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The Joint Ways & Means Transportation Proposal

On Tuesday, House and Senate leaders announced a transportation finance plan crafted by the House and Senate Ways and Means Committees. This Budget Brief describes that Joint Ways and Means (JWM) proposal, examining what it includes – and what it doesn't include.

The proposal would generate about $500 million in new tax revenue and would call on transportation agencies to raise additional revenue from a combination of tolls, fare increases and fees. The tax revenues would come from a small increase in the gas tax, tobacco taxes including $1 increase in the cigarette tax, and several tax reforms that would primarily affect businesses. These are explained in more detail below.

The revenue would primarily fund operating costs at the MBTA and the Massachusetts Department of Transportation (MassDOT), and the cost of shifting employees from the capital budget to the state operating budget. That transfer, and some of the new revenue, would allow for some additional capital spending. The JWM proposal, however, would fund only a portion of the transportation system's long-term infrastructure investment needs identified by MassDOT.

The package provides no specific revenue for education initiatives. It does not target revenue to make higher education more affordable, to expand access to high quality early education and care, or to make targeted investments in K-12 schools (for discussion of Governor's proposals in these areas see: massbudget.org/870).

The proposal also provides significantly less revenue than had been proposed in the Governor's budget to reduce budget cuts in this year's budget. As the state continues to feel the effects of both $3 billion in income tax cuts from 1998-2002 (massbudget.org/859) and the weak national economy, budget writers face a gap of over a billion dollars just to pay for the costs of current services (massbudget.org/858). With less new revenue, the legislature will face greater challenges in balancing the budget without underfunding important services or relying on additional temporary revenue sources.

INVESTMENTS

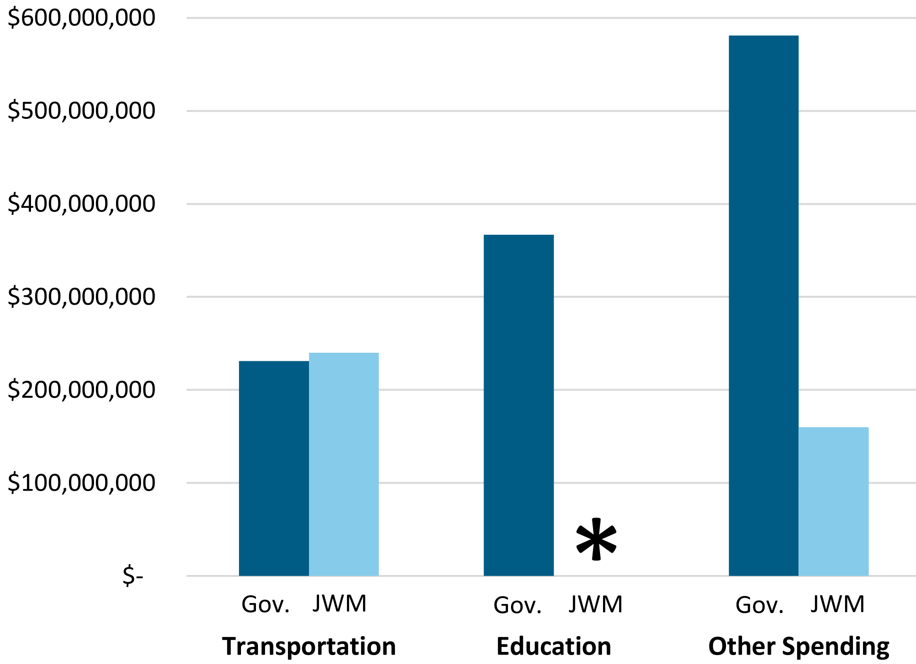
The Joint Ways and Means (JWM) plan for investing this new revenue differs from the Governor's plan in two primary ways:

- The JWM plan focuses mostly on transportation investments, including much more limited investments in education and other areas of the budget.
- Once fully implemented, the scope of new transportation funding under the JWM is more limited, investing less in infrastructure improvements, in particular.

Under both plans less revenue would be available for supporting programs in FY 2014 than in future years. For FY 2014, the Governor makes available $1.18 billion, with that money invested across transportation, education, and other areas of the budget. The JWM proposal, by contrast, would raise about $400 million for FY 2014, with approximately $240 million of that targeted for transportation. The remaining amount, roughly $160 million, would be available for supporting other programs. MassBudget projects a $1.28 billion budget gap for FY 2014, making it very likely that much of this remaining revenue would be required for fending off cuts that would otherwise be necessary.[1] The House and Senate plans for closing this gap and investing any revenue not dedicated to transportation will become clearer when their budgets are released.

The Gov's Plan Invests More in Education & Other Budget Areas

Investments based on new tax revenue proposals, FY 2014



*The JWM plan does not include targeted funding for education, but it's possible that House or Senate budgets may propose some such funding.

Estimates based on the Governor's "Raising Revenue for Critical Investments" Issue in Brief & JWM's "Overview of the Legislative Transportation Finance Framework" presentation.

In addition to funding new transportation and education investments, the Governor's revenue proposal generates about $580 million to help address other budget priorities. These include:

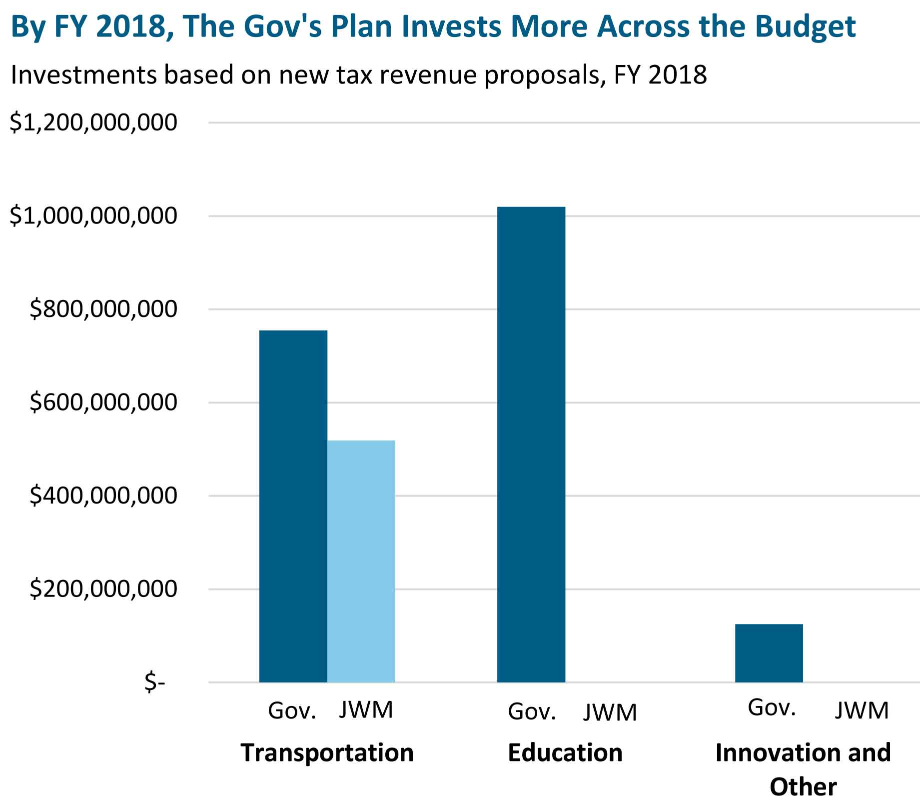
- Avoiding cuts that would otherwise be required to balance the budget.
- Phasing-in previously planned multi-year initiatives, including reforms to the Chapter 70 education aid formula and funding Chapter 257 provider rate increases.[2]

[1] For more detail on MassBudget's FY 2014 budget gap calculation please see *A Preview of the FY 2014 Budget* available online at: http://www.massbudget.org/report_window.php?loc=budget_preview_2014.html

[2] Of the nominal $226 million increase to Chapter 70 under the Governor's FY 2014 budget, MassBudget allocates $167 million to "Other (largely cuts avoided)" and $59 million to "Education" since we estimate that $167 million is required to fund maintenance increases. By contrast, the remaining $59 million would represent real funding increases to school districts. For more information on MassBudget's maintenance calculations please see *A Preview of the FY 2014 Budget* available online at: http://www.massbudget.org/report_window.php?loc=budget_preview_2014.html

- Providing modest increases elsewhere in the budget, such as restoring adult dental benefits for MassHealth and Commonwealth Care recipients, increasing unrestricted local aid, and funding maintenance increases so that other programs can keep up with rising costs.

Once fully phased-in, the Governor's plan would provide greater long-term transportation spending and significantly boost state investments in education, as shown in the graph below. Based upon the supporting detail currently available for the JWM proposal, only $194.1 million of the $520 million in new tax revenue raised for FY 2018 would be dedicated to transportation. Since budget documents do, however, discuss targeting much of the remaining $324.9 million for future capital projects, this analysis includes this revenue in FY 2018 spending totals for transportation. It is possible, however, that in future years the Legislature would devote less of this new revenue to transportation and some to other areas of the budget.



Estimates based on the Governor's "Raising Revenue for Critical Investments" Issue in Brief & JWM's "Overview of the Legislative Transportation Finance Framework" presentation.

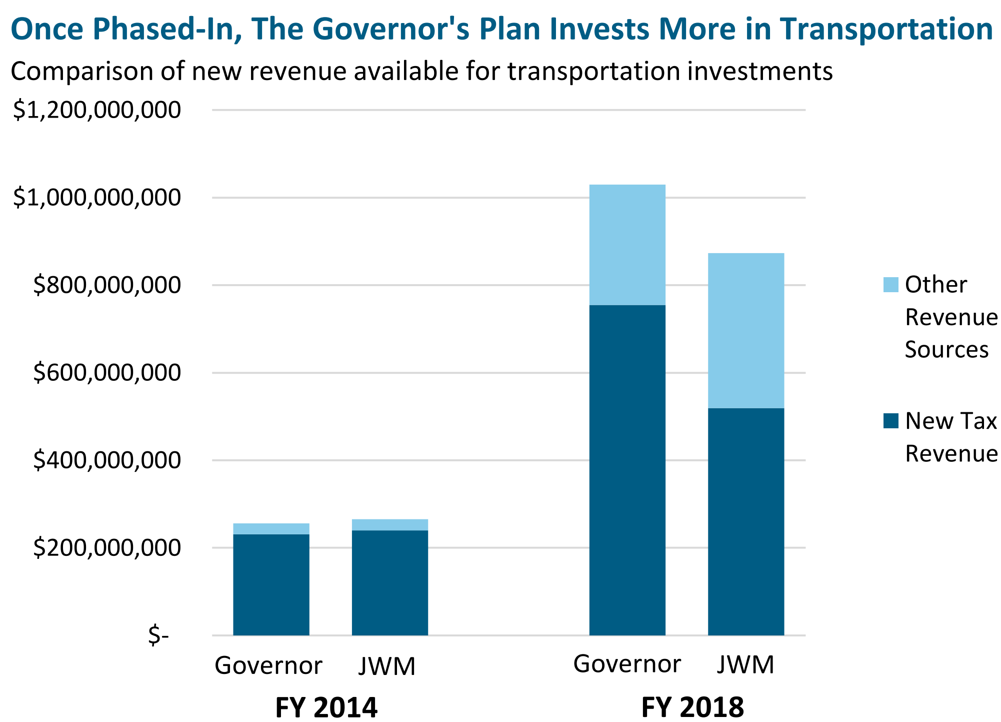
It appears very unlikely that the JWM plan would include sufficient new revenue for education initiatives such as those included in the Governor's plan, which includes increases for:

- Early education: eliminating the waitlist for low-income child care support and making a series of investments in quality supports. See massbudget.org/867
- K-12 education: increasing Chapter 70 education aid and providing expanded learning time grants to middle schools across the state. See massbudget.org/864

- Higher education: increasing support for UMass campuses, state universities, and community colleges, as well as more than doubling support for needs-based financial aid. See massbudget.org/878

For more information on the Governor's education investment proposals, please see Investments and Revenue in the Governor's Budget.

Further, the Governor's plan invests more money in transportation over the long term. The graph below compares total new revenue available to transportation under both proposals, including revenue from newly proposed tax policy changes (the bottom bars) and revenue from non-tax revenue sources (the top bars). It is important to note that the $157 million funding difference observed for FY 2018 is an annual difference and that a gap of roughly this size would continue throughout future years. Over the long-term this lower JWM funding level could significantly affect the state's ability to keep up with the transportation system's capital needs, in particular.



Both plans direct $25 million in new gambling revenue for transportation in FY 2014. In future years, the JWM relies more heavily on increasing transportation user fees (captured within "Other Revenue Sources"), such as increased MBTA fares, RMV fees, and tolls.

TAX REVENUE

The Joint Ways and Means (JWM) proposal would raise an estimated $520 million in new annual tax revenue. This contrasts sharply with the Governor's tax package proposal, which would raise an estimated $1.9 billion annually in new tax revenue. The two proposals do not make for easy apples-to-apples comparison; the Governor proposes substantially increasing investments in areas beyond transportation (and raises more revenue in order to do so), while the JWM proposal is focused primarily on transportation.

Unlike the Governor's proposal, the JWM proposal does not include changes to the fundamental structure of any of the state's major taxes; it does not include rate increases or decrease to the personal income tax or sales tax, and it contains no changes to personal income tax breaks or to the value of the personal exemption (all of which are part of the Governor's proposal). Instead, new tax revenues are generated through a combination of excise tax increases (tobacco and gas taxes) and reforms to certain taxes paid by businesses.

Like the Governor's plan, the JWM proposal includes generating significant additional revenue for transportation from non-tax sources. Any non-tax revenue that does not come from budget cuts and other cost reductions at the MBTA and MassDOT will need to come from increases in fees, tolls and fares. (The specifics of these non-tax revenue sources are discussed in a later section of this factsheet.) The specific *tax* proposals in the JWM transportation revenue package include the following:

EXCISE TAX CHANGES

- A $1 increase in the cigarette excise tax from $2.51/pack to $3.51/pack would raise an estimated $150 million annually (the Governor proposes an identical increase). In addition to new revenues, increases in cigarette and tobacco taxes may have an impact on levels of tobacco consumption in Massachusetts for both adults and particularly for youth.[3] Over 16 percent of Massachusetts adults are current smokers and over 9 percent of youths ages 12-17 are current smokers.[4] In Massachusetts in 2010, smokers purchased more than 220 million packs of cigarettes.[5] The economic costs associated with smoking (including direct medical costs and lost productivity) have been estimated at over $10 per pack.[6] Any reduction in usage due to higher user costs (resulting from the proposed tax increases) is likely to improve individual health and reduce negative impacts to the state related to tobacco use.

  Like most sales taxes, cigarette taxes are regressive, collecting a larger share of household income from low and moderate income households than from upper income households; purchasing an identical quantity of cigarettes will consume more of a low-income person's income than it will for a high-income person.

- Equalization of tax rates on other tobacco products with the tax rate on cigarettes would raise an estimated $16 million annually (the Governor proposes an identical increase). This change would affect taxes on cigars and "smokeless" tobacco products. (Smokeless tobacco products include items such as chewing tobacco, snuff, and nicotine-containing breath mints and lozenges, all of which the Surgeon General is concerned are marketed toward children by the tobacco industry.[7]) As with increased cigarette taxes, higher taxes on other tobacco products will disproportionately affect low and moderate income households.

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[3] Surgeon General's 2012 Report: http://www.cdc.gov/tobacco/data_statistics/sgr/2012/
U.S. Centers for Disease Control and Prevention: http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/#costs
[4] U.S. Centers for Disease Control and Prevention: http://www.cdc.gov/tobacco/data_statistics/state_data/state_highlights/2010/states/massachusetts/index.htm
[5] Massachusetts Dept. of Public Health: http://www.mass.gov/eohhs/docs/dph/tobacco-control/sales-tobacco-fy07-fy11.pdf
[6] U.S. Centers for Disease Control and Prevention: http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/#costs
[7] Surgeon General's 2012 Report: http://www.surgeongeneral.gov/library/reports/preventing-youth-tobacco-use/factsheet.html

- Increasing the gas tax by three cents per gallon would raise an estimated $95 million in new annual revenue in FY 2014. Indexing the gas tax to inflation, meanwhile, would prevent further erosion of the inflation-adjusted value of the gas tax, resulting in an additional $15 million in annual purchasing-power in FY 2015 (when this change would go into effect) that otherwise would be lost to inflation.[8] The Governor's proposal calls for indexing the gas tax for inflation but does not include an increase in the rate.

  The gas tax was last adjusted for inflation in 1991 and has lost value steadily ever since. If the gas tax were to have the same purchasing-power value today as it had in 1991 (i.e., if we adjust for inflation), we now would be paying 36 cents per gallon rather than the 21 cents per gallon we actually do pay.

  Like other sales and excise taxes, the gas tax disproportionately affects low and moderate income households. Allowing the gas tax to continue its steady decline in value (by *not* indexing it to inflation) would reduce taxes as a share of household income more for lower income households than for upper income households. Raising the gas tax and then indexing it to inflation therefore would have the opposite effect; it would disproportionately increase taxes on low and moderate income households. At the same time, these changes would have other, beneficial effects, including positive impacts on the environment.

JWM TAX REVENUE PROPOSAL	Annualized*
Excise Sales Tax:	
Increase cigarette tax by $1.00/pack	150,000,000
Harmonize tax rates for cigars & smokeless tobacco w/ cigarettes	16,000,000
Increase motor fuels tax by $0.03/gal and index to inflation	110,000,000
Sales Tax Subtotal	**276,000,000**
Business Taxes:	
Extend sales tax to certain computer services	161,000,000
Clarify market sourcing rules for corporate excise sales factor	35,000,000
Reclassify utility companies as regular corporations	48,000,000
Business Taxes Subtotal	**244,000,000**
TOTAL	**520,000,000**

*Annualized estimates are for TY15 (the first full year of implementation), discounted to reflect estimated FY14 values.

[8] As indexing continued to prevent erosion of the inflation-adjusted value of the gas tax, the annual "gain" from indexing would grow over time.

BUSINESS TAX CHANGES

- Application of the sales tax to computer systems design services and to the modification of prewritten software would raise an estimated **$161 million** annually. (The Governor similarly proposes subjecting some computer-related services to the sales tax, though his plan includes a wider range of services and consequently raises about $100 million per year more from this source than does the JWM proposal.) As businesses are the primary consumers of these services, this tax increase would fall mostly on businesses. Currently, the tax code differentiates between the sale of pre-written computer software (taxable) and the additional cost of customizing it for an end user (not taxable, as this is considered a service). This proposal would tax the customization of software, as well as computer systems planning and design services. The JWM proposal does not include extension of the sales tax to cover remote data storage, computer facilities management services (such as on-site management and operation of clients' computer systems) or data processing management services.

- Clarification of certain rules governing how corporations calculate the taxes they owe to the Commonwealth for sales made to Massachusetts customers would raise an estimated **$35 million** annually (the Governor proposes an identical increase). At present, the rules are unclear about how a company must allocate its service sales to Massachusetts-based customers for the purpose of calculating the state taxes it owes the Commonwealth. As a result, some multistate companies headquartered outside of Massachusetts are asserting that they do not need to treat as Massachusetts sales, for tax purposes, service sales made to Massachusetts customers when the company calculates the amount of corporate income tax owed to the Commonwealth.

  The JWM plan includes a proposal to update the Massachusetts tax code, making clear that service sales must be attributed to the state in which the customer is located when calculating the share of a company's total profits that will be taxed by the Commonwealth. If a company is required to pay corporate income taxes in Massachusetts (i.e., if the company has "nexus"), sales made to Massachusetts-based customers will be counted as Massachusetts sales for tax purposes, regardless of where the company is headquartered. The flip side of this tax code clarification is that companies that are headquartered in Massachusetts and are selling services to out-of-state customers would *not* have to count these service sales as Massachusetts sales in their tax calculations, thus reducing the amount of tax they owe to the Commonwealth.

- Elimination of a special tax classification (with a special, low tax rate) for utility corporations will generate an estimated **$48 million** in tax revenue annually. (The Governor proposes an identical increase, though he also would eliminate the special classification for certain securities investment businesses, thus generating another $35 million annually). This special classification is a tax code provision that largely responds to circumstances that no longer exist. When utilities were heavily regulated they received special tax treatment that reflected their special status. Today, firms in the traditional utilities sectors – like phones and energy – often operate just like other corporations. The JWM proposal would end the special tax status for utility corporations and tax them like other companies.

OTHER REVENUE

In addition to the $520 million in new annual *tax* revenue outlined above, the JWM proposal also draws on a number of *non-tax* revenue sources. The JWM proposal relies more heavily on non-tax revenue sources than does the Governor's plan. A portion of these revenues could come from unspecified budget cuts or other costs reductions at the MBTA and MassDOT. It is likely, however, that much of the additional revenue would come from fee, fare and toll increases - similar to but larger than those proposed under the Governor's plan. Under both plans, a smaller amount of non-tax revenue would come from casinos, MassPort and the state's convention centers.

The specifics of these proposals for non-tax, agency revenues are as follows:

- The JWM plan calls for substantial new revenue from MassDOT and MBTA sources, rising from **$91 million in FY 2015** to **$282 million in FY 2018**. The plan defines target percentages for both the MassDOT and MBTA budgets that will be provided by "in-house" revenue streams. In the case of MassDOT, the JWM sets a target of 51 percent of MassDOT's budget to be generated "in house", rising from 47 percent in FY 2014. For the MBTA, the target share will rise from a low of 31.5 percent in FY 2014 to 34 percent by FY 2018.

  Having set these target percentages, the JWM proposal then establishes the corresponding revenue amounts that will meet these target percentages. Unless substantial savings can be generated through budget cuts or other cost reductions at the MBTA and MassDOT, these new revenues very likely would need to be drawn from the list presented in the Governor's transportation plan.[9] For MassDOT, this would include increased RMV fees, highway toll increases, and savings generated through "all electronic tolling" (AET) on the Mass Pike. For the MBTA, the sources of potential additional in-house revenue are limited to fare increases.

  As shown in the table below, in order to meet the JWM proposal's targets, the amount of additional revenue generated from these sources under the JWM plan would have to exceed the amounts proposed under the Governor's plan. Neither the JWM proposal nor the Governor's plans call for any increases from these revenue sources in the first year (FY 2014).

  As with most sales and excise tax increases, low and moderate income households would be affected disproportionately by fee, toll and fare increases.

[9] See Governor's FY 2014 budget materials (section titled "Additional Transportation Revenue"): http://www.mass.gov/bb/h1/fy14h1/exec_14/hbudbrief5.htm

TRANSPORTATION NON-TAX REVENUE PROPOSALS	FY 2014 ($ millions)		FY 2015 ($ millions)		FY 2016 ($ millions)		FY 2017 ($ millions)		FY 2018 ($ millions)	
	Governor	JWM	Governor	JWM	Governor	JWM	Governor	JWM	Governor	JWM
New MBTA &MassDot Revenue Targets	0	0	44	91	149	259	199	237	203	282
MassPort, Gaming and Conv. Ctr. Revenue Targets	25	25	22	22	10	10	71	71	72	72
TOTAL	**25**	**25**	**66**	**113**	**159**	**269**	**270**	**308**	**275**	**354**

SOURCE: Governor's budget documents and materials released with Transportation Finance Framework

- As casino gambling or "gaming" comes to Massachusetts, new revenues will become available to the Commonwealth. Application, licensing and other start-up fees will begin to generate state revenues from casinos as early as FY 2013. The JWM proposal appears to follow the Governor's tax package proposal in dedicating a portion of these fees - **$25 million in FY 2014** and **$12 million in FY2015 -** to transportation funding.[10] Once the casinos are up and running (assumed to occur in FY 2017), a portion of the casinos' profits will be shared with the Commonwealth. The Framework, like the Governor, appears to rely on some **$50 million** a year in gaming-related revenues to be directed toward its transportation funding package.

- MassPort and the Convention Center will be expected to contribute an additional **$11 million** and **$10 million a year**, respectively, under both plans.

[10] See Governor's FY 2014 budget materials (section titled "Additional Transportation Revenue"): http://www.mass.gov/bb/h1/fy14h1/exec_14/hbudbrief5.htm