State Budget Shortfalls Due to COVID-19: Proposals for New and Increased Taxes on Billionaires and Top Earners

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While the COVID-19 pandemic has wreaked havoc on everyone's daily lives, it has also taken a toll on the budgets of many state and local governments. The Federal Government has and likely will continue to provide some aid to states, however, many will still find themselves with a significant budget shortfall. As a result, California and New York, in particular, are proposing tax increases on top earners, as well as the implementation of new types of taxes, never before implemented in the United States. New York and California combined account for less than 20% of the overall population of the US, however, more than 56% of billionaires living in the US live in one of those two states. Will increased and new taxes change that statistic, sending billionaires fleeing to states like Florida, Wyoming and Nevada?

With New York facing a possible $14 billion budget gap, one pending proposal would increase the current 8.82% top state income tax rate to as much as 11.85% for those earning more than $100 million. Another proposal, dubbed the "billionaire's tax," would tax the unrealized capital gains of all billionaires living in New York. Since capital gains are taxed as ordinary income in New York, the rate of the billionaire's tax would be 8.82%, or up to 11.85% if that increase is also enacted. If, for example, Bloomberg's company (Bloomberg, LP) were to increase in value by $4 billion in 2020, that gain, even though unrealized, would result in an approximate $352 million tax bill, or up to $463 million if coupled with the state's income tax rate increase. The billionaire's tax, if passed, is estimated to raise more than $23 billion in its first year and $5 billion per year thereafter.

Similarly, California has two proposed tax hikes that would impact only the state's top earners. California currently tops out at a 13.3% income tax rate – the highest in the country. Assembly Bill 1253 would raise that even higher, imposing an additional tax of 1% to 3.5% incrementally on income over $1 million. Meanwhile, Assembly Bill 2088 goes a step further and seeks to impose a wealth tax of 0.4% on a taxpayer's assets that exceed $30 million. This would include not only marketable securities and real estate, but also hard to value assets like art, antiques, closely held business interests, and other tangible personal property. Whereas wealth taxes were once quite common in Europe, one has never been enacted in the United States. And, in what could be a sign of things to come for New York and California, France lost an estimated 42,000 millionaires while its wealth tax was in effect, potentially costing France twice the revenue it generated with the wealth tax.

Recognizing that higher state taxes, particularly given the federal $10,000 cap on deducting state and local taxes, may lead to an exodus of each state's highest earners, both California Governor Gavin Newsom and New York Governor Andrew Cuomo have voiced concern over the willingness of billionaires and other top earners to remain in their states if these measures are implemented. New York City Mayor Bill DeBlasio, on the other hand, when asked about the wealthy leaving the city, said, "Let's focus on working people. Let's focus on the millions upon millions of people who are the backbone of New York City. I am not going to beg anybody to live in the greatest city in the world." If the income tax increases are enacted, a high earning New York City resident could find him or herself paying nearly 38% in federal income taxes (including the Affordable Care Act surtax), almost 12% in state income taxes (without getting an offsetting deduction), and close to 4% on New York City income taxes, for a total individual tax rate of 54%. In a state where the highest 2% of earners pay half of the state's income tax, a large reduction in billionaires and other top earners would have a real impact on New York's tax revenues. California tax revenues are even more concentrated; less than 1% of households there account for approximately half of the state's income tax revenue. Likewise, a resident of California could see a combined tax rate of nearly 55% with the proposed increase.

Though the constitutionality of both the billionaire's tax and the wealth tax would surely be challenged if enacted, is the threat of their implementation enough to convince those in the highest tax brackets in states like California and New York to take up residency in low or no income tax states like Florida? Many Floridians are already seeing an onslaught of relocations from hard hit COVID areas in the northeast, like New York. Only time will tell, but the country could very well see a significant shift in its billionaire population in the months and years ahead.

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