Massachusetts Budget and Policy Center

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FACTS AT A GLANCE

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The Sales Tax

Massachusetts has a general sales tax of 5 percent, with exemptions for food and clothing purchases under $175. The sales tax is the second-largest source of tax revenue for the state, and is projected to generate just over $4 billion in the coming fiscal year. Of the 45 states that have a general sales tax, Massachusetts ranks last in terms of the revenue the sales tax raises as a percentage of personal income.

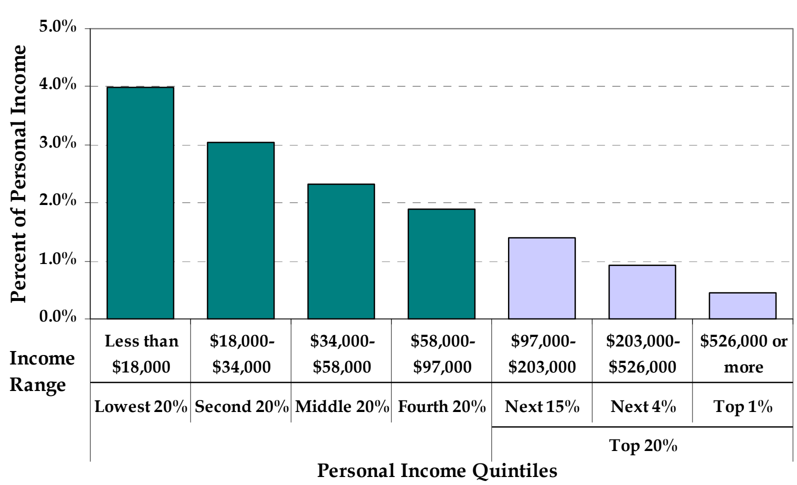
WHAT WOULD BE THE REVENUE EFFECT OF A SALES TAX CHANGE?

If the state were to increase the sales tax from 5 percent to 6 percent, it would increase state revenue by approximately $800 million a year. However, because the sales tax has not kept up with changes in the economy, the revenue raised by such an increase would likely decline over time as a share of the economy. As more people shop online, where it is difficult to collect the sales tax, and as more economic activity shifts to the service sector, which is not subject to the sales tax, Massachusetts loses revenue that it had been collecting through this tax.

IS THE SALES TAX REGRESSIVE OR PROGRESSIVE?

As the chart below demonstrates, the general sales tax is very regressive – that is, low- and middle-income people pay a much higher percentage of their income towards it than higher-income people do. The chart below shows that those at the 80th percentile of income and above contribute less than half as much to the sales tax, as a percentage of their income, than the lowest income earners in the state. Similarly, those earning between $34,000 and $58,000 contribute twice as much to the sales tax, again as a percentage of their income, as do income earners in the top 5 percent. An increase in the sales tax would therefore hit low and middle-income people harder than high-income people.

Distribution of Personal Income Dedicated to State Sales Tax in Massachusetts, 2006



Source: Institute for Taxation and Economic Policy

ADDRESSING THE REGRESSIVITY OF THE SALES TAX

Although low-income people pay a relatively large share of their incomes in sales taxes, because their earnings are low the actual dollar amount of taxes collected from them is not large. The bottom 20 percent of income earners would pay, on average, $70 more towards the sales tax if that tax were raised by a penny. Therefore the total sales tax increase for the 611,000 taxpayers in that quintile would be about $43 million, or about 5 percent of the total revenue generated. This means that the regressive effects of a sales tax increase on the lowest earning quintile could be minimized without having a large effect on the amount of revenue created by the increase.

WHAT ARE THE OPTIONS FOR SALES TAX MITIGATION?

To reduce the regressivity of the sales tax, the state could expand existing programs designed to help low-income residents, or it could adopt new tax mitigation policies:

Expand the EITC: The state could expand its Earned Income Tax Credit (EITC) program, which encourages work for low-income earners. The EITC, which currently provides 15 percent of the federal benefit,[1] could be increased to 25 percent. With such a change, the maximum credit would provide approximately $1,200 to eligible low-income workers. Increasing the EITC would affect more than 300,000 Massachusetts residents and would cost approximately $60 million. The benefits of expanding the EITC are providing relief to some low-income families through an existing tax program so attendant administrative costs would be minor. The downside to expanding the EITC to mitigate the effects of the sales tax is that it would not help those low-income residents, such as the elderly or unemployed, who do not meet the earned income requirement.

Expand the Property Tax Circuit Breaker: The state could expand the property tax circuit breaker to all residents (not just those over 65) whose property tax bill exceeds 10 percent of their income. Such a tax credit would affect approximately 125,000 residents and the cost would be determined by the amount of the credit. If the credit were set at a maximum of $350, it would cost an estimated $45 million. Unlike the EITC, this option would not be limited to residents meeting earned income requirements.[2]

Create a New Low-Income Tax Credit: The state could provide a new low-income tax credit. If the state were to raise its sales tax to 6 percent, someone in the lowest income quintile would pay approximately $70 dollars more over the course of the year. To offset this increase, the state could provide a refundable tax credit of between $30 and $90 dollars depending on family status and income. If fully taken advantage of, such a credit could largely negate the regressive nature of the tax increase on low-income households. The cost of this credit would vary depending on how many people used it, but assuming a 100 percent participation rate and a maximum eligible income level of $38,000, this would cost approximately $65 million.

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[1] For more information on the state's Earned Income Credit see MassBudget's report: "Following Through on Welfare Reform: How Savings Could Support Lower-Income Working Families" available online at: http://www.massbudget.org/documentsearch/findDocument?doc_id=584

[2] For more information on the state's Property Tax Circuit Breaker see MassBudget's report: "Property Taxes: Helping Those Who Need it Most," available online at: http://www.massbudget.org/documentsearch/findDocument?doc_id=596