Examining Tax Fairness

Please note: this report does not reflect the 2018 changes to the federal tax law.

Taxes are the primary way we pay for the things that we do together through government. These include things like police and fire protection; public education; roads, bridges and public transportation; a safety net for when people face hard times; and more. Determining how much people at different income levels pay in taxes is important when considering the fairness of tax policy changes. While most taxes in Massachusetts have a fixed rate—for example, the state has a flat 5.15 percent income tax—different income groups are affected differently by each tax. These differences can be explained in terms of regressivity and progressivity—how taxes vary by income level.

Proportional or "Flat" Taxes

A tax is proportional (or "flat") if the same tax rate is applied to all income levels. A flat income tax, with no deductions or exemptions, would collect the same proportion of each filer's income, regardless of income level.

Progressive Taxes

A tax is progressive if the share of income people pay in that tax increases as their income rises. Progressive taxes shift taxes away from those with the least ability to pay and onto people with higher incomes.

Regressive Taxes

A tax is regressive if the share of income paid in that tax increases as income declines. Regressive taxes ask those with the least to contribute the most as a share of their income.

TAX FAIRNESS IN MASSACHUSETTS

A tax system typically is composed of a variety of different types of taxes. Usually, the system will include some taxes that are progressive and some that are regressive. Regressive taxes sometimes meet other criteria of a good tax, such as enhancing stability of the overall tax system, and thus may be a valuable part of the overall system. When considering progressivity and regressivity, it therefore is important to examine not just individual taxes, but rather the overall tax system in a state.

As the chart below shows, overall, the Massachusetts tax system is regressive, collecting a larger share of household income from lower-income households than it does from upper-income households. This is primarily due to the property tax and the sales tax, each of which has the effect of taxing lower-income people at significantly higher rates than higher income people. (For more information on the property tax, see the property tax chapter of MassBudget’s tax primer. For more information on the sales tax see MassBudget’s Sales Tax Fact Sheet.)
The one major tax in the Massachusetts tax system that reduces somewhat the regressivity of the overall system is the personal income tax. The Massachusetts personal income tax is progressive in its effect even though there is a flat income tax rate in Massachusetts. This is due to a number of progressive features of the personal income tax, including a provision that exempts very low income filers from paying the income tax; a relatively large personal exemption for which all filers are automatically eligible; and a state-level Earned Income Tax Credit. For more information on the features of the state income tax that makes it progressive, see MassBudget's Income Tax Fact Sheet.

The state system is even more regressive if we take into account the effect of the "federal offset," which allows taxpayers to deduct their state income taxes when calculating their federal taxable income. This deduction reduces the federal tax liability of filers paying state-level income taxes (for more, see MassBudget's factsheet on The Effects of Raising Rates and Exemptions.)

The value of the deduction depends on the amount of state-level income tax a filer has paid; the mix of income a filer reports (investment vs. wage and salary income); and the top marginal rate at which a filer pays federal taxes. For high-income filers who are paying federal taxes at the 39.6 percent rate on a portion of their income, this deduction can be very valuable. For most low and moderate income households, however, this deduction provides little if any benefit (see chart, above).
TOP 1% PAYING LESS OF INCOME IN TAXES THAN OTHER 99% COSTS $2.2 B

The current regressivity of the system would be eliminated if all income groups paid the same share of their household income in taxes – in other words, if the system was “flattened.” The chart below shows how tax levels would change for people at different income levels if everyone paid taxes at the same effective rate (adding together sales taxes, income taxes, property taxes, gas taxes and all other taxes), which, when averaged across income groups, is about 9.7 percent overall.

As we see in the chart below, the highest income one percent of taxpayers currently are paying, on average, approximately $85,000 a year less per household than they would pay if they were taxed at the average rate paid by all taxpayers (about 9.7 percent). The loss of these tax dollars from these top income households costs the Commonwealth over $2.2 billion a year.

Lowest Tax Levels for Those with Highest Incomes Results in Large Revenue Losses

Source: Institute for Taxation and Economic Policy.