renter's deduction, and the senior property tax circuit breaker.

In contrast, several legislators voiced their reservations about provisions targeted to higher-income earners, including revisions to the estate tax and a reduction in the tax rate for short-term capital gains. Their reservations fell into three categories: (1) concern about forgone state revenue; (2) the inability to see why relief to higher-end taxpayers is necessary; (3) the belief that taxpayers do not leave a state because of state tax increases.

While all three reasons are obstacles to passage of this important legislation, the latter two are very troubling and warrant further examination.

When legislators questioned supporters of changes to the estate tax and capital gains tax rates about why such relief was necessary, many supporters responded only indirectly, suggesting they were necessary to improve Massachusetts' competitive position. While that is true, there is a more compelling reason for the reforms.

Massachusetts needs estate tax and short-term capital gains tax relief because we disproportionately rely on taxpayers subject to them and the newly imposed income surtax to fund state government. It is in our collective interest to give them a reason to remain here.

Much was made that the top 1 percent of taxpayers would largely benefit from the estate tax and short-term capital gains tax rate changes, but there was no mention of the fact that the tax burden is highly concentrated among such taxpayers.

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 those "one-percenters" are responsible for approximately 14 percent of annual tax collections. When estate and sales taxes are included, the percentage is even higher.

With passage of the income surtax, our reliance on this small group of taxpayers is even more concentrated.

These statistics, in addition to dispelling the notion that high-income earners don't pay their fair share, lay bare the fact that loss of 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 tax burden of our current estate tax and short-term capital gains rates. These outlying tax policies, in combination with the income surtax, make Massachusetts a very costly state in which to live or retire for those who are subject to them. Because the surtax is embedded in the state Constitution and difficult to change, revisions to the estate tax and short-term capital gains tax rates are the most expedient way to mitigate these harmful policies.

Many legislators and opponents of the governor's tax package seemed skeptical about the notion that state tax increases cause out-migration among impacted taxpayers, particularly as it relates to millionaires. In defense of this position, they cite a well-known study by Cristobal Young and Charles Varner of Stanford University entitled *Millionaire Migration and the Taxation of the Elite: Evidence from Administrative Data* (American Sociological Review, 2016).

Reliance on this study is flawed for several reasons, but I will emphasize three of them:

This Study Was Pre-Pandemic and Does Not Account for Increased Mobility

The Young and Varner study was published in 2016. Since that time, the world has grappled with the COVID-19 pandemic and the resulting changes to the way we work and live. Among them are the widespread adoption of technology for business, shopping, and living and the ability to work remotely. These changes have led to a well-documented increase in the general population's mobility—often prompted by relative cost differences among the states.

For Massachusetts, with its predominance of white-collar industries, the mobility trend has been particularly pronounced. In fact, 24 percent of Massachusetts employees work remotely, according to recent U.S. Census Bureau Survey, a much larger percentage than the national average of 18 percent.

It is unrealistic to think that an 80 percent increase in the tax rate for taxpayers with annual income of $1 million or more—in combination with our onerous estate tax and short-term capital gains rate—will not cause some portion of impacted taxpayers to rethink their domicile in this new era of mobility. It is also contrary to what Massachusetts-specific data show.

Census and Other Recent Data Document Out-Migration

Lawmakers need look no further than the recent article on the front page of *The Boston Globe* indicating that Massachusetts has lost 110,000 people since April 2020. Several other studies document this trend.[1] While people leave the state for many reasons, the tax burden appears to be a factor. Florida and New Hampshire, neither of which has a state income tax or estate tax, were the top destinations for those leaving Massachusetts. A previous Pioneer Institute report also documents this trend.

For Massachusetts, this out-migration trend is bound to continue, or accelerate, given state demographics. That's because in addition to a more mobile workforce, Massachusetts has a large and growing population over 65 years of age. Retirees on fixed income are more sensitive to cost variations among the states.

As Young acknowledged, "Tax-induced migration is higher among people of retirement age, people living off investments rather than wages…" Thus, it is reasonable to assume that Massachusetts will see an uptick in the number of older residents subject to the income surtax and the estate tax who leave the Commonwealth for lower-tax environments.

The Young and Varner Study's Methodology Is Flawed in Two Material Respects

Young and Varner's study has material weaknesses in terms of the timeframe examined and the narrow definition of millionaire used. The study tracked migration by identifying California taxpayers who filed a full-year resident return in California in one year and part-time/nonresident return in an adjacent year. This is not a sufficient timeframe, as many taxpayers may not make the decision to move in the immediate aftermath of the tax change. Experiencing the actual impact of the tax change may spur them to leave, and the process of changing domicile can take more than 12 months.

Moreover, Young and Varner acknowledge that the vast majority of taxpayers reporting income of over $1 million in any one year are not likely to do so the following year, stating "a representative millionaire will only have a handful of years in the $1 million or more tax bracket.

Thus, it is highly conceivable that a millionaire could have filed in one year, not been subject to the tax in several subsequent years and moved jurisdiction by the next time they would be required to file as such. Such taxpayers would not be reflected in Young's study.

Finally, the study controls for variables other than tax rates that influence a taxpayer's decision, such as weather, housing costs and a state's economic strength. While this may isolate the effects of tax rates for academic purposes, all those factors are in fact part of the decision-making process for taxpayers considering a move and, comparatively speaking, Massachusetts doesn't do well on them.

Recent, Massachusetts-Specific Data Indicate that Tax Increases Are the Primary Reason for Those Contemplating Change of Domicile

The Massachusetts Society of Certified Public Accountants recently released some alarming survey results about the impacts of the income surtax on outmigration.

Approximately 82 percent of the 270 CPAs surveyed, representing 5,500 high-income Massachusetts taxpayers, indicated that their clients expressed plans to leave Massachusetts in the next 12 months, with 61 percent of them indicating tax policy is the primary reason, and the remaining 31 percent citing tax policy as a reason.

In other words, 100 percent of trusted tax professionals report that tax policy is a factor in their clients leaving the Commonwealth. If even a fraction of those considering moving follow through, Massachusetts will lose significant tax revenue and never see a large portion of the revenue anticipated from the income surtax.

Finally, the notion that a tax increase will have no effect defies longstanding government logic and practice. A fundamental principle of tax policy is neutrality, meaning the tax system should exert minimal impact on the spending and decision-making of individuals and businesses. The system should be broad based, utilize a low overall tax rate with few, if any, loopholes, and avoid multiple layers of taxation through tax pyramiding.

Implicit in this principle is the acknowledgement that tax policy that is not neutral motivates avoidance behavior. Governments acknowledge this to be true by routinely imposing tax increases to disincentivize certain behaviors, such as smoking through high cigarette excises or eating junk food by taxing candy and soda. Conversely, they provide tax breaks to encourage more of certain behaviors, such as capital investments through a generous investment tax credit or cleanup of contaminated sites through a brownfields tax credit.

It is inconsistent and unreasonable, then, to think that taxpayers affected by the 80 percent increase in the tax rate on income over a million dollars would have no reaction.

Lawmakers should support Gov. Healey's proposals to reduce the short-term capital gains tax rate and raise the income level at which the estate tax applies. Migration from Massachusetts, whether primarily or partly due to tax burdens, poses a challenge that policymakers cannot ignore. Easing the burden for those who shoulder it may by itself be insufficient to stem the tide, but it is a necessary part of any strategy to make Massachusetts more competitive.

[1] Heeding the Warning Signs (2022) Massachusetts Taxpayers Foundation; UMass Boston Donahue Institute: publication on census data.

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