MassCPAs™
Massachusetts Society of CPAs

Massachusetts is Losing Residents and it's Getting Worse:

Can Tax Policy Changes Mitigate Outmigration?

Summary

Massachusetts residents have been leaving the Commonwealth[1], and according to a survey of Massachusetts CPAs, the trend is only going to get worse among their high-income clients. The survey of CPAs indicates that thousands of residents with more than $1 million in annual taxable income plan to relocate from the Commonwealth in the next 12 months. However, there are tax policy changes that Massachusetts policymakers can make to mitigate some of the disincentive to remain Massachusetts residents.

According to CPAs representing high-income clients, increasing the estate tax exemption to $5 million, reducing the short-term capital gains tax rate and eliminating the Sting Tax are three changes most likely to influence high-income taxpayers to stay in Massachusetts.

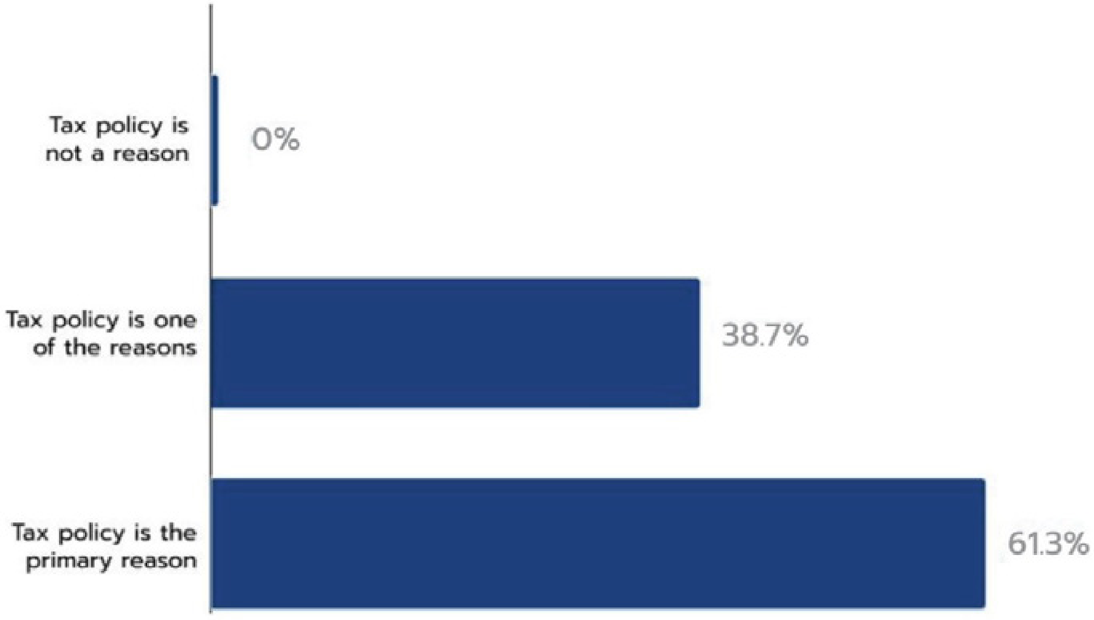
[1] *See the final section of this report for a discussion of the supporting data.*

Survey Results

The Massachusetts Society of CPAs (MassCPAs) recently worked with MultiState Associates to survey approximately 270 CPAs about the impact of recent tax policy changes on high-income taxpayers (defined as Massachusetts residents with an annual taxable income in excess of $1 million). These CPAs represent roughly 5,500 high-income Massachusetts taxpayers. The survey results indicate that, due to the Commonwealth's tax policies, many high-income taxpayers are seriously considering plans to relocate from Massachusetts in the next 12 months.

- 82% of CPAs surveyed indicated that their high-income clients have expressed plans to leave Massachusetts in the next 12 months. Florida and New Hampshire are overwhelmingly the most popular choices for relocation. While some may argue that a move to Florida is driven by a desire for better weather and a different lifestyle, the fact that the second most popular destination is New Hampshire suggests that people want to stay in the area but may be motivated instead by a lower cost of living, including a lower tax burden. Furthermore, New Hampshire is set to **repeal its Interest and Dividends Tax** by 2026, which would make a decision to relocate even more appealing.
- 61% of respondents indicated that tax policy is the primary reason their clients are considering leaving the Commonwealth in the next 12 months. An additional 39% of CPAs indicated that tax policy is a consideration for relocation. 0% of respondents indicated that tax policy is not a factor in the decision for high-income taxpayers to relocate.

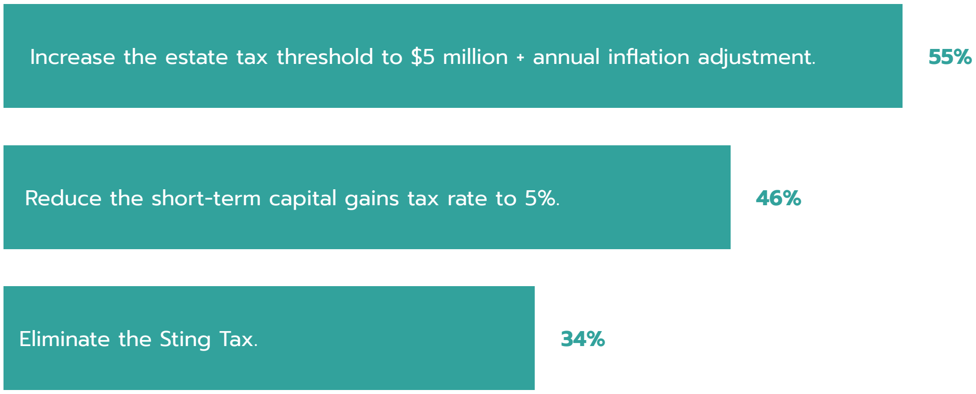
Does Massachusetts' overall tax policy play a significant role in your client's consideration to move their domicile out-of-state?



Survey Results (continued)

- More pointedly, half of CPAs said that the new Millionaire's Tax specifically is the primary reason their clients are considering a move in the next 12 months.
- When asked to select a single tax policy change out of nine potential options that may deter high-income taxpayers from relocating, 65% of CPAs responded that the top policy option would be to increase the estate tax threshold to $5 million and adjust the threshold annually for inflation. However, the second most selected option was "none of the above," which indicates for some taxpayers, making only one change would not be enough to mitigate the impacts of the new surtax and that multiple policy changes will be necessary to retain high-income taxpayers.
- When asked what combination of tax policy changes would most likely deter clients from relocating, the most popular answers included increasing the estate tax threshold to $5 million with an inflation adjustment, reducing the short-term capital gains tax rate to 5% and eliminating the Sting Tax.[2]

Which combination of tax policy changes would be most likely to deter your clients from relocating out-of-state?



[2] *Respondents were permitted to select multiple answer choices, so percentages total more than 100%.*

The Impacts of Being an Outlier

In terms of state tax policy, Massachusetts is an outlier, and was even before voters approved the Millionaire's Tax in November 2022. Being an outlier makes it more difficult for the Commonwealth to compete with its regional neighbors and on the national landscape when it comes to attracting jobs, residents and capital investment, but it also violates basic tax principles of neutrality and economic efficiency.

The current tax code introduces complexity and incentivizes opportunities to use a domicile change as a tax planning tool, which creates a host of unintended consequences for the state. Before the Millionaire's Tax Massachusetts maintained a competitive edge in our region with the relatively low, flat individual income tax rate, which helped mitigate other issues such as the uniquely burdensome short-term capital gains tax rate and estate tax. Unfortunately, that is no longer the case.

Massachusetts should take action to reduce its status as a policy outlier in order to retain its residents. Therefore, adopting tax policies that reduce our outlier status such as the recommendations mentioned in this report and others, like expanding the use of single sales factor apportionment for multi-state employers, would make the Commonwealth more attractive to do business and help to maintain competitiveness.

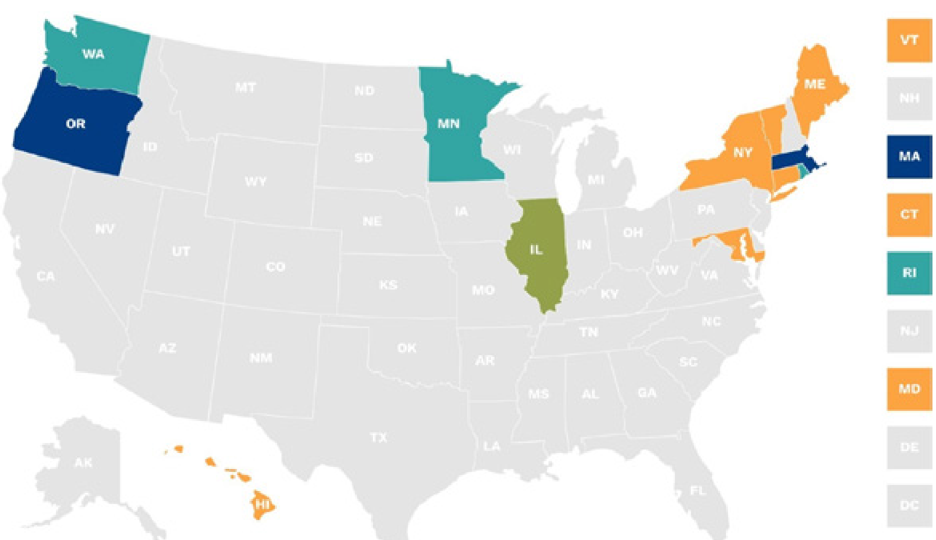
Where Massachusetts Stacks Up

Estate Tax

The survey results support improving other tax policy areas to offset the negative impact of the new higher tax rate. Massachusetts CPAs reported that increasing the estate tax exemption to $5 million and adjusting the threshold annually for inflation is the tax policy change most likely to influence their clients to remain in the Commonwealth. This makes sense: of the 12 jurisdictions that impose an estate tax, Massachusetts has one of the most punitive estate taxes nationwide. The current $1 million exemption is the lowest exemption threshold in the country (tied with Oregon). Neighboring northeastern states with similar political makeups offer much more generous exemptions: New York's is $6.1 million, Vermont's is $5 million, Rhode Island's is $1.7 million, and Connecticut's matches the federal threshold at $12.92 million. Meanwhile, **New Jersey repealed** its estate tax in 2018. Raising the estate tax threshold and adjusting it for inflation would immediately make Massachusetts more competitive with its neighbors.

Additionally, the Massachusetts "cliff effect" makes the Commonwealth's estate tax more punitive than Oregon's $1 million exemption. Massachusetts is the only state to apply the tax to the full value of the estate once the $1 million valuation threshold is triggered. This is in contrast to the normal approach of only taxing the estate value above the exemption level.

How high is the estate tax exemption threshold?



Estate tax exemption $1 milllion or below

Estate tax exemption between $1.1 – 3 milllion

Estate tax exemption between $3.1 – 4.9 milllion

Estate tax exemption $5 million or above

N/A (no estate tax)

Capital Gains

Massachusetts' unique 12% tax rate on short-term capital gains makes the Commonwealth a clear outlier and undesirable to those most likely to realize short-term capital gains. In fact, Massachusetts has the second highest short-term capital gains rate in the nation.

Research shows that punitive taxes on capital gains have particularly negative impacts on entrepreneurs and encourages immediate consumption over savings. Though most states do not even differentiate between short-term and long-term capital gains, reducing the rate to 5% brings the capital gains treatment closer to the norm, and lessens the negative impact on savings and entrepreneurship.

It's important to note that capital gains are a volatile revenue source, often rising and falling in response to general economic conditions. As a result, Massachusetts only includes a portion of the revenue collected from the tax in the state's operating budget. Therefore, reducing the short-term capital gains rate would have little state budget impact.

Sting Tax

The Sting Tax is an additional entity-level tax of roughly 2% on S-corps with gross receipts between $6 million and $9 million, with an additional 2.9% tax on S-corps with gross receipts in excess of $9 million.

The Sting Tax was enacted in the late 1980s to protect a tax benefit for small businesses while leveling the playing field for large S-corps and C-corps. Since its passage, the net income amounts ($6 million and $9 million) that trigger the additional excise tax have not been adjusted, which has resulted in more small businesses being impacted. Now, with the additional 4% surtax, this means for many small businesses and other S-corps, their shareholders will be paying more than the Massachusetts Corporate tax rate of 8%, which is in direct conflict with the intent of the law.

This structure of imposing an additional tax on S-corps is a significant disincentive to growing a business in Massachusetts and in conjunction with the new 4% surtax is arguably unique among the states.

Massachusetts Outmigration: A Review of Additional Data

Outside data supports this survey's conclusion: the Commonwealth is rapidly losing residents to other states.

The way people live and work has changed considerably over the last few years. A recent **Census survey** found that the number of people who primarily work from home has tripled and now remote workers represent nearly 18% of Americans. Massachusetts, in particular, is a leader as one of the states with the highest percentage of remote workers, with 24% of people working remotely. With a dwindling reliance on in-office interaction, it's increasingly easy for employees and employers alike to relocate to a different state.

In a **recent report**, the Tax Foundation analyzed IRS data and found that Massachusetts is losing more residents than almost any other state in the country. From 2019 to 2020 (the most recent data available), Massachusetts lost a net 36,982 residents. As a share of the 2019 population, Massachusetts lost 0.54% of its residents. Though one half of a percent may seem minor, the median state gained 0.11% of population, so Massachusetts is facing a somewhat unique challenge. Additionally, looking at tax return data, of the taxpayers that Massachusetts lost in 2020, at least 2,116 of those taxpayers had an adjusted gross income (AGI) above $200,000.

Conversely, neighboring states New Hampshire and Vermont actually gained residents during the same time period. New Hampshire increased its population by 0.73%, and Vermont's population increased by 0.5%. Although Vermont levies higher taxes than the average state and has a high individual income tax rate, its overall tax collections per capita are still **10.3% lower** than Massachusetts.

Potential Impact

The increased flight of high-income taxpayers would be challenging for Massachusetts as an **estimated 35%** of the Commonwealth's total revenue is derived from income taxes. While it is difficult to determine the exact distribution of income taxes at the state level, they should be similar to the federal distributions given the linkage between the state and federal income tax codes.. IRS data regarding federal income tax liability by state shows that Massachusetts filers with an AGI above $1 million represent **over 30% of the Commonwealth's total federal income tax liability**. It's clear that continued outmigration would present significant budget and funding challenges for the Commonwealth.

Income tax revenue isn't the only thing Massachusetts may lose as high-income residents leave the Commonwealth. High-income taxpayers of course pay other types of taxes, such as sales taxes and property taxes, which fund important budget priorities, including education and transportation, and also make economic contributions outside of tax revenue.

According to the IRS, over 50% of charitable contributions come from Massachusetts residents with income over $1 million. A recent study from Bank of America and the Indiana University Lilly Family School of Philanthropy found that the average affluent household donated $43,195 to charity in 2020, and a large portion of the contributions are focused on their local communities: "Among affluent households who gave charitable gifts to basic needs and/or health-related organizations in response to the pandemic, most (89.9%) gave to local organizations within their communities, while a third (35.4%) gave to national organizations."

This is a particularly important point when considering a change in domicile, as one key metric for determining whether a taxpayer is truly a resident of a different state is to follow the investment in their community through donations. Most high-income taxpayers who leave Massachusetts are very likely to end or decrease their contributions to local Massachusetts organizations because of the requirements to legally relocate. In order to change your domicile, a number of **factors will be considered for tax purposes**, including (but not limited to) the location of bank accounts, location of new employment, membership in churches and clubs and overall involvement in the new community. Overall, there is a strong incentive for taxpayers to distance themselves from the Commonwealth and local community to prove a relocation.

Massachusetts is Ready for Effective Tax Reform that Reinvests in its People and Businesses

Much has been written and debated about the migration of residents due to tax policy, but what is undisputed is that tax policy weighs differently on people when considering an out-of-state move as residents have different tolerances for high tax burdens. Some may have been willing to bear Massachusetts' tax policy in the past, but moving from a five to nine percent income tax rate is an unprecedented 80% rate increase. That will undoubtedly inspire affected Massachusetts residents to reconsider their primary residence.

For some, tax policy may be the primary reason for relocation, while for others it may be an afterthought. But for most making a voluntary relocation, tax policy and general cost-of-living are a consideration when deciding where to live. Massachusetts should take steps to mitigate these concerns or risk outmigration by thousands of residents and billions of dollars in lost revenue.

The proposals to eliminate tax on all estates under $5 million, reduce the short-term capital gains rate, eliminate the Sting Tax and more would make the state more competitive with its regional neighbors and slow the migration of high-income individuals from the Commonwealth.