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The Millionaire Migration Myth: Why a Fair, Graduated Rate Income Tax Won't Drive Away Millionaires

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1. **The Context.**

Last year, state Senator Don Harmon and state Representative Naomi Jakobsson introduced identical resolutions in the General Assembly to amend the income tax provisions of the 1970 Illinois State Constitution.[1] The purpose of the proposed amendment is to eliminate the requirement that the state's personal income tax be imposed at one, flat rate. Instead, the amendment would permit Illinois to tax lower levels of income at lower rates and higher levels of income at higher rates, thus allowing the state's income tax to track ability to pay. More recently, Speaker Michael Madigan proposed a two-tier income tax structure, with a higher rate imposed on the taxable income that is in excess of $1 million, and a lower rate for all other income.

Both proposals have been attacked on the grounds that imposing higher rates on higher levels of income — and particularly on income above $1 million — is unfair because it somehow punishes success and ultimately will drive millionaires out of the state causing economic harm. As it turns out, however, the overwhelming body of evidence show that these attacks have no merit.

2. **To be Fair, Income Tax Rates Must Vary in Accordance with Ability to Pay.**

Both all the data — as well as best fiscal policy practices — dispel any argument that having lower rates apply to lower levels of income and higher rates to higher levels of income unfairly punishes success. Start with best fiscal practices. Far from punishing success, an income tax structure that assigns lower rates to lower levels of income and higher rates to higher levels of income is the only way to respond fairly to how income growth is actually shared among different income classes. This venerable principle goes back to 1776 and Adam Smith, the father of capitalism. In his seminal work, the *Wealth of Nations*, Smith posited that a fair tax in a capitalist economy should "remedy inequality of riches as much as possible, by relieving the poor and burdening the rich."[2]

Smith contended that would be fair taxation in a capitalist economy, because affluent folks would receive a disproportionate share of income growth over time. A recent analysis of IRS data shows Smith was right. Over the 1979-2011 sequence, after adjusting for inflation, the wealthiest 10 percent in America realized 139.8 percent of national income growth—or more than all of it. That means fully 90 percent of all Americans on average earned 39.8 percent less in real terms in 2011 than in 1979.

So, to treat taxpayers fairly, Illinois needs the flexibility to tax lower levels of income at lower rates than higher levels of income—something the state Constitution prohibits. This makes Illinois a tax outlier. Thirty-three of the 41 states in America with an income tax have a fair, graduated rate structure.[3] Illinois doesn't. According to a national study, that's a primary reason Illinois ranks as one of the three most unfair taxing states in the country—imposing tax burdens (as a percentage of income) on low and middle income families that are more than double that of millionaires.[4]

3. **A Fair, Graduated Income Tax will not Drive Millionaires out of Illinois.**

Research on the migration of people generally and high-income households specifically finds there is no statistically significant correlation between a state's tax policies and the propensity for a family to migrate.[5] Indeed, other factors like proximity to family or a job, housing prices and even weather are what really matter. Following is a short summary of the research in this area.

4. The New Jersey Experience.

Forty-one states in America have a personal income tax. New Jersey is one of the 33 states with a personal income tax that has a fair, graduated rate structure. In 2004, New Jersey increased its top income tax rate from 6.37 percent to 8.97 percent. This new top rate only applied to taxable income above $500,000. In 2010, Stanford University issued a study that analyzed whether this change in New Jersey's tax policy, dubbed a "millionaire's tax," encouraged millionaires to leave the state. New Jersey is located close to other states like New York and Connecticut, and cities like Philadelphia, so that migration out of state to avoid the New Jersey "millionaires tax" was feasible, given that the individuals moving would be able to retain their jobs and stay close to their families. But despite this, the number of in-state millionaires continued to grow after the state's "millionaire's tax" passed.[6] This outcome should not be surprising given that, the researchers found that people overall do not generally migrate in response to a tax increase.

In fact, research on the number of millionaire households per state demonstrates little correlation between state income taxes and millionaire location. A study done in 2013 by Phoenix Marketing International, a wealth research firm, ranked U.S. states by millionaires per capita. The firm defined millionaire households as those with $1 million or more in investable assets. What Phoenix Marketing found was "being ranked at the top of the millionaire-ratio list is as much a function of geography as policy."[7] As shown in Figure 1, the top five states include a high income tax state (Hawaii) and a no income tax state (Alaska) as well as three states with fair graduated income tax rate structures (Maryland, New Jersey and Connecticut) with higher rates assessed against higher levels of income.

Figure 1
Millionaire Households per Capita 2013

Rank	State	Total Households	$1M+ in Investable Assets	Ratio Millionaires to Total Households
1	Maryland	2,199,912	169,287	7.70%
2	New Jersey	3,238,448	242,647	7.49%
3	Connecticut	1,376,955	100,754	7.32%
4	Hawaii	466,705	33,520	7.18%
5	Alaska	269,890	18,209	6.75%

Source: Phoenix Marketing International, *Ranking of U.S. States by Millionaires per Capita 2006-2013* (2014). http://w3.phoenixmi.com/wp-content/uploads/2014/01/Phoenix-GWM-U.S.-Ranking-States-By-Millioinaires-Per-Capita-2006-13.pdf

5. **Most Residents including Millionaires Do Not Migrate out of a State for Tax Reasons.**

Based on the findings of most research in this area, people move for many complicated, interrelated reasons.

- The main reasons cited for moving to a different state are employment, family-related matters, and education. In fact, a study done by Jeffrey Thompson of the Political and Economic Research Institute at University of Massachusetts Amherst, found that "nearly 9 in 10 working age adults relocate for jobs, housing, and family related reasons."[8]
- Moreover, ample evidence shows that even after taxes are increased, people generally do not leave their homes states. One study by the PEW Research Center which surveyed American households confirmed that family ties are a major reason people do not leave their hometowns. Other top reasons cited were a sense of belonging, connection to friends, and having a good place to raise children.[9]
- According to a recent survey conducted by Endeavor Global, those rationales for staying in a state after taxes go up actually track what successful entrepreneurs look for when starting a business. The Endeavor Global survey found that low tax rates were rarely cited as a factor in entrepreneurial site-selection decision making.[10] Instead, the entrepreneurs surveyed responded that the most important factors to them in choosing a site were, first and foremost, access to a talented local employee pool, and second, proximity to customers and suppliers.[11]

6. Most People Don't Change State of Residency.

The bottom line is migration is just not that common. "On average, only 1.7 percent of U.S. residents moved from one state to another per year from 2001-2010, and only about 30 percent of those born in the U.S. change their state of residence over the course of their entire lifetime."[12] Furthermore, many studies have shown that a vast majority of individuals are drawn to states that have strong public services, which are paid for by tax dollars.[13] One study in particular, released by the Center on Budget and Policy Priorities, found that "amenities such as cultural facilities, recreational opportunities and well managed public services"[14] attract potential new residents. Well-funded public education matters as well.[15] This suggests, of course, that simply having a fair income tax with higher rates on higher levels of income and lower rates with lower levels of income will not drive migration out of a state.

7. Conclusion.

The following quote from the Center on Budget and Policy Priorities fairly and accurately sums what the evidence has to say about the myths of tax flight: "It would not be credible to argue that no one ever moves to a new state because of the desire to live someplace where taxes are lower. But neither is it credible to say that taxes are a primary motivation, nor that migration has a large impact on the revenue impact of tax measures."[16] Currently, Illinois tax policy is neither fair to taxpayers nor designed to sustain funding current service levels into the future. Reforming the state's personal income tax to a fair, graduated structure with higher rates for higher levels of income and lower rates for lower levels of income will not drive away millionaires, nor punish success.

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[1] SJRCA40 and HJRCA33 of the 98th General Assembly.

[2] Adam Smith, *Wealth of Nations* (London: W. Strahan and T. Cadell: 1776), Book 5, Chap. 2, Article I, footnote 4.

[3] Federation of Tax Administrators, *State Individual Income Taxes (Tax rates for Tax Year 2014—as of January 2014)* (Washington, DC: January 1, 2014).

[4] Institute on Taxation and Economic Policy, *Who Pays? A Distribution Analysis of the Tax Systems in All 50 States, Fourth Edition* (Washington, DC: January 2013), 35. The only state with a higher state and local tax burden on the lowest 20% of families is Washington, which does not have a state personal income tax.

[5] Cristobal Young and Charles Varner, *Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment* (Stanford, CA; June 2011) 257.

[6] Cristobal Young and Charles Varner, *Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment* (Stanford, CA; June 2011) 265.

[7] Thomas Frank, *Top States for Millionaire per Capita*, (CNBC.com: January 19, 2014).

[8] Jeffrey Thompson, *The Impact of Taxes on Migration in New England,* (Policy Economy Research Institute: University of Massachusetts, Amherst: April 2011), 5. While the study focuses on New England the paper also includes national comparisons.

[9] Pew Research Center, *American Mobility: Who Moves? Who Stays Put? Where's Home?* (December 28, 2008).

[10] Rhett Morris, *What Do the Best Entrepreneurs Want in a City? Lessons from the Founders of America's Fastest-Growing Companies* (Endeavor, February 2014).

[11] Rhett Morris, *What Do the Best Entrepreneurs Want in a City? Lessons from the Founders of America's Fastest-Growing Companies* (Endeavor, February 2014).

[12] Robert Tannenwald, Jon Shure, and Nicholas Johnson, *Tax Flight is a Myth: Higher State Taxes bring more Revenue, not more Migration* (Washington, DC: August 4, 2011), 1.

[13] Robert Tannenwald, Jon Shure, and Nicholas Johnson, *Tax Flight is a Myth: Higher State Taxes bring more Revenue, not more Migration* (Washington, DC: August 4, 2011), 2.

[14] Robert Tannenwald, Jon Shure, and Nicholas Johnson, *Tax Flight is a Myth: Higher State Taxes bring more Revenue, not more Migration* (Washington, DC: August 4, 2011), 6.

[15] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity* (Washington, DC: Economic Policy Institute, August 22, 2013), http://www.epi.org/publication/states-education-productivity-growth-foundations/; Michelle T. Bensi, David C. Black, and Michael R. Dowd. "The Education/Growth Relationship: Evidence from Real State Panel Data." *Contemporary Economic Policy* 22, no. 2 (April 22, 2004): 281-298; Jeffrey Thompson*, Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives* (Amherst, MA: University of Massachusetts Amherst, Political Economy Research Institute, August 18, 2010); Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 1.

[16] Robert Tannenwald, Jon Shure, and Nicholas Johnson, *Tax Flight is a Myth: Higher State Taxes bring more Revenue, not more Migration* (Washington, DC: August 4, 2011), 3.