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Blue States Warned of a SALT Apocalypse. It Hasn't Happened.

- **California, New York, Illinois income tax revenue rebounds**
- **Softer housing market in New York City suburbs may be warning**

To listen to New York Governor Andrew Cuomo, the 2017 Republican tax overhaul that limited state and local deductions to $10,000 was a devastating blow. The rich would flee, the middle class would suffer and blue state budgets would bleed.

Perhaps this will come to pass over time, but so far, there are almost no signs of it.

New York, in fact, saw revenue rise $3.7 billion in April from a year earlier, thanks to a shift in timing of taxpayer payments, a stock market that rallied through much of 2018 and a decade-long economic expansion that's pushed national unemployment to a 50-year low. Similar windfalls arrived in New Jersey, California and Illinois — states that, like New York, had warned of dire consequences from the law.

And it turns out that tax refunds across the U.S. in 2019 — those once-a-year checks from Uncle Sam that people use to pay credit card debt from Christmas or buy a washing machine — were roughly the same size as a year earlier. In all, about 64% of American households paid less in individual income tax for 2018 than they would have had the Tax Cut and Jobs Act not become law, according to the Urban-Brookings Tax Policy Center.

"Any comment that says this is an economic civil war that would gut the middle class is overblown," said Kim Rueben, the director of the State and Local Finance Initiative at the Tax Policy Center. "If there's going to be any effect of the SALT limit on the ability of some states to have progressive taxes it's too early to know that yet."

Read more: SALT Cap Will Leave About 10.9 Million People Feeling Tax Pain

Taxable Income

In some ways, the $10,000 limit on state and local tax deductions — SALT — is saving states money by lowering their borrowing costs. That's because investors seeking to reduce their tax bill are plowing a record-setting amount of cash into municipal bonds, driving interest rates lower. The extra yield that investors demand to compensate for the risk of holding Illinois general-obligation bonds, for instance, has fallen to the lowest since May 2015, according to data compiled by Bloomberg.

States are also benefiting from a broader tax base because the law eliminated some exemptions and limited deductions, like mortgage interest. Since states that levy income taxes use federal adjusted gross income or taxable income as the base, they have more income to tax.

Still, the nerves of Democratic governors and their budget officers frayed in December when income tax collections plunged by more than 30 percent from the prior December. Cuomo was quick to call the tax law “politically diabolical” and an act of “economic civil war” against the middle class.

Then April came.

New York collected $3.4 billion more in personal income tax revenue last month than a year earlier, a 57% increase, according to Comptroller Thomas DiNapoli. California took in $19.2 billion in April, exceeding Governor Gavin Newsom’s estimate by $4 billion.

New Jersey had a record April with tax collections up 57%, allowing it to boost forecasts for the year by $377 million and triggering a political battle over how to spend the windfall. Illinois individual and corporate tax revenue was $1.5 billion more than projected, allowing Governor J.B. Pritzker to scrap a plan to put off pension payments.

Timing Change

April personal income tax collections in 28 states and Washington increased by $16.3 billion, or 36.2% year-over-year to $61.4 billion, Bank of America Corp. said.

“SALT caps do not appear to be a broad system risk to state credit quality at this point,” S&P Global Ratings said recently.

A big reason for the sharp bounce-back after December’s deep revenue declines in New York and other high-tax states: The SALT limits caused some people to change when they paid their taxes. Wealthy taxpayers in December 2017 accelerated big tax payments to take advantage of the unlimited state and local tax deduction before it expired. Then, with the SALT deduction capped, that incentive evaporated and taxpayers waited until this April to pay their 2018 taxes.

Also, some individuals failed to adjust their W-4s after the passage of the tax law. So people who underwithheld received more in their paychecks since then but had to pay more tax in April or received lower refunds.

Trending Inline

Still, there are some indications that residents in high-tax states are fretting about the law. Thirteen percent of house-hunters in both New York and California said they have started looking for homes in states with lower taxes, according to a recent survey by brokerage Redfin Corp.

In Westchester County, where a typical property tax bill for a single family home is more than $17,000, the average sales price declined 7.6% between the first quarter of 2018 and the same quarter this year. Sales prices for luxury homes (average price $2 million) plummeted 22% during the same period, according to appraiser Miller Samuel Inc. and brokerage Douglas Elliman Real Estate.

Almost half of income taxes paid to California, New York and New Jersey are from the wealthiest 1% of earners. If they were to move in large enough numbers, those states could be in trouble. New York, New Jersey, Connecticut and Maryland sued the Trump administration last year to invalidate the $10,000 cap, saying that it unfairly targets them. States have sought to pass loopholes around the limit and there’s a push in Congress to reverse it.

But migration rates in high tax states most affected by SALT are below pre-recession levels, and generally in-line with U.S trends, Moody’s Investors Service said in April. Jobs, housing and the weather influence migration more than taxes, according to Moody’s analyst Marcia Van Wagner.

“Armageddon hasn’t resulted from the changes to SALT, but it still may be too early to measure its impact,” said Matt Dalton, chief executive officer of Rye Brook, New York-based Belle Haven Investments, which manages $9 billion of municipal bonds. “You see more mansions listed in New York. Manhattan real estate sales just had their worst quarter in a decade.”

Read more: Trump SALT Change Isn’t Causing People to Flee New York: Moody’s

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— With assistance by Patrick Clark