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OPINION | REVIEW & OUTLOOK

California's Tax-the-Rich Boomerang

A new study shows the 2012 tax hike drove high earners from the state.

By The Editorial Board

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The Capitol in Sacramento. **PHOTO:** RICH PEDRONCELLI/ASSOCIATED PRESS

Democrats in California have raised taxes on the rich again and again, and liberals claim it has no effect on taxpayer migration and does no harm to state tax revenue. A new study finds the opposite.

Stanford economists Joshua Rauh and Ryan Shyu analyzed how high earners responded to a 2012 referendum (Prop. 30) backed by Democrats that raised the top marginal rate on taxpayers with more than $1 million of income to 13.3% from 10.3%. The top rates on individuals earning more than $250,000 also rose between one and two percentage points.

First, the researchers examined whether higher taxes caused top earners to leave the state by measuring migration before and after Prop. 30 took effect. They noted a large uptick in the departure rate of taxpayers with more than $5 million in income following the tax hike—from 1.5% to 2.125%—and a commensurate outflow for taxpayers earning between $2 million and $5 million.

This essentially means that the likelihood of a wealthy resident moving out of California increased by about 40% after Prop. 30. Notably, the federal top marginal rate also rose in 2013, which the authors say softened the impact because the deductibility of state taxes also increased. After the GOP tax reform, state and local taxes are no longer fully deductible so the incentive to move is now greater.

Next, the economists examined how incomes changed in response to the tax hike by comparing filings from in-state high earners to non-residents. They found that "California top-earners on average report $522,000 less in taxable income than their counterfactuals in 2012, $357,000 less in 2013, and $599,000 less in 2014."

Non-investment income accounted for most of the decline in earnings. The economists don't give a reason, but it may be that high earners have responded to the tax hike by working less—for instance, logging fewer billable hours—or deferring compensation.

In sum, the study estimates that outward migration and taxpayer behavioral responses erased 45.2% of the expected revenue gains from the tax hike on top earners. This is especially relevant since liberal economists argue that the rich don't care about marginal tax rates and raising the top income rate to 70% won't affect revenue or incentives to work.

The study suggests Sacramento should think again. And watch out for the next recession when investment income and capital gains fall for the affluent. Democrats will have to soak the middle class even more than they already do to finance all of the new spending demands they are creating in the good times (e.g., free health care for undocumented immigrants).

That's one reason they're pushing a referendum next year to remove the state's constitutional tax cap on commercial property. The liberal forecast in California always calls for higher taxes.