

Mitigating State “Millionaire’s Tax”

Filing Separately in Your State May Provide Relief

With the passage of the Tax Cuts and Jobs Act of 2017 that eliminated the “marriage penalty” tax brackets, filing a joint federal tax return has mainly become a foregone conclusion for married couples. Under certain circumstances, couples may still opt to file separately. Reasons for filing separately include a pending divorce, separation, repayment of income-based student loans, state community property laws, or avoidance of “joint and several liability.” However, this article will focus on another consideration: the so-called millionaire’s tax provisions enacted by certain states.

As of this writing, six states and the District of Columbia have adopted surtaxes on high-income taxpayers whose taxable income exceeds certain thresholds. The most recent addition to the list is Massachusetts, where, in the November 2022 midterm elections, residents narrowly voted in favor of a 4% surtax on taxable income exceeding \$1 million. Other states with a millionaire’s tax include California, Connecticut, Maine, New Jersey and New York. Each state (and district) has its own variation of the surtax, so for our purposes, we will focus on New York and Massachusetts to highlight potential benefits of filing separately.

Most states require that taxpayers file using the same state return filing status as used for their federal return. (See state-by-state reference chart at the end of this article.) In the following, we highlight two tax planning scenarios—one for New York and one for Massachusetts. New York requires that the federal and state filing status match, while Massachusetts does not.

Key Takeaways:

- California, Connecticut, Maine, New Jersey, New York and the District of Columbia have adopted a version of the “millionaire’s tax,” which assesses a tax surcharge on income over a certain threshold
- In November 2022, Massachusetts voters approved a state constitutional amendment to assess an additional 4% of tax on taxable income exceeding \$1 million (adjusted for inflation) beginning in tax year 2023
- In some cases, the surtaxes can be sidestepped by filing separate state tax returns

New York Example

New York imposes a 10.3% tax on taxable income exceeding \$5 million and up to \$25 million. In other words, for every dollar over \$5 million, tax is calculated at 10.3 cents. In the following simplified example, consider a married couple with a combined income of \$6 million, earning \$3 million each. Assume they are not New York City residents (who pay an additional city tax) and that they have no other income, dependents, credits or itemized deductions. As previously indicated, New York requires that they file a joint state return if they file a joint federal return and vice versa.

If Married Filing Jointly:	If Married Filing Separately:
Federal Tax: \$2,198,986	Federal Tax: \$1,099,493 Each for a Total of \$2,198,986
NY Tax: \$616,347	NY Tax: \$288,728 Each for a Total of \$577,456

In this example, the taxpayers save approximately \$38,891 by filing separate federal and New York returns, as individually their income does not surpass the \$5 million threshold.

Massachusetts Example

Unlike New York's graduated tax rates, Massachusetts has traditionally adopted a flat tax of 5% on earned income, interest, dividends and other passive income and a 12% flat tax on short-term capital gains. With the new millionaire's tax, also called the Fair Share Amendment, an additional 4% of income tax will be imposed on every dollar of taxable income over \$1 million. In this example, consider a married couple who each earns \$900,000 and have no other income, dependents, credits or itemized deductions. Massachusetts allows separate tax returns for couples who file a joint federal return.

If Married Filing Jointly:	If Married Filing Separately:
MA Tax @ 5% = \$90,000	MA Tax @ 5% = \$45,000 Each
MA Surtax over \$1M @ 4% = \$32,000	No MA Surtax
Total Tax = \$122,000	Total Tax = \$90,000

In this example, the taxpayers save \$32,000 by filing separate Massachusetts returns to avoid the millionaire's tax that would be applied to their combined income.

Final Thoughts

There are many factors that warrant careful consideration and planning when filing separately. For example, the IRS requires that if one spouse itemizes deductions, then the other spouse must also itemize. Further, the titling of assets such as real estate, bank and investment accounts, rental properties, partnership interests, etc. can and will impact the calculations. Additionally, proper tax planning may also benefit your estate plan.

A new year always brings a new tax season, so be sure to consider all options. Your Cerity Partners advisor can help you determine the best outcome for you.

State by State Filing Status Requirements

States that require the same filing status used on the federal return:

California*	Colorado	Connecticut	Georgia	Idaho
Illinois	Indiana	Iowa	Kansas	Louisiana
Maine	Maryland	Minnesota	Missouri	Nebraska
New Jersey	New Mexico	New York*	North Carolina	North Dakota
Ohio	Oklahoma*	Oregon	Rhode Island	South Carolina
Utah	Vermont	Virginia*		

**With limited exceptions*

States that do not require the same filing status used on the federal return:

Alabama	Arizona	Arkansas	Delaware	Hawaii
Kentucky	Massachusetts	Montana	Pennsylvania	

States with unusual filing status rules:

Michigan

If filing a joint federal return, then married couples must file a joint Michigan return; if filing separate federal returns, then married couples may file either jointly or separately for Michigan.

West Virginia

If filing a joint federal return, then married couples may file either jointly or separately for West Virginia; if filing a separate federal return, then married couples must file separately in West Virginia.

States/District where filing status is not dependent on federal filing status:

Mississippi	Wyoming	District of Columbia
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Source: The Tax Book

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