

Bond Case Briefs

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New Jersey Millionaires' Tax a Double-Edged Sword for Bonds.

- **State's bonds could get more valuable as tax shelters sought**
- **But some risk seen that wealthiest could move out of state**

A millionaire tax is a Catch-22 for New Jersey's bondholders.

Taxing the rich at higher rates — which Governor Phil Murphy proposed Tuesday as part of his \$38.6 billion budget — would likely boost demand for municipal bonds because the interest is exempt from federal and state taxes. But at the same time, some investors say the Garden State's precarious finances could be worsened if wealthy people start moving out of a state where high property taxes are already a major complaint.

"It's going to be a tremendous balancing act because they're going to see how far they can push these taxes without losing the entire population of wealthy individuals," said Brad Harris, director of fixed income for Lantern Investments, which manages money for clients living in New Jersey.

Murphy came away from last year's budget negotiations with a higher levy on incomes above \$5 million, affecting about 6,700 people in and out of the state. In his budget speech in Trenton today, he said he could raise another \$447 million on those earning at least \$1 million. The hunt for extra money comes after New Jersey's income-tax collections, the state's biggest revenue source, fell 6 percent this fiscal year through January, in part because of a rush by wealthy residents to shift bonuses and other income into 2017 before President Donald Trump's tax overhaul took effect.

That law has since driven a stampede into New Jersey bonds as residents seek to drive down their taxable income after being hit by the \$10,000 cap on state and local deductions, which was broadly felt in the state. As a result, the extra yield that investors demand on New Jersey general-obligation bonds maturing in 10 years has fallen to 59 basis points, lower than the one-year average of 67 basis points, according to data compiled by Bloomberg, while bonds sold by borrowers in the state have outperformed the market.

A millionaire's tax would add to the already-strong demand, said Gary Pollack, head of the private clients fixed-income desk at Deutsche Bank Wealth Management.

That demand has drive yields closer to the benchmark for certain New Jersey bond issuers, particularly the ones that don't need state support, he said. Issuers that rely on funding from New Jersey's general budget trade "much cheaper" because of concerns surrounding the state's finances, he said. While both types of bonds will likely benefit from a millionaires' tax — driving down borrowing costs for the state and local governments — he said it could act as a drag on the economy in the longer term.

It is "a mixed blessing for the state's overall economy," Pollack said. "While there's an immediate boon to the state's tax receipts, on a long-term basis it might be negative as affluent taxpayers flee the state for lower-tax states."

But such concerns have been raised for years in states with high taxes, and whether such levies actually compel residents to move is still a subject of debate. Analysts from Morgan Stanley, for example, expressed skepticism that residents are fleeing high-tax states, saying the population loss in New York reflects the hollowing out of its manufacturing strongholds.

Taylor Financial Group, a wealth management company that specializes in high-net worth clients, has increased allocations to New Jersey municipals because of the new limit on state and local tax deductions, said Debra Taylor, principal of the firm in Franklin Lakes, New Jersey.

While buying more municipal bonds would blunt the impact of a millionaires' tax on investors, residents are becoming increasingly squeezed by the high cost of living, she said. Taylor said she's seeing more and more investors concerned about their taxes. In a Feb. 12 Monmouth University poll, 45 percent of residents said property taxes were the most important issue facing the state.

"The folks that are subject to this millionaires' tax have options," she said. "They'll figure out a way to avoid the tax or declare residency in another state."

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— *With assistance by Martin Z Braun, and Elise Young*