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How States would be Affected by Obama's Proposed Tax Increases on High-Income Earners

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President Obama's campaign to raise taxes on high-income earners presents an overly simplistic view of the economy, as if tax increases only affect those people who write checks to the IRS. However, when high-income families are hit with additional taxes, they don't keep it to themselves. They reduce spending on goods and services, hurting the local businesses that provide those things. This results in less hiring and investment by those businesses and ultimately less income for the whole community. The workers in these businesses also reduce their work, since they get paid less for it after taxes. High-income taxpayers also respond to tax hikes by saving and investing less of their income, since they keep less of the returns after taxes on capital gains and dividends. All of this hurts economic growth over the long run.

Businesses are also directly affected by the president's proposed tax increases, since the vast majority of businesses file under the individual tax code. These so-called pass-through businesses, such as partnerships, S corporations, and sole proprietors, earn more income and employ more workers than do traditional C corporations, which file under the corporate code. Further, most of this pass-through business income (about 66 percent) is reported by taxpayers earning more than $250,000.[1] This is why economic analyses that take into account the pass-through business sector find that significant harm is done to the economy by raising personal income tax rates on high-income earners.[2] For example, economists Robert Carroll and Gerald Prante found that 710,000 jobs would be lost as a result of the president's tax policies.[3]

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[1] Scott A. Hodge & Alex Raut, *Individual Tax Rates Also Impact Business Activity Due to High Number of Pass-Throughs*, Tax Foundation Fiscal Fact No. 314 (June 5, 2012), http://taxfoundation.org/article/individual-tax-rates-also-impact-business-activity-due-high-number-pass-throughs.

[2] Stephen Entin & William McBride, *Simulating the Economic Effects of Romney's Tax Plan*, TAX FOUNDATION FISCAL FACT NO. 330 (Oct. 3, 2012), http://taxfoundation.org/article/simulating-economic-effects-romneys-tax-plan.

[3] Robert Carroll & Gerald Prante, *Long-run Macroeconomic Impact of Increasing Tax Rates on High-income Taxpayers in 2013*, Ernst and Young, July 2012, http://waysandmeans.house.gov/uploadedfiles/ey_study_long-run_macroeconomic_impact_of_increasing_tax_rates_on_high_income_taxpayers_in_2013__2012_07_16_final.pdf.

Rather than pretending that the damage of tax increases is limited to "rich" people, it makes sense to look at overall economic effects, either nationally or within each state. As such, we apportion the revenue effects of the president's proposals to raise taxes on high-income earners, as estimated by Treasury,[4] to each of the states, based on the latest IRS data on the distribution of income.[5] These proposals include the expiration of the Bush tax cuts for those earning more than $200,000 (singles) or $250,000 (married), the reintroduction of the PEP and Pease limitation on deductions for high-income earners, higher estate and gift taxes, and the new proposal to limit the value of certain deductions and exclusions for high-income earners to 28 percent of income. See Table 2 for the revenue associated with each of these provisions and the rule we used to allocate it to the states. Treasury estimates the total tax increase from these provisions in 2013 is $85 billion and over ten years it is $1.6 trillion. Table 1 shows the results by state, in terms of the projected one year and ten year revenue increases, as well as the one year projected revenue increase as a percentage of state income.

In dollar terms, the states most affected are big, high-income states. California stands to lose $241 billion over ten years as a result of the president's tax policies. This is followed by New York at $186 billion, Texas at $131 billion, Florida at $104 billion, and Illinois at $74 billion. The state least affected is Vermont, which loses $2 billion over ten years. As a percent of income, Wyoming is most affected, losing 1.82 percent of income in 2013, followed by Connecticut, New York, Delaware, and Massachusetts. In all, thirteen states are set to lose at least 1 percent of income as a result of these tax increases, and every state loses at least 0.5 percent of income.

Note that these numbers are an understatement of the president's tax increases on high-income earners and everyone else, since they do not include any of the tax increases that are already law as part of the Affordable Care Act (ACA). The Congressional Budget Office estimates the cost of ACA tax increases at $1 trillion over the course of the next ten years,[6] and many tax increases directly fall on low- and middle-income earners. Nor do the numbers in Tables 1 and 2 reflect the numerous other tax provisions in the president's proposed budget, including many tax increases on businesses operating abroad or involved in oil and gas exploration.

It remains to be seen how the showdown over extending the Bush-era tax cuts will play out. The president's proposed tax increases on high-income earners have received no support from Congressional Republicans,

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[4] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals* (Feb. 2012), http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf.

[5] Internal Revenue Service, *SOI Tax Stats – Tax Year 2010: Historical Table 2,* http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2.

[6] William McBride, *Obamacare Taxes Now Estimated to Cost $1 Trillion over 10 Years*, TAX FOUNDATION TAX POLICY BLOG, July 26, 2012, http://taxfoundation.org/blog/obamacare-taxes-now-estimated-cost-1-trillion-over-10-years.

while the President has promised to veto any extension of the Bush tax cuts that includes an extension for high-income earners. See our recent report for how states would be affected by this fiscal cliff scenario.[7]

Table 1: How Obama's Proposed Tax Increases on High-income Earners Affect States

	2013-2022 ($Millions)	2013 ($Millions)	2013 (Percent of State Income)
Alabama	$13,181	$685	0.69%
Alaska	$2,788	$143	0.66%
Arizona	$20,248	$1,095	0.78%
Arkansas	$8,190	$472	0.83%
California	$240,754	$12,937	1.26%
Colorado	$27,534	$1,545	1.09%
Connecticut	$47,908	$2,564	1.76%
DC	$3,156	$169	0.71%
Delaware	$6,674	$355	1.49%
Florida	$104,312	$5,877	1.26%
Georgia	$32,984	$1,722	0.80%
Hawaii	$3,928	$213	0.64%
Idaho	$3,656	$199	0.67%
Illinois	$74,349	$4,015	1.11%
Indiana	$16,313	$851	0.59%
Iowa	$8,190	$437	0.61%
Kansas	$11,514	$633	0.90%
Kentucky	$10,373	$559	0.64%
Louisiana	$15,598	$819	0.84%
Maine	$3,338	$183	0.61%
Maryland	$32,676	$1,659	0.87%
Massachusetts	$60,233	$3,268	1.40%
Michigan	$30,137	$1,568	0.69%
Minnesota	$26,037	$1,383	0.91%
Mississippi	$6,390	$313	0.59%
Missouri	$19,855	$1,061	0.78%
Montana	$2,963	$165	0.76%
Nebraska	$7,218	$406	0.90%

[7] William McBride & Ed Gerrish, *How the States would be Affected by Extension of the Bush Tax Cuts and Other Provisions*, TAX FOUNDATION FISCAL FACT NO. 325 (Aug. 1, 2012), http://taxfoundation.org/article/how-states-would-be-affected-extension-bush-tax-cuts-and-other-provisions.

Nevada	$15,536	$907	1.36%
New Hampshire	$7,749	$449	1.09%
New Jersey	$69,779	$3,540	1.15%
New Mexico	$5,043	$279	0.67%
New York	$185,789	$10,103	1.61%
North Carolina	$27,982	$1,460	0.70%
North Dakota	$3,013	$165	0.89%
Ohio	$32,913	$1,721	0.64%
Oklahoma	$12,428	$669	0.84%
Oregon	$11,656	$636	0.72%
Pennsylvania	$56,343	$3,011	0.89%
Rhode Island	$4,210	$224	0.79%
South Carolina	$11,328	$611	0.65%
South Dakota	$3,193	$173	0.87%
Tennessee	$20,801	$1,116	0.82%
Texas	$131,083	$7,068	1.14%
Utah	$8,595	$477	0.81%
Vermont	$1,982	$113	0.72%
Virginia	$45,074	$2,363	0.97%
Washington	$32,543	$1,783	0.93%
West Virginia	$3,471	$193	0.54%
Wisconsin	$19,186	$994	0.69%
Wyoming	$5,133	$321	1.82%

Note: Only includes President Obama's plan to allow Bush tax cuts to expire for high-income earners and also to limit deductions for high-income earners. Does not include any other proposal or any tax increases already scheduled to go into effect as part of the Affordable Care Act. Source: Treasury, IRS, Tax Foundation

Appendix: Methodology

Table 2 shows each of the president's proposals considered in this analysis and the Treasury Department's estimate of the associated revenue increases over one and ten years. The table also shows the rules we used to apportion the tax increases to the states, based on IRS returns from 2010. This must be considered a rough estimate since the IRS data has rather wide income intervals at the state level. Particularly in the case of the top rates, the IRS provides data on those earning between $200,000 and $500,000, but the top rate applies to taxable income of $388,350 or more. As a result, IRS data at the national level, with more income intervals, was used to formulate the rules.

Table 2: Tax Increases on High-Income Earners in President's 2013 Budget

	Tax Increase ($Millions)		
Provision	**2013**	**2013-2012**	**Rule for Apportionment to States**
Raise top two rates to 36% and 39.6%	$23,101	$441,554	1/2 to filers earning more than $200,000, 1/2 to filers earning more than $500,000.
Reinstate limitation on itemized deductions and the personal exemption phaseout	$5,884	$164,927	To all filers earning more than $200,000.
Raise capital gains rate to 20%	$5,811	$35,966	To all filers earning more than $200,000 and reporting investment income, according to investment income.
Raise dividend rate to 39.6%	$21,537	$206,415	To all filers earning more than $200,000 and reporting investment income, according to investment income.
Increase estate and gift taxes	$1,132	$143,294	To all filers earning more than $500,000.
Reduce value of certain deductions and exclusions	$27,096	$584,197	To all filers earning more than $200,000.
Total	$84,561	$1,576,353	

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