S. 212: Millionaire Migration and Massachusetts

This is a brief response to two questions from the committee: Would millionaires leave Vermont, and What is happening in Massachusetts?

S. 212 proposes replacing the education property tax on a residence (and up to two acres around it) with a tax on the Adjusted Gross Income of residents. Although the rate would vary between towns depending on the locally voted spending per pupil, it is anticipated that the new rate would average around 2.5% of AGI.

Under current law, households with incomes less than $140,000 pay the lesser of a property tax on their housesite, or a tax based on their income. On average, these households would not see much difference with the tax bill under the proposal. However, higher-income households, who currently pay an education tax based on the value of their housesite, would generally see an increase. On average, the property tax bill on the housesite of a millionaire is 1% of AGI or less; the proposal would result in an average rate for these residents of 2.5% of AGI. This proposed change has prompted the question: would high income residents move to another state, meaning Vermont would lose not only education taxes, but other taxes as well?

Graham Campbell and Chloe Wexler of the Legislative Fiscal Office analyzed IRS data for 2006-2015 and wrote two papers looking at migration patterns in Vermont as well as the relationship between migration between states and tax burdens. They found:

> Net migratory flows between states appear to be only weakly associated with differences in state tax burdens. For example, although most of Vermont's net loss in taxpayers is to states with lower tax burdens, states with lower overall tax burdens than Vermont, such as New Hampshire and Maine, lose more taxpayers to Florida as a percentage of tax returns.
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> This conclusion appears to agree with the bulk of academic literature on migration and tax burdens. Taxpayers may move for any number of reasons. Much of the academic literature on migration has tended to find that other variables, namely distance, housing costs, weather, and overall economic conditions are more significant drivers of migration than differentials in tax burdens.

With this work as background, we looked for more information on the highest income filers, and on sudden and substantial tax increases.

High income filers and Migration

In general, the academic studies find that millionaire migration is responsive to tax rates. However, because millionaire migration is so small in the first place—around 1% to 2%--a statistically significant increase in that migration rate may not have much effect. There seem to be two main reasons to explain why the migration rate of millionaires does not increase more in response to high taxes: millionaires are embedded in their communities, and millionaire status often lasts only one year.

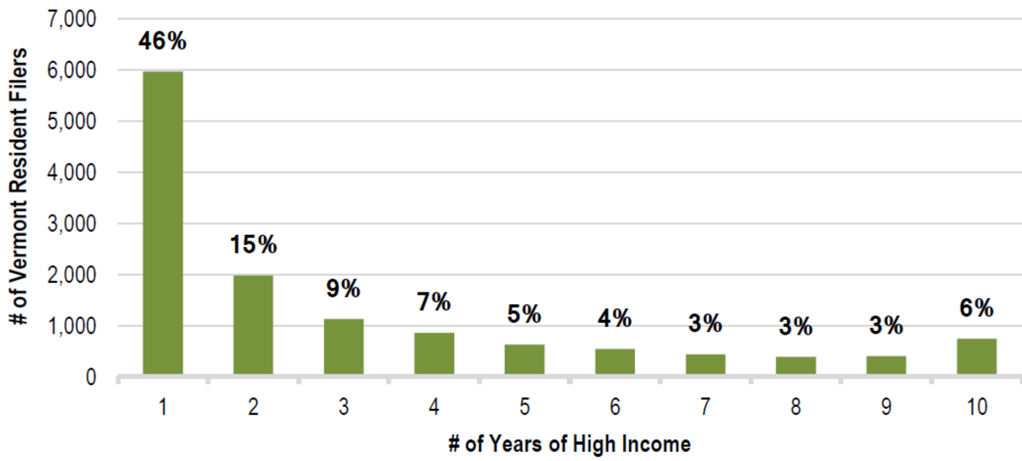
Young et al (2016) used IRS tax return information to analyze migration and found that the migration rate of millionaires is <u>less</u> than that of the general public. They explain:

> Marital status stands out as a prominent factor in millionaire migration. Single individuals have roughly twice the migration rate of married couples (4.1 versus 2.2 percent), and we see a similar pattern for the general population. However, nearly all millionaires are married (90 percent, compared to only 58 percent of the general population). Similarly, millionaires are more likely to have children at home (50 percent, compared to 40 percent among the general population). High levels of family responsibilities—marriage and children—ground elites in their communities and states.

Similarly, Vermont tax filings for millionaire homeowners in 2019 showed an average of 2.6 exemptions, while filings for other homeowners showed an average of 2.1 exemptions.

In addition, millionaire status tends to be a one-year event, and people are less likely to uproot to avoid a one-year tax change. The chart below shows that nearly half of Vermont filers who reported incomes over $300,000 only once in the ten years 2016-2015, and only 6% reported that level of income all ten years.

Figure 15. Share of Vermont Residents Who Ever Report High Income in One or More Years, Calendar Years 2006-2015



Young et al (2016) conclude:

> Millionaire tax flight is occurring, but only at the margins of statistical and socioeconomic significance. First, millionaires are not very mobile and actually have lower migration rates than the general population. This is in part because family responsibilities and business ownership are higher among top income-earners, which embeds individuals in their local regions. Nevertheless, there is an observable pattern of elite migration from high-income-tax to low income-tax states; when millionaires migrate, their relocation decisions are influenced by tax rates, in a way that we do not see for the general population. Yet, because migration flows represent a very small share of top income-earners, the observed patterns of migration have little impact on the millionaire population tax base even over 13 years.

Short-term Response to Tax Increase

New Jersey, California, and Spain provide examples of sudden substantial increases in tax rates on higher earners, and studies have analyzed the results.

New Jersey

In 2004, New Jersey increased the income tax rate for incomes greater than $500,000 by 2.6%. (Although it applied to incomes greater than $500,000, it was known as the millionaire tax and the term "millionaire" in the quotations to follow is defined as any filer subject to the new rate.)

Young and Varner (2011) analyzed the results and found:

> Migration, nonetheless, has certainly increased since the new tax was introduced in 2004. In the pre-tax period (2000–2003), net out-migration averaged 9.3 per thousand millionaires. Since the new tax was imposed, net out-migration has risen to 14.5 per thousand, an increase of 56 percent. Yet, as the baseline migration rates are so low, the impact on the stock of millionaires is very small.
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> This initial analysis offers two basic conclusions: (1) migration has a small impact on the millionaire tax base, accounting for only 3 percent of the variation in the number of millionaires each year; and (2) there is an observable increase in migration associated with the introduction of the new millionaire tax bracket.

California

In 2012, Proposition 30 increased the marginal rate by 3% for singles filers with incomes greater than $500,000 and for joint filers with incomes greater than $1,000,000, bringing the top marginal rate to 13.3%.

Rauh and Shyu (2019) analyzed the results and found that:

> For those earning over $5 million, the rate of departures spiked from 1.5% after the 2011 tax year to 2.125% after the 2012 tax year, with a similar effect among taxpayers earning $2-5 million in 2012. The increase in departure rate is significant but smaller for taxpayers in the new top bracket earning under $2 million.

Spain

Prior to 2011, income tax rates were the same in all Spanish regions. At that point, a reform allowed regions to adjust rates and tax brackets, and by 2014 the range in top marginal rates amounted to as much as 4.5 percentage points from region to region.

Agrawal and Foremny (2018) analyzed the results and found an uptick in migration <u>to</u> regions with lower tax rates. However, they found that the migration effect was not a major factor in the revenue raised.

> Although the migration response is significant, the taxable income responses are likely small meaning that the elasticity of the tax base is well below unit elastic. ... Our revenue simulations suggest that changes in the stock of top taxpayers has minimal tax base effects.

Behavioral Effects

Agrawal and Foremny (2018) decomposed the revenue effect of the tax increases in Spain into three components:

> The model suggests that the effect of changes in taxes on revenue can be decomposed into a mechanical (tax rate) effect from higher taxes, a behavioral effect from changes in taxable income, and a migration effect. The last effect depends on the stock elasticity of migration. Using our stock elasticities, we find the mechanical effect dominates the other effects for all regions in Spain, which has important implications for how much additional revenue a region can raise [lose] by raising [lowering] its top tax rates.... We conclude that, at least in the short-run, migration does not pose a large threat to redistributive taxation. (p.5).

Rauh and Shyu (2019) similarly separated the change in the stock of millionaires from the behavioral changes and found that migration represented a loss of 4.3% of the potential revenue resulting from the tax rate change. However, they found an additional reduction in potential revenue of 40.9% due to income management and tax avoidance strategies.

Massachusetts Millionaire Tax Ballot Initiative

What is known as both the Fair Share Amendment and the Millionaires Tax will be on the ballot in Massachusetts this November. The constitutional amendment would place a 4% surtax on any income over $1,000,000.

At this point there are only estimates of the effect, and they are based on some of the same academic papers mentioned. The Massachusetts Department of Revenue calculated the mechanical effect of the change, but did not account for the effects of migration and tax shifting.

The Center for State Policy Analysis of Tufts University (2022) published a paper by Evan Horowitz designed to explain the issues and provide a rough estimate of the migration and behavior effects. The summary states:

> Building on the latest economic research, and examining how similar taxes have affected other states, we find that:
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> - Factoring in expected behavioral changes by high earners, the Massachusetts millionaires tax would raise about $1.3 billion in 2023 — and do so in a highly progressive way likely to advance racial and economic equity.
> - Some high-income residents may relocate to other states, but the number of movers is likely to be small.
> - Tax avoidance could be widespread, cutting substantially into the amount of revenue raised by the levy.
> - Together, cross-border moves and tax avoidance would reduce millionaires tax revenue by roughly 35 percent. (Absent these responses, the tax would be expected to raise $2.1 billion in 2023.)

More specifically, the report estimates that the potential revenue resulting from the tax change would be reduced by 5% due to out migration and that other tax avoidance effects would reduce the potential new tax revenue by 30%.

The proposed change in Massachusetts is of particular interest because the state has been the source of 13% of Vermont’s in-migrants and the destination of 11% of Vermont’s out migrants. (Campbell and Wexler, 2019).

The report on the Fair Share Amendment from the Center for State Policy Analysis is recommended as a clear and readable presentation of the possible implications. However, there are dueling opinions and a few are listed below.

Articles estimating the effects of the proposed Massachusetts Fair Share Amendment

Paper	**Summary**
Horowitz (2022) Center for State Policy Analysis	Estimates 5% loss in revenue from out migration, 30% loss from tax avoidance
Wise and Berger (2018) Mass Budget and Policy Center	"Young and Varner's analysis indicates that, were the Fair Share Amendment to be approved, some 99.1 percent of the Massachusetts millionaire population would continue to reside in Massachusetts and pay the higher tax amounts."
Sullivan (2018) (Pioneer Institute)	This paper looks at the research of Cristobal Young and raises eight issues about its reliability with respect to the Fair Share initiative
Young (2018)	Response to Sullivan's eight questions (above article). Also provides a new look at census data on top income earners in New Jersey, Massachusetts, and Florida.

What does this suggest for Vermont?

None of the percentages from the other studies can be directly applied to the Vermont proposal because it is not a change in the top marginal rate. The Vermont proposal, in contrast, is an elimination of the education property tax on the house and two acres, and an imposition of a (variable) rate on AGI (and not on taxable income). But just to get a sense of the range, for the median Vermont millionaire, the change would result in a tax increase roughly equivalent to the Massachusetts 4% hike in the rate on income greater than $1,000,000. Applying the changes in the migration rates from the studies mentioned, Vermont could see a loss ranging from 2-12 millionaire households in response to the proposed change.

It is generally accepted that there are fewer tax avoidance opportunities with a broad tax base than with a narrower one. Vermont's proposal would rely on a broad tax base – Adjusted Gross Income. Taxable income, on the other hand, results from many deductions and exemptions that allow for different tax avoidance strategies. For this reason, tax avoidance may not reduce the potential tax revenue as much in Vermont. On the other hand, the lack of tax avoidance measures may increase the likelihood that a household would change its residence to another state – or claim to be a resident of another state.

At this point, we don't have data to understand recent changes in migration influenced by the increased options for working remotely, the pandemic, and climate change.

This is not a thorough analysis of either of the two questions you posed, and it indicates that more work should be done. However, I wanted to respond and to give you some preliminary information.

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