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Possible Reforms to the Governor's Tax Plan

In his FY 2014 budget, the Governor proposes making significant new investments in education and transportation, as well as limiting cuts to other program areas. He proposes paying for these investments with a tax increase, one that would raise an estimated $1.9 billion in new, annual revenue and would do so in a progressive manner (i.e., most of the additional revenue would come from higher income households). The net revenue gain ($1.9 billion) would be the combined result of some half-dozen specific sets of tax code changes that together compose the Governor's overall tax package.

Various elements of the Governor's proposal could be changed in ways that would raise the same amount of revenue in a similarly fair way. To illustrate this point, in this Facts At A Glance we provide examples of four such alternatives, based on the Governor's actual tax proposal.

FOUR ALTERNATIVES

In each of the examples that follow, the general structure of the Governor's actual tax package proposal is maintained: the personal income tax rate is raised from its current 5.25 percent, while the general sales tax rate is lowered from its current 6.25 percent.[1] Unlike the Governor's proposal, each of the four examples below maintains, as a continuing part of the tax code, all of the 40-plus personal income tax breaks the Governor has recommended eliminating. In each of the four alternatives, we adjust the various parameters such that the total net gain in annual revenue roughly matches the $1.9 billion that would be raised under the Governor's proposal. The specifics of each alternative are as follows (see also the summary table, below):

- **Governor's Proposal**: The tax rate on all income is set at 6.25 percent while the sales tax rate is lowered to 4.50 percent. Forty-plus personal income tax breaks are eliminated, while the personal exemption is doubled, to $8,800 for single filers (S) and $17,600 for married couples filing jointly (MFJ).
- **Alternative 1**: Like the Governor's proposal, the tax rate on all income is set at 6.25 percent and the personal exemption is doubled. Unlike the Governor's proposal, the sales tax rate is lowered to 5.90 percent (rather than to 4.50 percent), and no personal income tax breaks are eliminated.
- **Alternative 2**: The tax rate on *most* income is raised to 6.25 percent (similar to the Governor's proposal) and, like the Governor has proposed, the personal exemption is doubled. The tax rate on short-term capital gains, however, is left at its current 12 percent rate, rather than being reduced to 6.25 percent as proposed by the Governor. (Continuing to tax this type of income at 12 percent maintains approximately $100 million in personal income tax revenue that otherwise is lost under the Governor's

[1] In each example—just as the Governor has proposed—the sales tax exemption for candy and soda is eliminated; cigarette and tobacco taxes are increased; sales taxes are applied to certain computer services; clarifications of the corporate tax code are made; and several corporate tax breaks are capped or eliminated. (For a detailed discussion of the Governor's tax proposal, see this MassBudget *Brief*: http://massbudget.org/report_window.php?loc=revenue_gov_14.html)

proposal.) Also unlike the Governor's proposal, the sales tax rate is lowered to 5.75 percent and no personal income tax breaks are eliminated.

- **Alternative 3**: Like the Governor's proposal, the tax rate on all income is set at 6.25 percent. Unlike the Governor's proposal, the sales tax rate is lowered to 5.25 percent, no personal income tax breaks are eliminated, and the personal exemption is raised to just half again its current value ($6,600 (S)/$13,200 (MFJ)).
- **Alternative 4**: The tax rate on *most* income is raised to 6.25 percent (similar to the Governor's proposal). The tax rate on short-term capital gains, however, is left at its current 12 percent rate, rather than being reduced to 6.25 percent as proposed by the Governor. Like the Governor's proposal, the sales tax rate is lowered to 4.50 percent. Unlike the Governor's proposal, no personal income tax breaks are eliminated and the personal exemption remains at its current value ($4,400 (S)/$8,800 (MFJ)).

FY2014 Tax Package Options	Governor's Proposal	Alt. 1	Alt. 2	Alt. 3	Alt. 4
Personal Income					
Tax Rate	6.25%	6.25%	6.25%	6.25%	6.25%
Tax Rate on Short-Term Capital Gains	6.25%	6.25%	12.00%	6.25%	12.00%
Eliminate 40+ Personal Income Tax Breaks	Yes	No	No	No	No
Value of Personal Exemption	$8,800 (S) $17,600 (MFJ)	$8,800 (S) $17,600 (MFJ)	$8,800 (S) $17,600 (MFJ)	$6,600 (S) $13,200 (MFJ)	$4,400 (S) $8,800 (MFJ)
Revenue Subtotal (in millions)	*$2,654*	*$1,394*	*$1,494*	*$1,949*	*$2,603*
Sales (rate change only)					
Tax Rate	4.50%	5.90%	5.75%	5.25%	4.50%
Revenue Subtotal (in millions)	*-$1,433*	*-$283*	*-$404*	*-$813*	*-$1,433*
All Other Changes*					
Revenue Subtotal (in millions)	*$707*	*$799*	*$788*	*$756*	*$707*
TOTAL REVENUE *(millions, annual)*	***$1,928***	***$1,910***	***$1,878***	***$1,892***	***$1,877***

*Includes Governor's proposed changes to taxing certain computer services, eliminating sales tax exemption for soda and candy, increasing rates on cigarettes and tobacco, eliminating several corporate tax breaks and clarifying several corporate tax rules.

As noted, all of the alternatives—as well as the Governor's actual tax package proposal—are progressive in their net effect, raising the new revenue primarily from higher income households. Of the four alternatives to the Governor's proposal presented here, alternatives 1 and 2 are the most progressive because each includes a doubling of the personal exemption, a change that is particularly beneficial to low and moderate income households.