

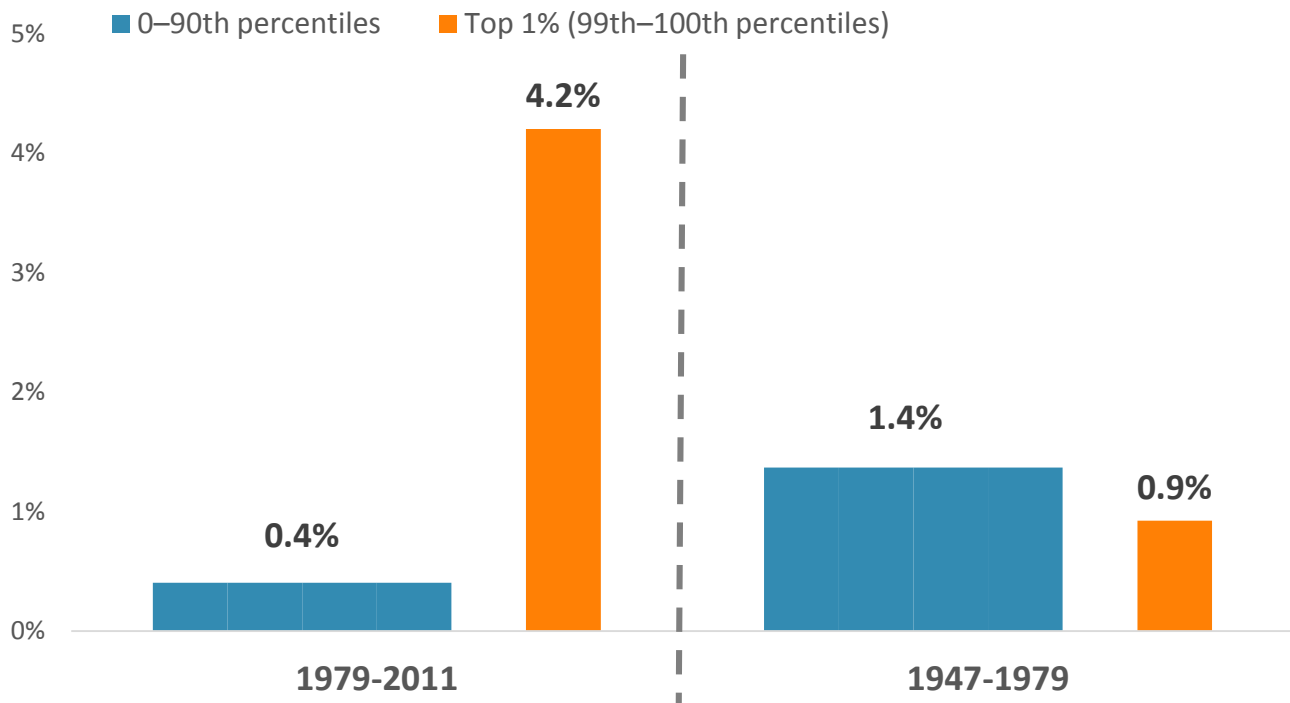
Funding Improvements for Schools, Roads, and Public Transit with Tax Reforms that Improve Fairness

We can expand opportunity for our people and strengthen our economy by making smart investments to improve our schools; make our colleges and universities affordable; and build a transportation system that gets families, students, workers and customers to the places they need to be. There are fair and effective ways that we could pay for these investments. This fact sheet examines one option.

Since the late 1970s, the incomes of most Massachusetts households have increased very little while the benefits of economic growth have gone disproportionately to the very highest income households in Massachusetts. From 1979 through 2011, incomes of the Top 1% in Massachusetts grew ten times faster on an annual basis than incomes of households in the Bottom 90% (see chart, below). These highest income households captured just under half of *all* income growth in Massachusetts during this period, well more than tripling their average real annual incomes. This is a change from the decades immediately following WWII. In that period, the benefits of economic growth were broadly shared, as the chart and table below show.

Growing Inequality Replacing Broadly Shared Prosperity

Annual growth rate of average income, by MA income group, in two periods ('47-'79 and '79-'11)



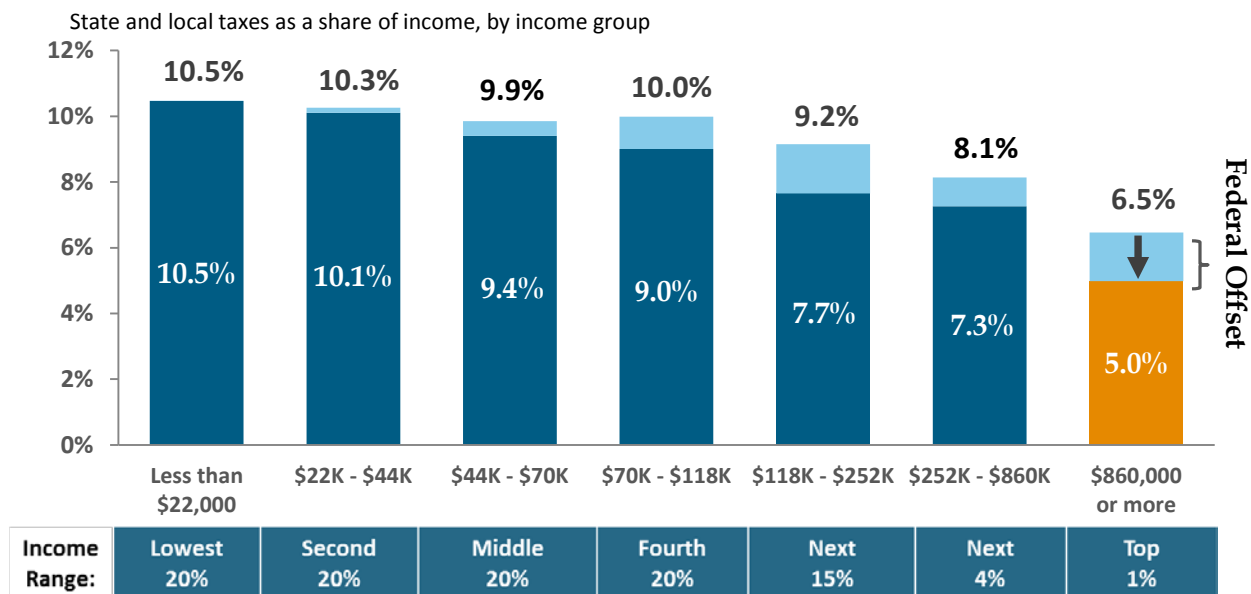
Source: Sommeiller & Price, analysis of IRS state-level SOI data and Piketty and Saez top income data set

Compound Annual Growth Rate of Income		
Income Group	1947-1979	1979-2011
0–90th percentiles	1.4%	0.4%
0-99th percentiles	1.6%	0.9%
90th–95th percentiles	2.6%	1.4%
95th–99th percentiles	2.0%	2.1%
Top 10% (90th–100th percentiles)	1.8%	2.6%
Top 1% (99th–100th percentiles)	0.9%	4.2%

Data Source: Sommeiller & Price analysis, using state-level IRS SOI data and Piketty & Saez top incomes data set

Our economic growth is not translating into significant economic progress for most of our people and this directly harms working families. The lack of more broadly shared economic progress also has harmed our state’s ability to make important investments that can make life better for working people. The highest income residents in Massachusetts, who have captured so much of the gains from our state’s economic growth over the last several decades, actually pay a smaller share of their income in state and local taxes than the rest of the population (see chart, below, and MassBudget’s factsheet, [Examining Tax Fairness](#)). When a large share of total income growth goes to the group that contributes the smallest share of their income in taxes, this means tax collections suffer – we wind up with less revenue to invest in schools, colleges, roads, bridges, buses and trains. (Note: The “federal offset” - shown in the chart below - further reduces tax levels, particularly for higher income filers. A detailed discussion of the federal offset follows, below.)

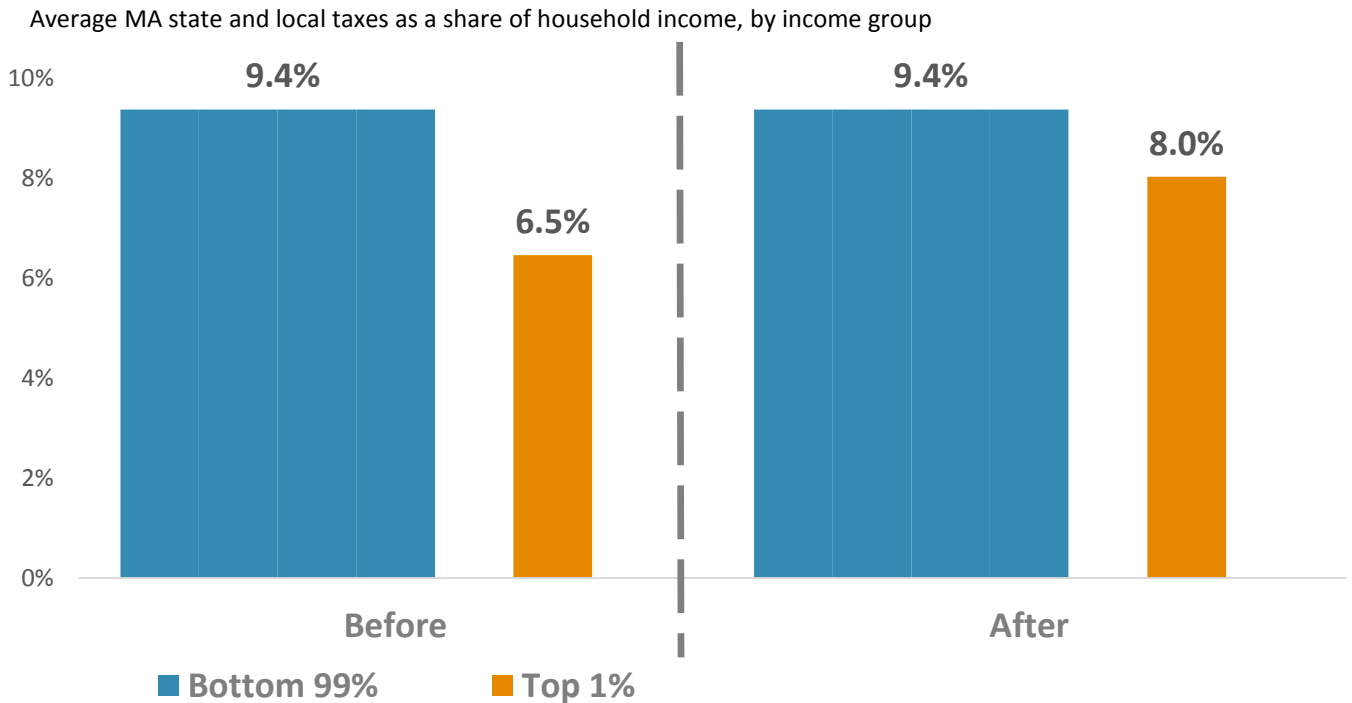
Top 1% Pay Smallest Share of Income in State and Local Taxes (Federal Offset further Reduces Their Taxes)



Sources: Distributional analysis from Institute for Taxation and Economic Policy. All taxpayers, 2012 incomes, 2015 tax laws.

Under a recently proposed change to our tax laws, the state’s highest income households would pay something closer to the share of their income paid by other Massachusetts households (see chart, below). This would generate new revenue to improve public schools, reduce college costs, repair roads and bridges, and fix our public transit systems.

Effects of Addt'l 4% Tax On Income Over \$1 M on Taxes as Share of Income



Source: Institute on Taxation and Economic Policy. All taxpayers, 2012 income levels and 2015 tax law

The proposed change would tax income above \$1 million at a higher rate than income under \$1 million. Income over the \$1 million threshold would be subject to an additional 4.0 percent tax. The \$1 million threshold would apply uniformly to single filers, head of household filers and married couples filing jointly, and would be indexed to inflation. ¹ The Massachusetts Department of Revenue (DOR) estimates that this reform would generate about \$1.9 billion in new revenue annually in 2019, the first tax year in which the proposal would be implemented (this 2019 estimate translates into the equivalent of about \$1.7 billion in today’s dollars). ² DOR estimates that the increase would affect about half of one percent of all filers.

By definition, this change - which would require amending the state constitution - would affect only those households with taxable incomes above \$1 million and would only affect the *portion* of their taxable income that exceeds the \$1 million threshold. For example, a household with \$1,250,000 of taxable income would pay the additional tax only on the top \$250,000 of this total taxable income. As a result, the *overall* tax rate paid by these high income households on their *total* taxable income (also called their “effective tax rate”) would rise gradually with increasing income (see table, below). Continuing the example from above, the effective income tax rate on the total \$1,250,000 would be 5.8 percent: a 5 percent rate applied to the full \$1,250,000 combined with an additional 4.0 percent rate applied just to the \$250,000 of income that exceeds the \$1 million threshold.

Importantly, *state and local* income and property taxes can be deducted from a filer’s *federal* income when determining a filer’s final *taxable* federal income, a feature known as the “federal offset”.³ As a result, these state and local taxes can reduce the federal taxes a filer owes. For high income households, federal taxes typically are reduced by an amount equal to about a third of the state and local income and property taxes these households have paid (the federal offset is a deduction that primarily benefits upper income households).⁴ As a result, the *state-level* tax increase produced by the Fair Share Amendment would reduce *federal* taxes for most high income filers.

Taking the federal offset into account, we see that high income households – even those with very high incomes – would not be paying especially high effective state income tax rates. Using the same example from above - but taking the federal offset into account - a household with taxable income of \$1,250,000 would have an effective state income tax rate of about 3.4 percent under this proposal (see table, below); the federal offset would reduce this household’s federal taxes by more than \$24,000. A household with \$5 million of taxable income would have an effective state income tax rate of 5.5 percent, with the federal offset reducing this household’s federal taxes by more than \$135,000.

Effective State Income Tax Rates (ETR) with 4% Addt'l Tax on Income over \$1 Million		
Taxable Income (\$s)	ETR before federal offset	ETR including federal offset
1,000,000	5.0%	3.4%
1,250,000	5.8%	3.9%
1,500,000	6.3%	4.2%
2,000,000	7.0%	4.7%
2,500,000	7.4%	5.0%
3,000,000	7.7%	5.1%
4,000,000	8.0%	5.4%
5,000,000	8.2%	5.5%

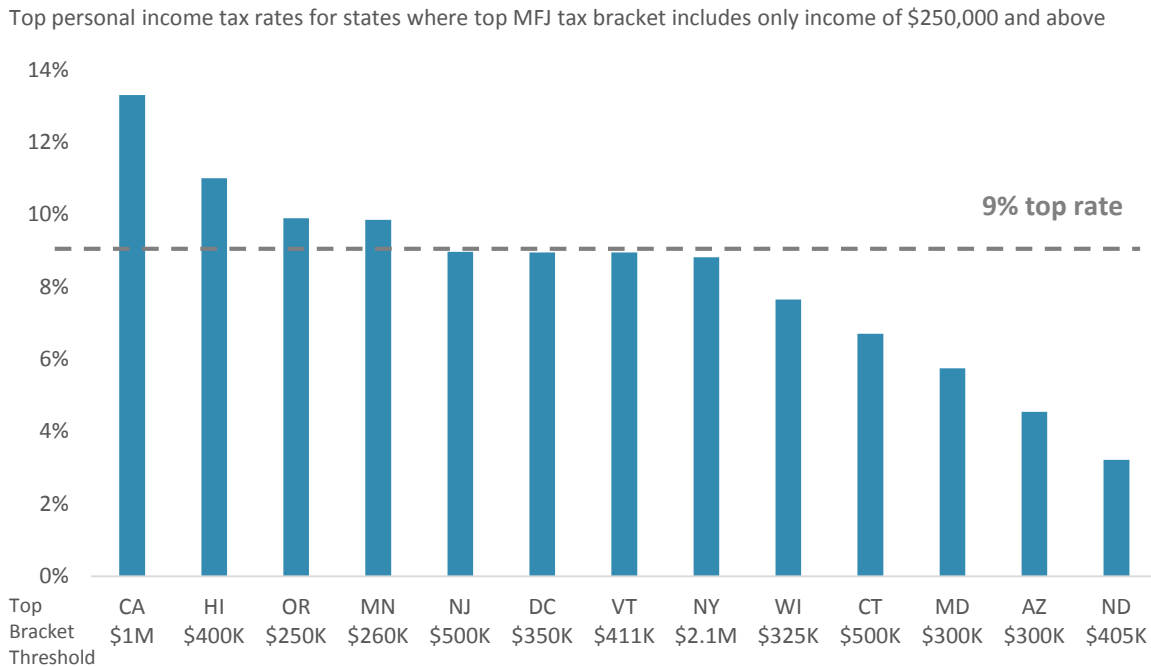
Source: MassBudget calculations based on Institute on Taxation and Economic Policy distributional analysis

It is worth noting that evidence from states across the nation shows that tax increases on top income households produce substantial new revenue to fund key public priorities,⁵ while having little to no impact on the residence decisions of these households.⁶ Large numbers of wealthy households have not packed up and fled from states that *have* raised taxes in order to move to states that have *not*. Moreover, a half-century of research has confirmed the value of targeted investments in education and the many positive effects such investments have on individuals, the overall workforce and a state’s economy.⁷ Research into the broader effects of targeted transportation investments likewise reveals how essential these systems are to creating a successful state economy.⁸

One way to pay for these investments is with tax reforms that, as has been proposed, would require the state’s highest income households - those households that have benefitted the most during the last several decades and that now have lower tax levels than the rest of us – to pay an additional tax on the share of their income that exceeds \$1 million a year.

Massachusetts is among just eight states with flat income tax structures. (Nine states levy no broad-based income tax.). Of the 41 states that tax personal income, 33 tax higher incomes at higher rates. Of these 33 states there are 12 states and the District of Columbia that have a high-income top tax bracket that includes only income of \$250,000 or higher (for married joint filers). Eight of these apply a top tax rate close to or above 9 percent on high incomes. With a top rate of 9 percent, Massachusetts would tax very high income taxpayers at rates similar to or lower than these eight (see chart below). Notably, most of these eight have high per capita incomes and high per capita GDPs, as does Massachusetts.

Most States With Higher Rates on Incomes Over \$250,000 Have Top Rates Close to 9%



¹ The million dollar threshold would be indexed to inflation, resulting in regular upward adjustments to the actual threshold figure.

² [Highlights from DOR analysis of the Education and Transportation Amendment proposal](#)

³ Institute on Taxation and Economic Policy, *A Primer on the "Federal Offset"*, August 2011: http://itep.org/itep_reports/2011/08/how-state-tax-changes-affect-your-federal-taxes-a-primer-on-the-federal-offset.php

⁴ Institute on Taxation and Economic Policy, *Who Pays*, 5th Edition, January 2015: <http://www.itep.org/whopays/> Because the federal offset is a deduction from taxable income, its value to filers differs depending on the top tax rate paid by that filer. In the federal system, tax rates increase as a filer's taxable income rises. For the highest income filers, the top rate on wage and salary income stands at 39.6%, applied to income above approximately \$400,000 (see IRS 2014 Tax tables, pg. 88: <http://www.irs.gov/pub/irs-pdf/i1040tt.pdf>). Thus, a high-income filer who pays \$1,000 more in state taxes will deduct that \$1,000 from her federal taxable income – she will not be taxed on this income. This will reduce her federal tax by as much as \$396 if she is in the highest tax bracket (\$1,000 * 39.6% = \$396). Capital gains income – as opposed to wage and salary income – is taxed at anywhere from 0 percent to 20 percent. The benefit from the federal offset, as related to capital gains income, thus will be lower than for most wage and salary income.

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- ⁵ Political Economy Research Institute, *Raising Revenue from High-Income Households*, March 2012: http://www.peri.umass.edu/fileadmin/pdf/published_study/Revenue_PERI_March5.pdf
- Young & Varner, et al, *Millionaire Migration and the Taxation of the Elite*, October 2015, forthcoming in the *American Sociological Review*
- ⁶ Center on Budget and Policy Priorities, *State 'Income Migration' Claims Are Deeply Flawed*, October 2014: <http://www.cbpp.org/research/state-income-migration-claims-are-deeply-flawed>
- ⁷ MassBudget and the Economic Policy Institute, *A Well-Educated Workforce Is Key to State Prosperity*, August 2013: http://www.massbudget.org/report_window.php?loc=education_wages_epi.html
- ⁸ Political Economy Research Institute, *Prioritizing Approaches to Economic Development in New England*, August 2010: <http://www.peri.umass.edu/236/hash/3f1bd7d2221409d39332894e8e2e0c72/publication/422/>
- Alicia H. Munnell, "Infrastructure Investment and Economic Growth," *Journal of Economic Perspectives*, Vol. 6, No. 4, Fall 1992: <https://www.aeaweb.org/articles.php?doi=10.1257/jep.6.4.189>