Is the SALT Cap Promoting Tax Flight?

An Econometric Analysis of Changes in Interstate Migration Patterns in Response to State and Local Taxation Since the Enactment of the 2017 Tax Cuts and Jobs Act

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1 Introduction

In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA), which includes a provision limiting the state and local taxes (SALT) deduction one can claim in their federal tax return to $10,000. The SALT deduction was included in the original federal tax code to mitigate the "double taxation" people would face if they lived in a high tax state and now had to pay federal taxes as well. This deduction enabled them to reduce their taxable income by the amount of either annual property and state income taxes paid or sales taxes they paid in a year. And now, with the cap in place, there has been an increase in outmigration from high-tax states. The question that this paper aims to answer is whether the SALT cap is causing this increase in outmigration or if there are other factors driving this exodus.

2 Objective

The objective of this paper is to create a model that determines whether the enhanced financial burden the state and local tax deduction cap of $10,000 has on higher-income taxpayers is causally influencing net interstate migration rates or if underlying factors correlated with higher tax rates are driving this exodus from high tax states.

3 Methodology

Ordinary least squares, fixed effects, and random effects models were constructed using panel data in each state in each year from 2013 to 2022. Most control variables are lagged by one year since it takes time to arrange to move to a different state. The tax rate variables are not, however, because tax policy changes are not enacted until the following year the bill is passed. The data was sourced from the US Census, the Tax Foundation, the National Centers of Environmental Information, the FBI, and the Bureau of Economic Analysis. 2020 and 2021 are omitted due to data availability issues that stemmed from the pandemic.

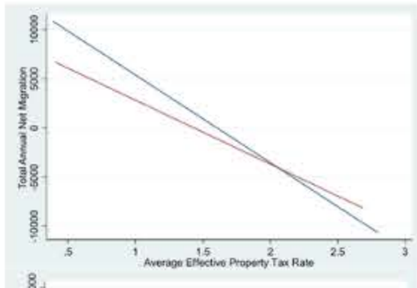
$$NetMigration_{it} = \beta_0 + \beta_1 TopMTR_{it} + \delta_1 TCJA_t * TopMTR_{it} + \beta_2 SalesTax_{it} + \delta_2 d2TCJA_t * SalesTax_{it} + \beta_3 PropertyTax_{it} + \beta_4 ViolentCrime_{it-1} + \beta_5 AvgTemp_{it} + \beta_6 CostOfLiving_{it-1} + \beta_7 WrkFrmHome_{it-1} + \beta_8 Educ_{it-1} + \beta_9 MedianAge_{it} + \beta_{10} Contig_i + u_{it} + a_i$$

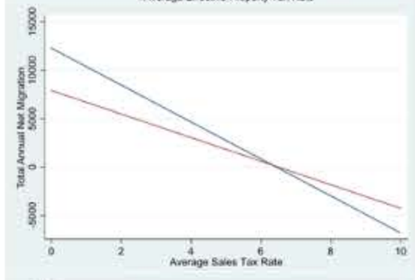
4 Summary Statistics and Regression Results

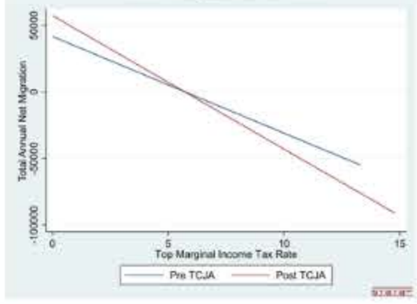
Variable	Obs	Mean	Std. dev.	Min	Max
NetMigration	405	0	53809.43	-339746	242920
TopMTR	405	5.726074	3.390141	0	14.78
TCJATopMTR	405	2.143852	3.498192	0	14.78
SalesTax	405	6.462034	2.339024	0	10.02
TCJASalesTax	405	2.438799	3.486186	0	10.02
PropertyTax	405	1.54137	0.53607	0.389997	2.799102
TCJAProperty	405	0.538882	0.766398	0	2.686055
AvgMTR	405	4.751061	2.611572	0	11.40804
TCJAAvgMTR	405	1.835642	2.903011	0	11.40804
StSales	405	5.118938	1.92713	0	7.5
TCJAStSales	405	1.913259	2.744738	0	7.25
ViolentCrime	405	0.379149	0.177585	0.10259	1.296389
AvgTemp	405	53.03926	8.557315	28.6	73.4
CostOfLiving	405	92.8379	25.27171	56.145	164.992
WrkFrmHom	405	6.20642	4.631923	1.9	48.3
Educ	405	30.97852	6.493951	18.6	63
MedianAge	405	38.41407	2.401799	30.2	45.1
Contig	405	0.034568	0.182909	0	1

	(1)	(2)	(3)
VARIABLES	OLS	FE	RE
TopMTR	-7,991***	-421.9	-5,662***
	(698.4)	(2,176)	(1,219)
TCJAMTR	-2,684***	-2,068***	-2,034***
	(934.5)	(477.9)	(460.0)
SalesTax	-5,114***	-4,982	-5,459***
	(1,062)	(3,097)	(1,896)
TCJASalesTax	502.9	1,163**	1,175**
	(917.0)	(498.1)	(490.4)
PropertyTax	-22,351***	-34,613***	-25,852***
	(4,293)	(9,080)	(6,566)
ViolentCrime_1	-73,738***	-50,981**	-57,138***
	(12,938)	(21,663)	(17,869)
AvgTemp	2,408***	-601.1	1,117**
	(256.3)	(745.6)	(467.9)
CostOfLiving_1	-1,135***	-856.9***	-858.5***
	(117.4)	(293.2)	(186.3)
WrkFrmHom_1	-448.8	-1,229***	-904.9***
	(515.7)	(335.0)	(306.4)
Educ_1	3,155***	2,901**	1,520**
	(505.6)	(1,254)	(728.3)
MedianAge	1,722*	-7,128**	-1,443
	(902.2)	(3,062)	(1,652)
Contig	18,720		-4,279
	(11,843)		(25,954)
Constant	-38,327	411,884***	165,333**
	(39,745)	(126,944)	(73,061)
Observations	405	405	405
R-squared	0.545	0.173	
Number of Id		51	51
Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			

	(1)	(2)	(3)
VARIABLES	OLS	FE	RE
SalesTax	-4,553***	-1,248	-4,213**
	(1,108)	(3,142)	(1,906)
TCJASalesTax	-864.9	-283.5	-462.0
	(1,234)	(623.4)	(621.5)
PropertyTax	-22,083***	-46,516***	-29,769***
	(4,625)	(8,910)	(6,587)
TCJAProperty	-2,637	1,895	1,571
	(5,248)	(2,721)	(2,687)
TopMTR	-9,044***	-2,710	-6,892***
	(599.8)	(2,179)	(1,198)
ViolentCrime_1	-73,408***	-46,262**	-54,690***
	(13,074)	(22,242)	(18,220)
AvgTemp	2,372***	-263.4	1,065**
	(258.7)	(777.3)	(471.6)
CostOfLiving_1	-1,132***	-772.9**	-736.5***
	(119.4)	(314.7)	(194.4)
WrkFrmHom_1	-707.4	-1,126***	-996.7***
	(515.3)	(357.0)	(319.9)
Educ_1	3,159***	1,032	924.4
	(514.2)	(1,278)	(751.3)
MedianAge	1,735*	-8,427***	-1,594
	(912.6)	(3,128)	(1,663)
Contig	18,057		-9,790
	(12,004)		(25,869)
Constant	-34,906	496,965***	184,622**
	(40,152)	(128,709)	(73,275)
Observations	405	405	405
R-squared	0.536	0.129	
Number of Id		51	51
Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			







5 Main Results and Discussion

The main results of these regressions show that, while the impact of property and sales tax on interstate migration has not changed much since the TCJA was enacted, the deterrent effect of income tax has been enhanced by a statistically significant margin. The Hausman test determined fixed effects to be the most suitable model for this dataset. Based on that model, the top marginal income tax rate previously had no effect on net interstate migration. However, under the TCJA, a 1% hike in the top marginal income tax rate within a state decreases interstate migration by an average of 2,068 people annually. This result is statistically significant at the 1% level. Based on the scales of the variables, the models constructed suggest violent crime and cost of living still have the strongest deterrent effects on interstate migration. Variable specification analysis was performed for robustness and yielded similar results. The Breusch-Pagan test for heteroskedasticity was also performed, and variance inflation factors were calculated to determine collinearity. Neither model is statistically heteroskedastic, but there is moderate collinearity between TCJA*Property and TCJA*SalesTax in the second model. This suggests that, since 2018, states with higher sales tax rates tend to have higher property tax rates. Moreover, people are choosing to move out of states with higher income tax rates, even if it means they will have to live in a state with higher property and sales tax rates.

6 Conclusion

With the TCJA set to expire in 2025, this result may be something for policymakers to consider in determining whether to repeal, modify, or retain the SALT cap. If the cap is repealed, further research can be performed on this topic to more decisively determine if the SALT cap is the driving causal factor behind the newfound enhanced deterrent effect of income tax rates on interstate migration or if the regressions are capturing the long-term changes to migration trends caused by the pandemic, given that a much greater number of people work from home now. Additionally, researchers can look into how the exodus of people from high-tax states is impacting the efficacy of state-funded programs or if this effect is offset by the reduction in population.

Related literature
Cohen, Lai, and Steindel (2014) , Gius (2009), Clark and Hunter (1992), Okamoto (2019), Dickey and Magante (2024)