people • partnerships • policy
massbudget
Massachusetts Budget & Policy Center

October 17, 2022

Even Among Retirees with High Wealth, Few Will Pay the Fair Share Tax

By Phineas Baxandall, Senior Analyst and Advocacy Director

Key Takeaways

- Less than 1 percent of older tax filers in Massachusetts have an income high enough to pay Fair Share taxes.
- Retirees with high wealth generally have much lower annual incomes than their wealth.
- The millionaire tax, like other personal income taxes, calculates income from wealth only based on *gains* in the annual value of sold assets above their previous purchase price. This is generally far less than the sale price and only a fraction of wealth is likely to be sold each year.
- Tax filers can subtract the costs incurred from improving or selling an asset, and they are entitled to large capital gains deductions from the value of a primary residence.

Less than 1 percent of older taxpayers (0.8 percent) in Massachusetts have income high enough to pay a new Fair Share tax. The "millionaire tax" only applies to the portion of a taxpayer's annual taxable income over $1 million.[1] For many retirees, much of their income is not subject to the income tax and therefore not subject to an additional tax on income over $1 million. And wealth, such as personal savings and investments, are not subject to the income tax. Even when wealth is sold to generate additional financial gains, this income is often tax-exempt or shielded by widely used deductions.

The "millionaire tax" is paid based on annual *income*, not accumulated wealth

The Fair Share tax would apply only on the portion of taxable *income* over $1 million that somebody receives in a single year. For retirees living off investments, only the *capital gain* from when they sell an asset is taxable, not the value of the entire stock or bond portfolio. For retirees drawing income from retirement accounts, if they are taxable at all, it is the amount of that year's withdrawal or distribution from the account, not the value of the assets themselves, that are taxed.

Even somebody with exceedingly large retirement savings, say $10 million, isn't likely to sell off all their assets or enough to generate million-dollar capital gains in a single calendar year. The Social Security Administration projects that a man retiring today at 65 can expect to live another 19 years and a woman can expect to live 23 more years.[2] Liquidating all your assets in one year is unlikely to make sense.

Taxable income from selling an asset is typically a fraction of the sale price. For example, if somebody has $2 million in saved stocks, bonds, and mutual funds that they originally purchased for $1.2 million over the years, then the maximum possible capital gain for the year would be

$800,00, well under the threshold for any Fair Share tax. Similarly for housing wealth, only the fraction of the sale price that exceeds its previous purchase cost is a taxable gain, and only after also deducting $500,000 on a couple's primary residence from the final sale price, in addition to deducting costs for past improvements and the cost of the sale and closing. Less than 1 percent of Massachusetts home sales exceed their previous price by $1.5 million or more.

Individuals who can afford to hold onto their assets until the end of their lives are exempted from ever paying taxes on the capital gains from those assets. Gains on assets that are held until death are not subject to income tax, either for the deceased or their heirs who inherit the assets.[3] Large concentrations of wealth may still be subject to estate taxes, but those taxes are unaffected by the Fair Share tax, and the assets received as inheritance do not count as income toward a potential Fair Share tax payment.

A large part of retirement savings is exempt from taxation

Most retirement income is not from selling off large non-retirement assets. Retirees tend to rely on IRAs, 401K accounts, public pensions, and Social Security, which receive various kinds of tax breaks.[4]

Even so, most retirees with taxable forms of individual retirement accounts, pensions, and annuities will not have retirement income exceeding $1 million. Less than 1 percent of Massachusetts tax filers receiving taxable distributions from individual retirement accounts had taxable income that totaled over $1 million, according to the most recent available statistics from the IRS.[5] Similarly, just over half of one percent of tax filers with income from taxable pensions or annuities reported a total income of $1 million or more.[6]

In those rare instances when someone sells enough assets in a single year to generate capital gains after deductions that exceed $1 million, the Fair Share tax still only applies to that fraction of income over $1 million. Consider a tax filer who sold several millions of dollars in assets in a single year, yielding capital gains totaling $1,020,000 after deductions. Without enactment of the Fair Share Amendment, the state tax on this sum would be $51,000. With the Fair Share amendment, an additional 4 percent tax would be applied only to the $20,000 amount above the $1 million threshold – an additional tax of $800. The Fair Share tax would increase their total state capital gains tax by 1.6 percent (or by far a far smaller percentage if federal taxes are also added to the picture).

Older and retired residents in Massachusetts will benefit from education and transportation investments funded by the Fair Share ballot question. Retirees are more likely to appreciate reliable public transit and well-maintained and well-lit roads, a well-educated workforce, good neighborhood schools that protect home values, and the many benefits to future generations. While the revenue for these investments would come narrowly from those most able to afford it, the benefits would be spread broadly.

Retirement Savings are Heavily Skewed Toward Higher Income White Households

Nearly half of families have no retirement savings at all. Nationally, about 1 in 10 households in the bottom 20 percent of income and just 1 in 3 households in the next 20 percent have a retirement account, whereas 9 in 10 people in the highest 10 percent of incomes have a retirement account.[1] Similarly, 25 percent of "Hispanic" people and 35 percent of Black people have a retirement account, compared to 57 percent of white people. The median balance of white accounts is more than double the median of Black and Hispanic accounts.

Sources: The Board of Governors of the Federal Reserve, "Survey of Consumer Finances (SCF)," November 4, 2021, Board of Governors of the Federal Reserve System, Survey of Consumer Finances, "Retirement Accounts by Race or Ethnicity", citing most recent 2019 data finds moreover that the average (mean) amount for non-Hispanic whites is almost triple that of Blacks and Hispanics. Economic Policy Institute, "The State of American Retirement Savings" (chart 5).

Endnotes

[1] Internal Revenue Service (IRS) Statement of Income for Massachusetts tax filers, 2019. The IRS defines an elderly tax filer as one in which the primary taxpayer is 60 years or older.
[2] Social Security Administration, Life Expectancy Calculator, at https://www.ssa.gov/oact/population/longevity.html . Wealthier individuals can moreover expect to live even longer. See "Association of Wealth with Longevity in US Adults at Midlife," Journal of the American Medical Association, *JAMA Health Forum.* 2021; 2(7) https://jamanetwork.com/journals/jama-health-forum/fullarticle/2782410
[3] The non-taxation of capital gains at death, also known as "stepped up basis at death," reduced Massachusetts income tax collection by $1.47 billion in Fiscal Year 2022, according to the Massachusetts Department of Revenue. See Tax Expenditure Budget, "1.022 Non-Taxation of Capital Gains at Death".
[4] Non-Roth Individual Retirement Accounts (IRAs), much like 401K accounts, provide those who contribute to them with an up-front tax break at the time that contributions are made. The distributions made from these accounts do

count as taxable income. Social Security benefits may be partially taxable, depending on how much income is earned from other sources. See "Income Taxes and Your Social Security Benefit," Social Security Administration. Treasury and other municipal bonds are also tax-free. Income generated by these assets is completely exempt from taxation and will not be counted toward the Fair Share tax.

[5] This number will also include people not yet retired who are drawing from their IRAs either for financial need or because they have reached the age when the law requires a minimum distribution (currently 72). The IRS reports 399,000 Massachusetts tax filers received distributions from taxable individual retirement account arrangements, of which 3,820 filers had a total income of $1,000,000 or more, according to the most recently available 2019 Statement of Income.

[6] Of the 611,940 Massachusetts tax filers with any income from a taxable pension or annuity, only 3,480 reported incomes of $1 million or more.