

Income Tax Cuts Cost Massachusetts Over \$4 Billion Annually, and Benefits Mostly Go to Highest Incomes

The state budget, and the taxes that fund it, are the primary way we pay for the things that we do together through government. These include providing education; building and maintaining public transportation, roads, and bridges; and helping people get back on their feet when they face hard times. Funding for these services has lagged, however, because of decades-old tax cuts.

In the late 1990s and early 2000s, the Legislature adopted a series of cuts to the state personal income tax. These cuts have played a major role in reducing the revenue available to fund the state budget and, as a consequence, have severely limited the capacity to fund essential services in the Commonwealth.

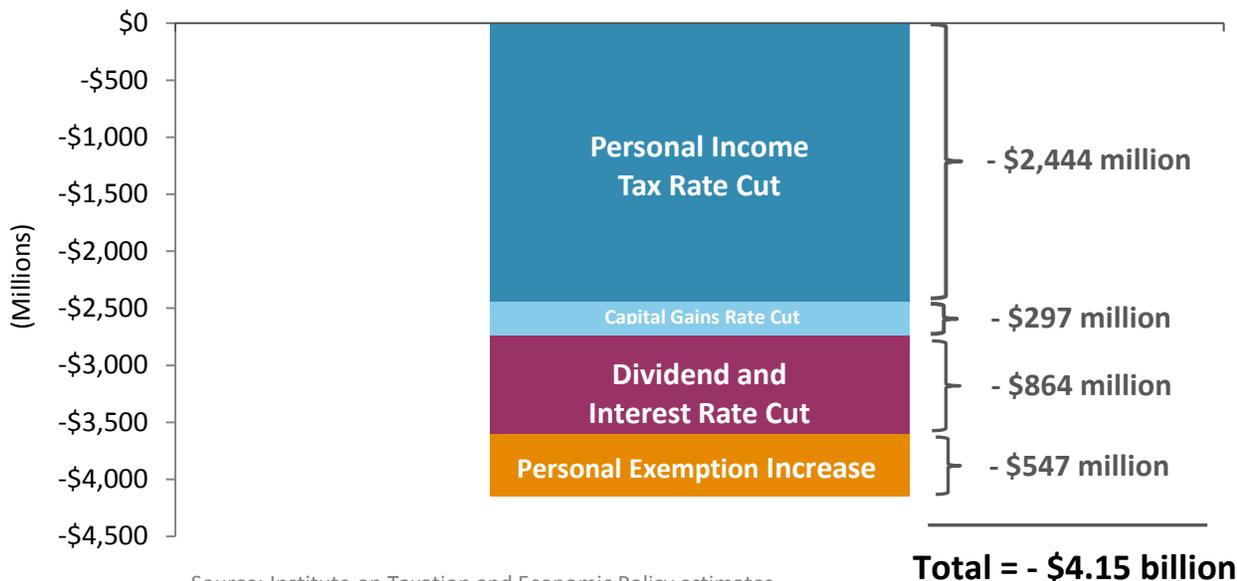
Four of these income tax cuts have been and continue to be particularly costly to the Commonwealth:

- 1) a cut from 5.95 percent to the current 5.05 percent in the tax rate applied to **wage and salary income**; ¹
- 2) a cut from 6.00 percent to the current 5.05 percent in the tax rate applied to **long-term capital gains income** (the profits people make when they sell real estate, art, stocks and bonds, etc.); ²
- 3) a cut from 12 percent to the current 5.05 percent in the tax rate applied to **dividend and interest income** (income derived from savings accounts, annual distributions from stocks or mutual funds, etc.); and
- 4) a doubling of the **personal exemption**, the amount people can deduct from their taxable income, from \$2,200 to \$4,400 for single filers and from \$4,400 to \$8,800 for married couples.

In the current fiscal year (FY 2019), these four tax cuts together will deprive the Commonwealth of \$4.15 billion in annual revenue.

Personal Income Tax Cuts Cost Commonwealth \$4.15 Billion per Year

Annual Revenue Loss (FY 2019) Due to Major Personal Income Tax Cuts (1998-2002)

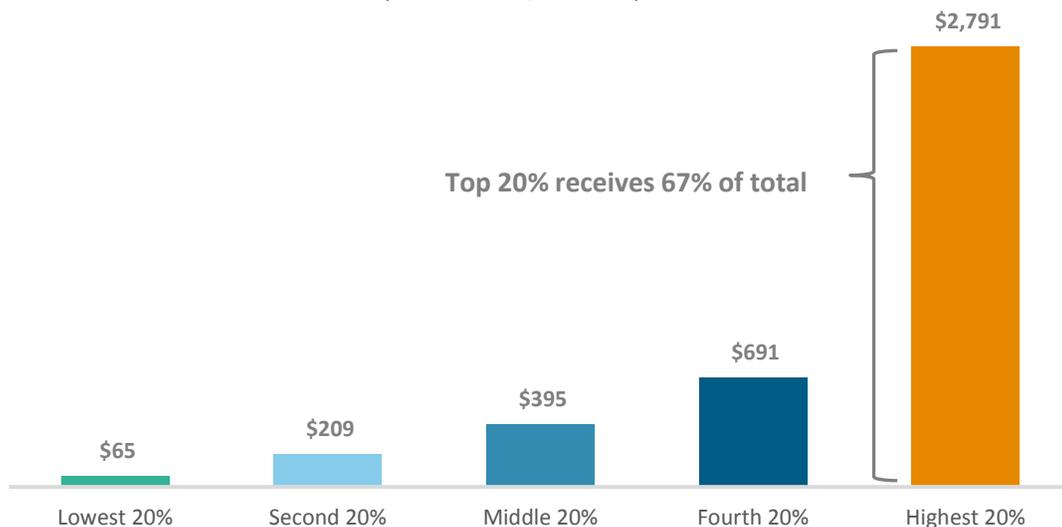


Source: Institute on Taxation and Economic Policy estimates

The tax benefits from these cuts have gone disproportionately to those with high incomes,³ a group that already has enjoyed [strong income growth](#) over the last several decades, while typical low- and moderate-income households have seen their incomes grow slowly, if at all. More than two thirds (\$2.79 billion) of the total \$4.15 billion reduction in annual taxes goes to the top 20 percent of households by income. The top 1 percent of households alone receives over a quarter of the total (28 percent), a reduction of \$1.15 billion in their annual taxes. The bottom 80 percent, meanwhile, receive only one-third of the total, with the lowest 40 percent of households receiving less than 7 percent of the total. Taken together, these tax cuts exacerbate the growing income inequalities noted above.

Top 20% Gets Two-Thirds of Income Tax Cuts Benefits

Total Reduction in Annual Taxes, by Income Group, Major Personal Income Tax Cuts (1998-2002), (2019 Estimate, \$ Millions)



Source: Institute on Taxation and Economic Policy, 2019 Incomes

These income tax cuts are part of the reason Massachusetts has an [“upside-down” tax structure](#), one that on average collects the smallest share of household income from those with high incomes, and larger shares of household income from low- and moderate-income households. As a whole, the major income tax cuts adopted during the late 1990s through early 2000s – because they focus such a large share of total tax reductions on high-income households – have added to the upside-down nature of the Massachusetts tax system rather than helping turn it right-side up. (While increasing the personal exemption improved tax fairness, it nevertheless resulted in a substantial revenue loss. See Endnote 3, below.)

Notably, the upside-down nature of the tax system disproportionately and negatively impacts communities of color. Due to a long history of systemic barriers to opportunity -- barriers that have prevented many people of color in Massachusetts from equitable access to high-paying jobs, education, and other avenues leading to higher household income -- [Black and Latinx workers](#) today are over-represented among low-income taxpayers and underrepresented among higher-income taxpayers. These tax cuts therefore add to racial and ethnic income inequalities in the Commonwealth.

In addition to these tax cuts resulting in the loss of \$4.15 billion in annual revenue, other factors also have affected state revenue collections in the years since 1998. These include state-level tax policy

decisions, as well as changes in consumer spending patterns and in the structure of the Massachusetts economy.

Though there have been several tax increases over this period – including increases to the state sales tax and gas tax, among others – other changes have added to the revenue losses described above. These include consumer shifts toward online shopping, changes in how businesses structure themselves and thus how they are taxed, and the growing concentration of income gains among the highest income households. The net effect of all tax increases and reductions since 1998 (combined with other factors affecting state tax revenues and economic growth) is that total state tax revenue as a share of state personal income has declined (from 6.3 percent in FY 1998 to 5.2 percent in FY 2019). Today, state tax collections are equivalent to a significantly smaller share of our state economy than they were 20 years ago. This decline will amount to a loss of \$5.95 billion in annual tax revenue for the Commonwealth in FY 2019.⁴

TAXES AS A SHARE OF STATE PERSONAL INCOME

When assessing a state’s tax system, it is useful to consider a range of questions.

Can the tax system provide adequate revenue?

How stable is the system?

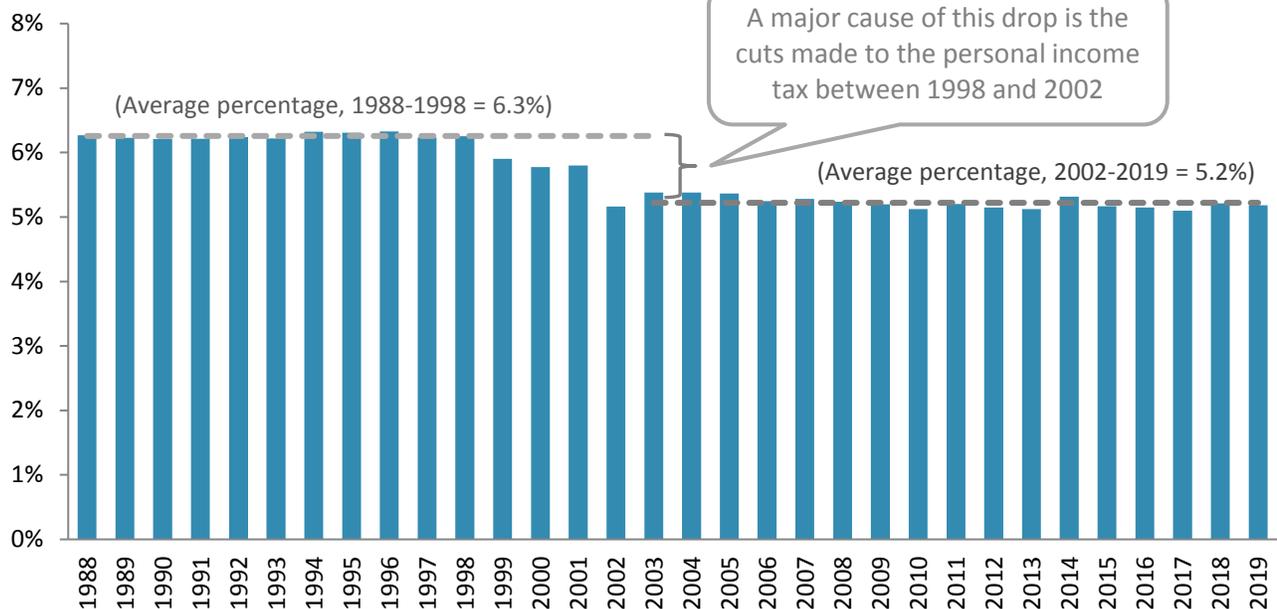
Do taxes consume an excessive share of the income generated by a state’s population?

How do tax levels in one state compare to those in other states?

Taxes as a share of state personal income is a particularly useful measure, one that helps answer such questions. This measure tells us how much tax is collected in a given year, as a share of all the income generated by people in that state. That income total represents the pool of available resources from which taxes can be generated. In Massachusetts, our state government collects a little over 5 percent of that pool in taxes each year.

Annual state taxes as share of state personal income down since 1998

Total state taxes as % of state personal income



Sources: Personal Income from US BEA (with adjustments for capital gains and other income sources). Tax data from MA Statutory Basis Financial Reports

This substantial decline in potential revenue collections has played a role in producing ongoing fiscal challenges for the Commonwealth – including severe shortfalls during economic downturns. In response to these chronic and acute budget shortfalls, state lawmakers have allowed inflation-adjusted funding to decline markedly in many program areas across the budget, such as local aid, public health, environment and recreation, and higher education. While some areas of the budget have seen very substantial funding increases – for example, health care expansion and reform, and areas within human services – revenue constraints have prevented the Commonwealth from funding these priorities *while also* maintaining investments in other key areas. Deep cuts in funding for essential public investments can [compromise the state's long-term growth potential](#) and harm the current and future well-being of the people who live and work in Massachusetts. (For more detail on historical funding levels for various areas of the state budget, see MassBudget's interactive [Budget Browser](#).)

¹ The Massachusetts Department of Revenue (DOR) expects the relevant thresholds for revenue growth will be met during 2019, which will trigger a further and final rate cut to 5.00 percent on January 1, 2020. DOR estimates this additional rate reduction will result in a further annual revenue loss of \$185 million. (See DOR Commissioner's Consensus Revenue Hearing testimony from Dec. 5, 2018, pg. 7: <https://www.mass.gov/lists/dor-briefing-book#fy2020->)

² Prior to 1996, long-term capital gains were taxed at 6.0 percent. In 1996, the rules governing taxation of long-term capital gains were modified such that the longer one held an asset, the lower the tax rate applied to the gain would be when the asset finally was sold. Rates ranged from 6.0 percent down to 0.0 percent. Among the changes included in the 2002 tax package was a provision setting a single rate for long-term capital gains equal to that of wage and salary income (5.3 percent at the time).

³ Given the wide income inequality in Massachusetts (and the U.S. as a whole), it is not altogether surprising that reductions in taxes that are levied on personal income would disproportionately benefit those collecting a large share of total income. Nevertheless, it is possible to design tax cuts – including personal income tax cuts – that target reductions toward low- and moderate-income households, rather than on the highest income filers. The increases made to the personal exemption amounts are a good example. While costing the Commonwealth some \$550 million in forgone annual revenue, this set of changes delivers only 8 percent of the total benefits to the highest income 5 percent of households and 70 percent of the benefits to the bottom 80 percent of households.

⁴ U.S. BEA State Personal Income in Massachusetts (SPI) – adjusted to include capital gains income and the income earned in MA by non-MA residents – was \$224,468.429 million in FY 1998. For that fiscal year, the state collected in taxes an amount equal to \$14.038 billion (or 6.254 percent) of this total. In FY 2019, MA adjusted SPI is projected to equal some \$555,270.208 million. Were the state still to collect an amount equal to 6.254 percent of this total, tax collections would equal \$34,725.967 million in FY 2019. Instead, the state expects to collect \$28,775.596 million, an amount equal to 5.182 percent of adjusted SPI. This gives a tax loss estimate in FY 2019 of \$5,950.371 million (\$34,725.967 million – \$28,775.596 million = \$5,950.371 million). (A brief discussion of some of the technical issues involved in adjusting total personal income, as well as the rationale for using this approach, can be found in [this memo](#) from the New England Public Policy Center, a research branch of the Federal Reserve Bank of Boston: <http://www.bos.frb.org/economic/neppc/memos/2008/weinerpopov073008.pdf>)