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Trend #1: "Millionaires' Taxes"

Top 10 State Tax Trends in Recession and Recovery, 2008 to 2012

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A number of states have enacted high income taxes on those with large incomes. Although nicknamed "millionaires' taxes," they have hit income at much lower levels. The trend seems to have petered out although California and Maryland may see further action.

The conventional wisdom is that states turn to income tax increases only as a last resort in dealing with state budget gaps. Much more politically attractive are the toolbox of things that Illinois and California in particular have used, such as furloughing employees, moving payments into the next fiscal year, increasing withholding, raising fees, imposing excise taxes like cigarette taxes, and just not paying bills. After those things, then come the sales tax and finally the income tax.

This recession has been different on that score. Some states have been more willing to raise income taxes by designing the increase to affect only a small subset of high-income earners. The income level at which the new top rate applies is often a sharp jump from where the top rate previously applied. Nicknamed "millionaires' taxes" because the first proposals kicked in at $500,000 or $1 million of income, more recent proposals have kicked in at much lower levels, such as $125,000 (Oregon) or even $60,000 (Delaware). (See Table 1 for top tax brackets in 2012).

Table 1: State "Millionaires Taxes" Apply to Lower Income Thresholds, 2012
State Income Tax Rates of 8 Percent or Higher

State	Individual Income Tax Rate	Bracket
Hawaii	11.0%	>$200,000
California	10.3%	>$1,000,000
Hawaii (2nd bracket)	10.0%	>$175,000
Oregon	9.9%	>$125,000
California (2nd bracket) (a)	9.3%	>$48,029
Oregon (2nd bracket) (a)	9.0%	>$7,750
Hawaii (3rd bracket)	9.0%	>$150,000
Iowa	8.98%	>$66,105
New Jersey	8.97%	>$500,000
Vermont	8.95%	>$388,350
District of Columbia	8.95%	>$350,000
Maryland (b)	8.95%	>$250,000
New York	8.82%	>$1,000,000
Vermont (2nd bracket)	8.8%	>$178,650
Maryland (2nd bracket) (b)	8.7%	>$150,000
District of Columbia (2nd bracket)	8.5%	>$40,000
Maine	8.5%	>$20,350
Maryland (3rd bracket) (b)	8.45%	>$125,000
Hawaii (4th bracket)	8.25%	>$48,000
Maryland (4th bracket) (b)	8.2%	>$100,000
California (3rd bracket) (a)	8.0%	>$38,004

Source: Tax Foundation, *Facts & Figures* (2012), http://www.taxfoundation.org/publications/show/2181.html.

(a) Bracket will be inflation-adjusted but state has not yet made figure available; amount shown is 2011 bracket.

(b) Maryland, in addition to the state income tax, has local income taxes in each county and in the city of Baltimore. For purposes of this chart, we use a 3.2 percent local tax rate, which is the rate in Baltimore and Montgomery, Prince George's, and Queen Anne's Counties.

New York (2003). Beginning in 2003, New York adopted two new top brackets (the top rate of 7.7% applied to income over $500,000) as a three-year temporary measure, which expired in the midst of the property tax boom at the end of 2005.[1] In 2009, New York added back the top brackets as a three-year measure, with a top state rate of 8.97% on incomes over $500,000. Slightly lower rates were extended before they were to expire at the end of 2011.

New Jersey (2004). New Jersey followed its neighbor in June 2004 when then-Governor James McGreevey signed into law an 8.97% tax rate on income over $1 million, retroactive to January 1, 2004, raising the top rate from 6.37%. While this makes it the first true "millionaires' tax," it was still a lower rate than California's then-top rate of 9.3%, which applied to income over about $41,000.

California (2004). In November 2004, California voters approved Proposition 63 (53.8% to 46.2%), creating a 10.3% top rate on income over $1 million to fund mental health services programs. (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.[1])

Maryland (2008). Also as part of a budget package, one that was designed to pay for expanded state services, Maryland in 2008 added four new income tax brackets, including a top rate of 6.25% on income over $1 million that expired at the end of 2010.[2] Notwithstanding their tax increases on high-income earners, New Jersey, Maryland, and California continue to experience serious budget shortfalls that are actually comparatively worse than those in other states.[3]

California, Connecticut, Delaware, Hawaii, Maine, New Jersey, Oregon, Wisconsin (2009). During 2009, more states joined the trend of high-earner taxes:

- California, as part of its 2009 budget agreement, raised its top rate from 10.3% to 10.55% for two years. (California voters may decide a constitutional amendment this year to raise the top income tax rate to 13.3%; the proposal has won the endorsements of Governor Jerry Brown and the California Teachers Association.[4])
- Connecticut added a top rate of 6.5% on income over $500,000, which rose in 2011 to 6.7% on income over $250,000.
- Delaware added a top rate of 6.95% on income over $60,000, to expire in 2014. It was reduced to 6.75% in 2011.
- Hawaii added three brackets through 2015, including a top rate of 11% on income over $200,000.

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[1] *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.

[2] Maryland has uniquely high county income taxes which average approximately 3 percent of income, so the 6.25% state-level rate brings the tax rate over 9 percent of almost all high-income Marylanders.

[3] *See generally* Joseph Henchman, *State Budget Shortfalls Present A Tax Reform Opportunity*, TAX FOUNDATION SPECIAL REPORT NO. 164 (Feb. 2009), http://www.taxfoundation.org/publications/show/24321.html.

[4] California Sales and Income Tax Increase Initiative (2012), http://ballotpedia.org/wiki/index.php/California_Sales_and_Income_Tax_Increase_Initiative_(2012).

- Maine's legislature tried to cut its top rate from 8.5% to 6.5% but at the last hour joined the millionaires' tax trend by adding a 6.85% rate on income over $250,000. However, this was repealed at the ballot box.
- New Jersey raised its top rate to 10.75% on income over $1 million, an increase that expired at the end of 2009.
- North Carolina adopted a two-year surtax of 2% on income over $60,000 ($100,000 for couples) and 3% on income over $150,000 ($250,000 for couples).
- Oregon voters approved an 11% top rate on income over $250,000 for 2009-2011, with a permanent 9.9% top rate on income over $125,000 for 2012 and thereafter.
- Wisconsin added a top rate of 7.75% on income over $225,000. (This has dropped to $224,210 in 2011 due to declining inflation adjustments.)

Rejection in Washington (2010). Voters in the Evergreen State have now voted seven times to reject a state income tax, following yet another defeat of the proposal in November 2010 by a margin of 34.4% to 65.6%. The measure was pushed heavily by Bill Gates, Sr., father of the Microsoft billionaire and successful in his own right, Gov. Christine Gregoire, the Service Employees International Union, and the National Education Association.

Initiative 1098 would have imposed a tax of 5% on income over $200,000 and 9% on income over $500,000, affecting just 1.2% of the population. The promise to use the money to provide some tax cuts and boost spending couldn't convince voters to junk a key advantage Washington has over other states. Proponents cited statistics showing that Washington's tax system is the most regressive in the United States, but that isolated statistic doesn't mean much since one must look at the federal and state systems together, and taxes as well as spending, to determine whether people get enough bang for their buck.

Maryland (2012). In May 2012, Maryland legislators approved a retroactive tax increase, adopting higher graduated income tax rates on income over $100,000 for singles and over $150,000 for joint filers.[5]

The trend may be new, but the policy has been tried before. Through the early 1990s, several states maintained double-digit income tax rates, including California (11% until 1996) and Hawaii (10% until 1998).[6] 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 all recognize that taxes matter.

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[5] *See* Scott Drenkard, *Maryland Senate Approves Income Tax Hike; Sneaks in Tobacco Hike Too*, TAX FOUNDATION TAX POLICY BLOG (May 15, 2012), http://www.taxfoundation.org/blog/show/28223.html.

[6] Some states have 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.

A "millionaires' tax" is poor policy: it is a narrow, high-rate tax on a highly mobile group of people who earn less in bad economic times, and the spending such a tax increase supports leads to voters benefitting while concluding that someone else is paying for it. The Washington state proposal, for instance, would have imposed an income tax on 1.2% of the population and used the money to provide some tax cuts for most and a large boost in spending for all. 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.

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