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Massachusetts Voters Approve the 'Millionaires Tax'

On Tuesday, voters in Massachusetts voted "yes" on Ballot Question 1, approving the imposition of a 4 percent surtax on Massachusetts taxpayers with a net income in excess of $1 million. This so-called millionaires tax will go into effect for tax years beginning on or after January 1, 2023.

Massachusetts currently taxes all income at a flat rate of 5 percent (except for a 12 percent rate applicable to short-term capital gains and collectible gains), irrespective of how much income the taxpayer earns. Question 1 represented the sixth attempt since 1915 to change the Massachusetts tax system from a flat rate to graduated rates that impose higher rates on higher earners. As a result of the passage of Question 1, Article XLIV of the Massachusetts Constitution will be amended to add the following language:

> *To provide the resources for quality public education and affordable public colleges and universities, and for the repair and maintenance of roads, bridges and public transportation, all revenues received in accordance with this paragraph shall be expended, subject to appropriation, only for these purposes. In addition to the taxes on income otherwise authorized under this Article, there shall be an additional tax of 4 percent on that portion of annual taxable income in excess of $1,000,000 (one million dollars) reported on any return related to those taxes. To ensure that this additional tax continues to apply only to the commonwealth's highest income taxpayers, this $1,000,000 (one million dollars) income level shall be adjusted annually to reflect any increases in the cost of living by the same method used for federal income tax brackets. This paragraph shall apply to all tax years beginning on or after January 1, 2023.*

Anyone who resides in Massachusetts and has turned on a television or opened their mailbox this year has heard of the millionaires tax. Those in favor of the tax argued that only 0.6 percent of Massachusetts taxpayers will actually pay the tax and that the funds are statutorily directed toward areas of great need, such as public transportation, public schools, roads and bridges. Those against the tax argued that there is no guarantee that the funds will be spent in the manner promised and that increasing taxes will prompt businesses and entrepreneurs to leave for states with lower taxes, such as New Hampshire and Florida.

Opponents of the tax also contended that Massachusetts already has more than enough tax revenue, as evidenced by its recent large tax refunds mandated by law. Earlier this year, incumbent Governor Charlie Baker announced that the Commonwealth generated so much tax revenue in its 2021 fiscal year that it triggered Chapter 62F, a little-known statute that has only been invoked once before (in 1987). Chapter 62F provides that Massachusetts must issue tax refunds to taxpayers if it generates tax revenue above a certain threshold. The Commonwealth exceeded that threshold in 2021, and it is estimated that Massachusetts taxpayers will receive refunds equal to approximately 13 percent of their 2021 tax liability.

On Election Day, it became clear that taxpayers saw both sides of the argument, with the vote remaining too close to call until later the following day. Nevertheless, Question 1 narrowly passed with roughly 52 percent of the vote, marking the first time since 1915 that Massachusetts will transition to a progressive tax system that taxes the highest earners at a higher rate.

Now that the millionaires tax has become law, Massachusetts taxpayers who expect to be subject to the increased tax rate have a few options for mitigating the impact. The 4 percent surtax will apply to tax years beginning on or after January 1, 2023, so selling an asset at a gain between now and year-end is one way to avoid the surtax. This will likely result in an increase in sales of appreciated securities, operating businesses, artwork and real estate before December 31, 2022. Taxpayers selling assets with payments made over time in installments may wish to trigger the gain in 2022. Taxpayers with certain eligible gains can also consider deferring and partially eliminating those gains by investing in qualified opportunity funds. Similarly, real estate investors could defer gain by entering Section 1031 like-kind exchanges for other real estate.

Other taxpayers may also consider making transfers of income-producing assets to trusts that are domiciled outside Massachusetts. All of these strategies must be measured on a case-by-case basis, but it is fair to expect a flurry of year-end tax-driven transactions.

Critics of Question 1 raised concerns that the millionaires tax would have a disproportionate impact on taxpayers who do not realize $1 million of income regularly but might have one exceptional year as a result of selling a business or a piece of real estate they have held for a long time. Income in excess of $1 million from such a sale after December 31, 2022, will be taxed in Massachusetts at nearly double the rate (9 percent vs. 5 percent) than would apply if the sale occurred prior to 2023. This could especially impact Massachusetts taxpayers who are close to retirement and banking on cashing in on that long-term investment after already seeing their retirement savings drop precipitously as a result of the bear market in 2022. It might also convince those taxpayers to sell their company or real estate between now and the end of the year.

Another option, of course, is to move to another state with lower tax rates. In an article (subscription required) published Wednesday in the *Boston Globe*, I raised the point that the millionaires tax could be the last straw for high-earning taxpayers who were already thinking about changing their domicile. Frankly, the trend is already underway. Massachusetts residents have been spending their winters in Florida for generations, and these so-called snowbirds continue to migrate in droves to the Sunshine State to take advantage of the warm weather, low cost of living, and absence of an income and estate tax. The pandemic turned many snowbirds into Florida residents, as soaring home prices in Massachusetts led many baby boomers to cash in on their homes and purchase early-retirement homes in Florida. Similarly, the pandemic-induced breakdown of the conventional work model and movement toward a hybrid work model convinced many younger workers to relocate to Florida to enjoy the warm weather and lack of commute without needing to leave their Boston-based jobs.

Today, as Boston-based companies seek to encourage employees to come back to the office, many of their employees are struggling to reconcile the return to the office with the associated waste of time and energy that comes with the city's gridlocked traffic and aging, unreliable public transportation system. When combined with the employment market's historically high demand for knowledge workers, it stands to reason that some of these employees will take their talents somewhere that is more affordable, comfortable and convenient. Businesses are following suit, as evidenced by the "Wall Street South" neighborhood in Palm Beach County. In 2020 alone, 11,000 people moved to Palm Beach County, resulting in a net income gain of $3.4 billion to the county, the highest increase in any county in the United States.

That said, changing one's domicile is not as simple as obtaining a new driver's license. Massachusetts is keenly aware that many of its residents live near tax-free New Hampshire or spend time in tax-free Florida, and the Massachusetts Department of Revenue (DOR) has a track record of aggressively auditing taxpayers who attempt to change their domicile. Thus, it seems safe to assume that the DOR will place an emphasis on reviewing tax returns filed by taxpayers who have historically filed resident tax returns but suddenly claim nonresident status in the wake of the millionaires tax. Changing one's domicile is possible, but taxpayers should understand that they bear the burden of proving they have changed their domicile and that they would be well advised to consult with an attorney before making the move.

Please consult with a tax attorney or contact your Day Pitney estate planning attorney if you would like to discuss planning options. The Day Pitney Tax group remains on top of these developments and can assist you.

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