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New Jersey's Gubernatorial Race, Part I: Governor Corzine Proposes 10.75% Income Tax Rate

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(See *Fiscal Fact* No. 172 for a discussion of Corzine's challengers' proposals.)

Executive Summary

As the only two states electing governors this year, New Jersey and Virginia can expect to be in the spotlight for the rest of 2009. Mirroring the national concern with revenue and spending, candidates in the New Jersey gubernatorial race are talking taxes.

Like 40 other states, New Jersey faces a mismatch between declining revenues and desired spending, and revenues have fallen faster than in other states. On May 19, the state Office of Legislative Services reported that income tax revenues are down 19% ($2.4 billion) from last year, and another $1 billion drop is expected next year. The National Conference of State Legislators (NCSL) estimated in April that New Jersey's budget shortfall is $7.1 billion for Fiscal Year 2010 out of a $29 billion general fund budget, with the shortfall continuing into Fiscal Year 2011.[1] (New Jersey officials now say that the shortfall is up to $9 billion, after income tax collection for April 2009 turned out to be 38% off.) NCSL notes, "This is the most dire fiscal situation in the state's recent history."

Fiscal policy in the Garden State reads like a "what not to do" for policymakers and stakeholders. The corporate income tax combines a high rate, onerous rules, and lavish subsidies for the politically connected. The sales tax is one of the highest in the country. The state is one of five to adopt a heavy individual income tax on high-income earners, which has reduced economic activity in the state. New Jersey residents also pay more property tax per capita than residents of any other state.

It's hard to imagine New Jersey could do much worse. The state's faltering economic performance is convincing evidence that taxes matter. Specifically, New Jersey's experience shows that complex, burdensome, opaque, and volatile taxes undermine long-term economic growth.

How New Jersey Ranks Against Other States

Table 1: New Jersey Among Highest Top Income Tax Rates
(excludes states that permit deduction of federal income tax)

Rank	State	Top Income Tax Rate
1	Hawaii	11.0%
2	California	10.55%
3	Rhode Island	9.9%
4	Vermont	9.5%
5	**New Jersey**	**8.97%**
5	New York	8.97%
7	Maine	8.5%

Table 2: New Jersey Has Highest 2008 State-Local Tax Burden in U.S.

Rank	State	State-Local Tax Burden
1	**New Jersey**	**11.8%**
2	New York	11.7%
3	Connecticut	11.1%
4	Maryland	10.8%
5	Hawaii	10.6%
6	California	10.5%
7	Ohio	10.4%
8	Vermont	10.3%
9	Wisconsin	10.2%
10	Rhode Island	10.2%

Source: *Tax Foundation State-Local Tax Burdens, 2008*
http://www.taxfoundation.org/taxdata/show/336.html

Table 3: New Jersey is Least Business-Friendly State in 2009

Overall Rank	State	Corporate Tax Rank	Individual Income Tax Rank	Sales Tax Rank	Property Tax Rank
41	Minnesota	44th	39th	40th	17th
42	Nebraska	32nd	33rd	42nd	48th
43	Vermont	31st	45th	15th	42nd
44	Iowa	46th	46th	26th	33rd
45	Maryland	14th	50th	31st	34th
46	Rhode Island	40th	42nd	30th	43rd
47	Ohio	33rd	47th	39th	46th
48	California	45th	49th	43rd	15th
49	New York	22nd	43rd	49th	45th
50	**New Jersey**	**39th**	**48th**	**41st**	**50th**

Source: *Tax Foundation State Business Tax Climate Index, 2009,* http://www.taxfoundation.org/research/show/22658.html

As the campaign heats up, each major candidate has developed a tax plan, seemingly out of recognition that taxes are a significant factor in the state's economic performance.

Governor Corzine Limits Property Tax Rebate Program, Spends Down Rainy Day Fund, and Looks Again to High-Income Earners

Due to unfunded mandates imposed by the state on several byzantine layers of local government, New Jersey property taxes are among the highest in the country. Their unpopularity has led to calls for action, and the state's response has not been to address the underlying mandates or redundancy. Instead, the state chose to shift tax revenue from local property taxes to state sales and income taxes, by offering state-level tax rebates and income tax deductions for the payment of local property taxes.

The rebate program, around since 1977 but greatly expanded under Gov. Jon Corzine (D) in 2007, has sent out $2.2 billion in checks per year. In 2008, the rebates were restricted to households that make under $150,000 per year.

Corzine proposed in March as part of his Fiscal Year 2010 budget to eliminate the income tax deduction for property taxes for all filers, except senior and disabled citizens, and scale back the property tax rebate even further to households that make under $75,000 per year. Additionally, he proposed raising the top income tax rate from the current 8.97% to 9.72%. The "double whammy" of eliminating both the property tax rebates and deductions proved unpopular, and the proposal was recently modified.

Now, Gov. Corzine's revised proposal eliminates the property tax deduction only for taxpayers who earn more than $150,000 in income, but eliminates the rebate checks for all except senior and disabled citizens (some 500,000 households would lose the rebates). However, the top income tax rate would go to 10.75%, with new 10.25% and 8% brackets as well. *(*See Table 4.*)* 61,300 filers out of 4 million would pay more, and officials estimate the income tax increases would raise $400 million. Payroll tax increases may also be a possibility.

Table 4: Gov. Corzine's Income Tax Proposal
(new brackets and rates bolded)

Income Brackets	Current Tax Rates	Corzine Proposed Tax Rates
>$0	1.40%	1.40%
>$20,000	1.75%	1.75%
>$35,000	3.50%	3.50%
>$40,000	5.525%	5.525%
>$75,000	6.37%	6.37%
>$400,000	6.37%	**8.00%**
>$500,000	8.97%	**10.25%**
>$1,000,000	8.97%	**10.75%**

To balance the 2009 budget, Corzine has proposed spending $450 million from the state's $700 million rainy day fund, cutting spending by $150 million in part by postponing a new preschool program, cutting $150 million in payments to the state's pension fund, and shifting approximately $450 million in expenses (including business subsidies) into the next fiscal year. A tax amnesty program is now projected to collect $200 million, twice as much as previously expected.

Some New Jersey residents endorse Corzine's decision to go after high-income earners, arguing that those who can afford to pay "a little more" should. The idea that a tax on high-income earners would save the day should not be new to New Jersey residents: just such a tax was enacted in 2004 to fix the state's budget. Following neighboring New York in June 2004, then-Governor James McGreevey signed into law the 8.97% tax rate on income over $1 million, retroactive to January 1, 2004. Since then, California, Maryland, and Hawaii have joined New York and New Jersey in imposing a new top rate near or above 10% on a small subset of high-income earners.

To evaluate Corzine's proposed rate increases, one need not even look at New Jersey's economic performance since the adoption of its "millionaires' tax" five years ago; double-digit state income taxes have been tried before and failed as fiscal policy. Through the early 1990s, several states maintained double-digit income tax rates, including California (11% until 1996) and Hawaii (10% until 1998).[2] These rates came down due to a combination of booming tax revenues from all sources, and growing expert understanding that location decisions of highly mobile entrepreneurs are sensitive to state income tax rates, particularly in the interstate context. To attract and keep good talent, create jobs and drive economic growth, legislators knew that state tax systems had to be competitive with their neighbors.

We still see elements of that today. Even in adopting its millionaires' tax, New York did not let its rate go above neighboring New Jersey's, and other states are wary of crossing the 10% psychological barrier. The California Franchise Tax Board has taken pains to deny that their 10.3%

top tax rate is in the double digits, referring on their website and on tax forms to a 9.3% top rate and elsewhere noting that there is a 1% surcharge.[3] (California's top income tax rate has now gone to 10.55%.)

If states are still concerned about interstate tax competition, what has really changed? The short answer is priorities. States that adopt new taxes on high-income earners are ones where policymakers are persuaded to ignore concerns about long-term economic growth in favor of a short-term budget fix that avoids deep spending cuts. In New Jersey, while the new millionaires' tax raised revenue for the state and helped reduce a budget shortfall, it also reduced the state's overall economic output and harmed its ability to grow during and after the recession.[4]

This is the tradeoff that proponents of taxes on high-income earners usually fail to acknowledge. Yes, such taxes will generally raise revenue in the short term without a sudden exodus of wealthy people fleeing to the state next door. But over the medium term, the taxes will negatively impact location decisions. People expanding old businesses or creating new ones will incorporate the higher cost of doing business into their decision-making and steer clear of the state. California currently faces an enormous brain drain of dynamic individuals after five years of double-digit income taxes, and it seems that New Jersey may now be seeing the evidence of a brain drain from its millionaires' tax. Hawaii has long been accused of chasing out its best and brightest, and it can only be exacerbating that problem with its new top tax rates.[5]

Conclusion

Most Americans gripe about property taxes, but New Jersey residents genuinely have a broken property tax system. But unless spending and mandates are addressed, the rebate programs and deductions just shift the same tax burden. At some point, even the popularity of the rebate checks may be undermined as more and more people are excluded from the program. Preserving the program by raising tax burdens on the New Jersey residents most needed for economic recovery is short-sighted.

Governor Corzine has proposed deferring some expenses, limiting eligibility for a troubling property tax rebate program, and hiking taxes on high-income earners. New Jersey was an early adopter of such a "millionaires' tax" several years ago, and its budget situation is now worse than that of other states. For those who deny that high tax rates and heavy tax burdens lead to a bad economy, one need only look at New Jersey. It remains to be seen which plan New Jersey residents think will make the Garden State bloom again.

Notes

1. National Conference of State Legislatures, *State Budget Update: April 2009*, at http://www.ncsl.org/bookstore/productDetail.htm?prodid=0151010159pdf.

2. Some states had double-digit income tax rates since the 1990s but also permit deduction of federal taxes from the state income tax. In these states (such as Montana in the 1990s and Iowa today), the high marginal tax rate on personal income is not immediately comparable to other states because of deductibility.

3. *See* William Ahern, "California Legislators Push for More Double-Digit Income Tax Rates," *Tax Foundation Fiscal Fact* No. 134 (Jul. 14, 2008), at http://www.taxfoundation.org/research/show/23370.html.

4. *See* Gerald Prante, "Did People Flee New Jersey After 2004 Income Tax Hike?," Tax Foundation Tax Policy Blog (Apr. 14, 2009), at http://www.taxfoundation.org/blog/show/24618.html.

5. See, e.g., "Brain Drain has Many Casualties" *Honolulu Star Bulletin*, April 16, 1999, *available at* http://archives.starbulletin.com/specials/braindrain.html; University of Hawaii at Mānoa, *Alumni Outcomes Survey 2003 available at* http://www.hawaii.edu/offices/app/opp/alumni/alumni03.pdf (finding that more graduates are moving out of state); University of Hawaii at Mānoa, *Discussion Brief*, 2008-4 v.4 *available at* http://vcafo.org/support_bulletin/2008-4.pdf (finding that large pe

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