Institute on Taxation and Economic Policy
1616 P Street, NW • Washington, DC 20036 • (202) 299-1066

That's Rich

Laffer and Moore's Assertions about State Tax Increases Don't Hold Much Water

> "Finally, there is the issue of whether high-income people move away from states that have high income-tax rates. Examining IRS tax return data by state, E.J. McMahon, a fiscal expert at the Manhattan Institute, measured the impact of large income-tax rate increases on the rich ($200,000 income or more) in Connecticut, which raised its tax rate in 2003 to 5% from 4.5%; in New Jersey, which raised its rate in 2004 to 8.97% from 6.35%; and in New York, which raised its tax rate in 2003 to 7.7% from 6.85%. Over the period 2002-2005, in each of these states the "soak the rich" tax hike was followed by a significant reduction in the number of rich people paying taxes in these states relative to the national average. Amazingly, these three states ranked 46th, 49th and 50th among all states in the percentage increase in wealthy tax filers in the years after they tried to soak the rich."
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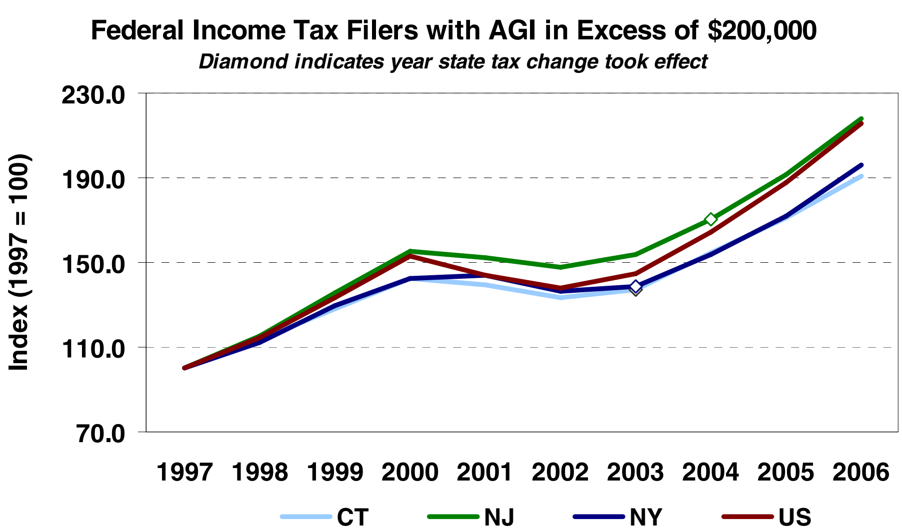
> *– Arthur Laffer & Stephen Moore, "Soak the Rich, Lose the Rich",* Wall Street Journal*, May 18, 2009*

After reading the preceding passage, one is left with the strong impression that, in the middle part of this decade, the Tri-State Area was witness to scene after scene ripped from the *Grapes of Wrath*, only with BMWs replacing Hudsons and Nevada standing in for California.

A more careful examination of Internal Revenue Service (IRS) data for the period from 1997 to 2006 reveals a far different picture, however. They show that the number of "rich" taxpayers (federal income tax filers with adjusted gross incomes (AGI) in excess of $200,000) rose considerably in Connecticut, New Jersey, and New York over the course of that ten year period, including in the years immediately following state income tax changes in those states. Indeed, at both the start of that ten year period and at its conclusion, Connecticut, New Jersey, and New York were generally "richer" than the national average – that is, they had a greater concentration of federal income tax filers with adjusted gross incomes in excess of $200,000 than the country as a whole – suggesting that state tax policy changes did little to drive away wealthy residents.



Examining each of these three states in turn further demonstrates the lack of connection between state tax policy changes and the exodus suggested by Laffer and Moore.

- **Connecticut**: Effective TY 2003, Connecticut raised its top income tax rate from 4.5 to 5.0 percent, but, since that rate was applied to all taxable income in excess of $20,000 (for married couples filing jointly; $10,000 for single filers), the change could hardly be described as targeting the very wealthy. Nevertheless, between 2002 and 2006, the number of "rich" taxpayers in Connecticut climbed from 61,601 to 87,935.

- **New Jersey**: Effective TY 2004, New Jersey added a new top tax bracket, applicable to taxable income in excess of $500,000 and utilizing a rate of 8.97 percent (thus affecting only a fraction of the filers Laffer & Moore classify as "rich"). Yet, between 2003 and 2006, the number of "rich" taxpayers in New Jersey climbed from 140,266 to 199,391.

- **New York**: Beginning in TY 2003, New York had in place two temporary top rates: 7.5% for taxable income above $150,000 (for married couples; $125,000 for single filers) and 7.7% for taxable income above $500,000 (for all filers). The lower of those two rates fell to 7.25 percent in TY05; both rates expired prior to TY06. Regardless, the number of rich filers in New York jumped from 217,807 in 2002 to 313,284 in 2006.

What's more, "rich" filers in each of these three states came to comprise a larger share of total filers in each of these three states from the mid-1990s to the middle part of this decade, suggesting faster growth in the number of rich filers in these states over time than in other portions of the income distribution. Again, in 1997, each of these three states had a larger share of "rich" filers than the US as a whole; in 2006, the same was still true.