MassBudget
Massachusetts Budget and Policy Center
Information. Participation. Democracy.

January 6, 2020

FY 2021 BUDGET PREVIEW: Will the Governor reboot his dependent deduction proposal or take a more targeted approach?

By Phineas Baxandall

Note: This is part of a MassBudget series looking ahead at some major stories to watch for in the FY 2021 budget debate. Check back for additional briefs and for a summary.

What to watch for in the Fiscal Year (FY) 2021 budget debate:

Will the Governor again propose to double the state's dependent deduction, which wasn't adopted by the Legislature, or will state lawmakers provide more targeted tax support for working families with greater need?

Introduction

In September 2019, the Governor proposed a small tax cut for many families. But there is a way to help working families through a different tax mechanism that delivers a better bang for the buck.

One question is whether the Baker-Polito Administration's budget for FY 2021 will reboot its proposal to double the tax deduction people can take off their income based on the number of **dependents** (like a child or grandparent) they have at home. That proposal was not adopted by the Legislature.

The Baker-Polito Administration estimated its proposal would cost the state $87 million per year in reduced tax collections. For about the same cost, the Commonwealth could increase the state **Earned Income Tax Credit (EITC)** by 10 percentage points – from a 30 percent match of the federal credit to 40 percent.

The EITC is an effective way to move people out of poverty as well as boost long term health and educational outcomes. Unlike the dependent deduction, it is targeted to working families in greatest need.

(Throughout this brief, you will see words in bold. These terms are defined in a glossary at the end of the report.)

What is the dependent deduction?

When people file their income taxes in Massachusetts, they currently can deduct $1,000 off their **taxable income** for each dependent they have at home. For example, a parent of two children with a taxable income of $50,000 would have $48,000 counted as taxable income after deducting $1,000 for each child.

What was Governor Baker's proposal regarding the dependent deduction?

Governor Baker proposed to double this dependent deduction — from $1,000 to $2,000 — in the FY 2019 **supplemental budget**. Under this proposal, the parent in the example with two dependent children could deduct $4,000 from their taxable income, bringing it down to $46,000.

This proposal would have cost the Commonwealth $87.5 million per year in reduced tax collections, while only saving working families an additional $50 per dependent in taxes. (This is because $1,000 less of a taxpayer's income would be subject to Massachusetts' 5 percent personal income tax rate.)

This proposal would not benefit those with the least income — because many are below the threshold to pay taxes or are already receiving a refund. By contrast, those with the highest incomes will more often benefit because there is no earnings limit to this deduction.

How can Massachusetts' tax policies better support working people?

Lawmakers who want to give working families a tax benefit could better target policies to those who need it most. Unlike deductions, refundable tax credits provide support even if other exemptions and deductions bring somebody's tax bill to zero.

Massachusetts has a variety of refundable tax credits for investors and corporations, but only one for ordinary, working-age taxpayers: the EITC.

The EITC delivers more bang for the buck than the dependent deduction because it is targeted to working households with incomes below about $56,000, depending on the number of children. The EITC has been shown to deliver a variety of benefits beyond supporting incomes and keeping people out of poverty. Many studies show the credit improves health outcomes for children and parents, and improves test scores and graduation rates, for instance.

Approximately 400,000 Massachusetts households receive the EITC each year, with recipients in every community.

For about the same annual cost as the Baker-Polito proposal, the Commonwealth could increase the state EITC by 10 percentage points – from a 30 percent match of the federal EITC benefit to a 40 percent match. Thus, a married couple earning $40,000 who have two children in 2019 would receive a Massachusetts EITC of $1,051 instead of the current $788.

Credits like the EITC are one way to balance out the state's tax system — which currently asks those with the least income to pay the largest percentage of it in taxes. Meanwhile, those who can afford to pay the most tend to contribute the smallest percentage of their incomes in taxes.

Glossary

- **Dependent:** A child or relative — who is not a spouse — who depends on the tax filer's income and meets other qualifications set by the Internal Revenue Service. These qualifications can include age or residency.

- **Earned Income Tax Credit (EITC):** A refundable tax credit for lower-income workers — especially those with children. When eligible workers file their annual income taxes, they can subtract their credit amount from the taxes they owe and can receive a refund if the credit is more than the amount they owe in taxes. Massachusetts currently offers a 30 percent match of the federal EITC.

- **Supplemental budget:** An additional budget that provides more funding to certain state programs and services to fill shortfalls.

- **Taxable income:** The amount of income used to calculate how much a person or company owes in taxes.