Institute for Policy Studies

Policy Brief

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State-level Initiatives to Increase Revenue and Reduce Inequality

Below is a list of tax reforms that States can enact to address economic inequality and generate significant revenue for a wide range of public investments. States have an opportunity to act to close the loopholes that hide and protect the wealth of the top 1%, remedy the impact of the new federal tax law that lowers taxes on the wealthy, and make critical investments in infrastructure, energy systems, and programs that create broader opportunity and shared prosperity. Concentrations of wealth are distorting our economy and undermining our democracy and civic health. State Administrations and State Legislatures can act to close the loopholes, put a brake on economic inequality and concentrations of wealth, and generate significant revenue.

Included in our suggestions:

- State-level tax increase on high income earners
- Restoration or expansion of state estate taxes
- Tax on corporations with extreme gaps between CEO and worker pay
- Carried interest tax
- Financial transaction tax
- State capital gains tax
- High-end real estate taxes to fund affordable housing and other priorities
- Luxury taxes
- State payroll tax on high incomes
- State corporate income tax

TAXES ON HIGH-INCOME EARNERS

The strong majority of Americans support progressive taxes on the rich. A joint Stanford-Treasury Department report showed that high taxes do not drive millionaires to move across state lines. State legislatures have increased taxes on the wealthy. In 2018, the New Jersey legislature increased taxes on incomes over $5 million. New York State and New York City have both increased taxes on high-income households as has Washington D.C.

In 2016, tax increases on high-income earners passed in both states where they were on the ballot, California and Maine. In California, voters extended the nation's highest top tax rate (13.3 percent) on those making more than $1 million per year, delivering an estimated $4 billion to $9 billion in annual revenue for human needs. Maine voters passed a 3 percent surtax on income over $200,000.

In 2018, Maine activists organized the first ballot initiative to fund universal home care through a payroll tax increase of 1.9% on salaries and wages over $127,000 a year. In the face of a heavily funded opposition campaign, the initiative failed to get majority support. But Caring Across Generations and other groups are working to apply lessons from this effort to similar campaigns in other states.

STATE ESTATE TAXATION

The estate tax is a levy on large fortunes when they are transferred from one generation to the next, with exemption thresholds that shield middle and working-class families. Before the Bush tax cuts passed in 2001, every state in the nation collected revenue from the state estate tax credit, which sent the first 16 percent of federal estate tax revenue to the states. Congress phased out this tax credit gradually until fully repealing it in 2005. Re-instating a progressive state estate tax in states that lost their state estate tax could generate significant revenue while reducing the concentration of wealth in intergenerational wealth dynasties.

In 2006, Washington state voters supported their state estate tax by a nearly 2-to-1 margin with the revenue raised directly funding education in the state (an education opportunity trust fund). A state estate tax has the power to fund critically important public initiatives like debt-free higher education and universal long-term care while halting the rising wealth at the very top.

The California College for All coalition is pushing legislation (and possibly a 2020 initiative) to levy a progressive tax on California estates and fund free public higher education, restoring the state's leadership role on accessible college. The estate tax would generate an estimated $4 billion a year and provide aid to 2.6 million California residents.

TAX ON CORPORATIONS WITH EXTREME GAPS BETWEEN CEO AND WORKER PAY

In 2016, the city of Portland, Oregon, adopted the world's first tax penalty on corporations with extreme gaps between their CEO and worker pay. The city's business license tax is 2.2 percent of adjusted net income. The surtax is 10 percent of the business tax liability for companies with a CEO-worker pay ratio of more than 100-to-1 and 25 percent for companies with a ratio of more than 250-to-1. More than 500 corporations that do business in the city, including mega-firms like Wells Fargo and Walmart, are subject to the surtax.

Such tax penalties are easy to administer because U.S. publicly held corporations began reporting the ratio between their CEO and median worker pay to the SEC in 2018.

Lawmakers in seven U.S. states and in the U.S. Congress have introduced legislation similar to the Portland tax: California, Connecticut, Illinois, Massachusetts, Minnesota, Rhode Island, and Washington. These efforts build on the living wage movement by creating an incentive to pull down the top end of the pay scale while sending a message that everyone in a workplace contributes value (not just the CEO).

CARRIED INTEREST TAX

States with significant financial sectors can take action to make up for Washington's failure to close the "carried interest" loophole, which allows private equity and hedge fund managers to reduce their tax bills by claiming a large share of their earnings as "capital gains" instead of ordinary income. This has allowed many of the wealthiest Americans to pay lower rates than firefighters and teachers. Legislation to close the carried interest loophole has been introduced in New York, New Jersey, Massachusetts, Connecticut, Rhode Island, Maryland, the District of Columbia, and

Illinois. New York Governor Andrew Cuomo has included a state-level "carried interest fairness fee" in his budget proposal two years in a row.

FINANCIAL TRANSACTION TAX

A financial transaction tax is a tiny fee – at rates of a fraction of a percent – on trades of financial instruments, such as stocks, bonds, and derivatives. Such taxes are promoted as having the dual benefits of discouraging short-term speculation while generating significant revenue. The notion of instituting a Financial Transaction Tax has gained increased attention at the federal level in recent years, but Congress has failed to take action.

This would not be relevant in states that do not have a large trading exchange. The Illinois state legislature is considering a bill that would place fees of $1-$2 per contract on Chicago's commodities and financial exchanges, with revenue estimated at $10 billion to $12 billion per year.

STATE CAPITAL GAINS TAX

A capital gains tax is a levy on income from investments rather than wages. In the 42 states (including DC) that impose capital gains taxes, rates range from 3.1 percent in Pennsylvania to 13.3 percent in California. States without a capital gains tax should implement one and states that have one should increase the rate to at least 10 percent. Raising or introducing such taxes would mostly impact the wealthy, since the top 1 percent owns half of the nation's financial wealth and the bottom 50 percent only own 0.5 percent of financial wealth. State capital gains taxes help ensure fairness between those who work paycheck to paycheck and those who pocket dividends.

HIGH-END REAL ESTATE TAXES TO FUND AFFORDABLE HOUSING AND OTHER PRIORITIES

Cities and States should consider taxes on luxury real estate investments, particularly unoccupied, vacant properties. A huge number of new luxury high-rise properties have been purchased, with many vacant and unoccupied, and many purchased by shell corporations, creating a method for the ultra-wealthy to hide their wealth. The impact has been to disrupt local real estate markets and push up existing housing prices for rent or sale higher and higher. States can pass enabling legislation to allow cities and localities to address this problem through taxes on vacant, unoccupied luxury units, and can consider transfer taxes, and laws to require beneficial ownership transparency in real estate transactions. States could also institute graduated real estate transfer taxes, taxing properties transferring over $1 million at progressively higher rates.

In 2016, San Francisco voters approved a tax on high-end real estate transactions that contribute to gentrification. The tax raises additional revenue from commercial and residential real estate transfers over $5 million. Funds have been used to provide free tuition and stipends to San Francisco residents at the city's community college.

New York City has implemented a new "Mansion Tax" on properties sold for more that $1 million. This tax takes the form of an additional payment equal to 1% of the home's sales price. The Mayor may increase the tax, and the plan would optimally bring in $200 million a year, with some percentage proposed to support affordable housing.

In Boston, city councilors have proposed levying fees on high-end real estate deals to help pay for more housing. The proposal would set a tax of up to 6 percent on many commercial and residential sales over $2 million and establish a "flipping" tax of up to 25 percent on some properties that are sold twice within two years. The fees could raise from $175 million to $350 million a year. Legislation has been introduced at the Massachusetts state level that would enable other Boston and other municipalities to implement luxury transfer taxes.

Affordable housing coalitions in other major cities are exploring implementing high-end real estate transfer taxes to off-set the huge disruption that wealthy investors have caused in local housing markets. Many favor using the revenue to fund the creation and preservation of permanently affordable housing and homeownership.

Several states have graduated real estate transfer tax rates and many more are exploring this as a means to capture the impact of wealthy investors on housing. Hawaii has a 2 percent real estate tax on sales between $600,000 and $1 million, and a 3 percent tax on transfers valued over $1 million. New Jersey has a number of graduated rates with 1.21 percent on properties over $1 million.

LUXURY TAXES

A luxury tax is a duty levied on luxury goods, such as high-end automobiles and expensive yachts. In Connecticut, the sales tax rate jumps from 6.35 percent to 7.75 percent on vehicles costing more than $50,000; jewelry costing more than $5,000; and apparel and footwear costing more than $1,000. The clothing tax also applies to handbags, luggage, umbrellas, wallets, or watches costing more than $1,000. In New Jersey, a tax penalizes both luxury cars and gas guzzlers by imposing a 0.4 percent surcharge on vehicles that have price tags above $45,000 or get less than 19 miles per gallon.

STATE PAYROLL TAX ON HIGH INCOMES

Federal payroll taxes for Social Security have a huge loophole for the wealthy in the form of a cap on the amount of income subject to the tax. It's currently $128,400 and is adjusted annually for inflation. This means a multi-millionaire and someone earning $128,400 per year pay the same amount in Social Security payroll taxes — not the same rate, the same amount. States can close this loophole by imposing a state level payroll tax on income above the federal cap. (See Maine proposal, detailed above.)

STATE CORPORATE INCOME TAX

With the federal corporate tax rate dropping from 35% to 21%, this is an opportune moment for states to recoup some of these funds by raising or introducing corporate income taxes. Forty-four states levy a corporate income tax, with rates ranging from 3% to 12%. Nevada, Ohio, Texas, and Washington impose gross receipts taxes instead of corporate income taxes, while South Dakota and Wyoming have neither.

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