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Massachusetts Budget and Policy Center

FACTS AT A GLANCE **April 3, 2013**

The Income Tax in Massachusetts

Income taxes are a form of tax that may be levied on various kinds of income, including wage and salary income, capital gains income, dividend and interest earnings, and income from rental properties. In Massachusetts, the income derived from any of these sources is subject to the state income tax, and almost all forms of income are taxed at a single rate, currently 5.25 percent (short-term capital gains are the one exception, being taxed at 12 percent). The income tax is the single-largest source of tax revenue for the Commonwealth, with collections totaling $11.9 billion in Fiscal Year (FY) 2012.[1]

The overall state and local tax system in Massachusetts is regressive, with lower-income households paying a larger share of their income in taxes than high-income households pay.[2] Both the property tax and the sales tax are regressive and together they make the overall system regressive. The income tax is the only major element of the overall state and local tax system in Massachusetts that is progressive: lower-income households pay a smaller share of their income towards the income tax than higher-income households do.

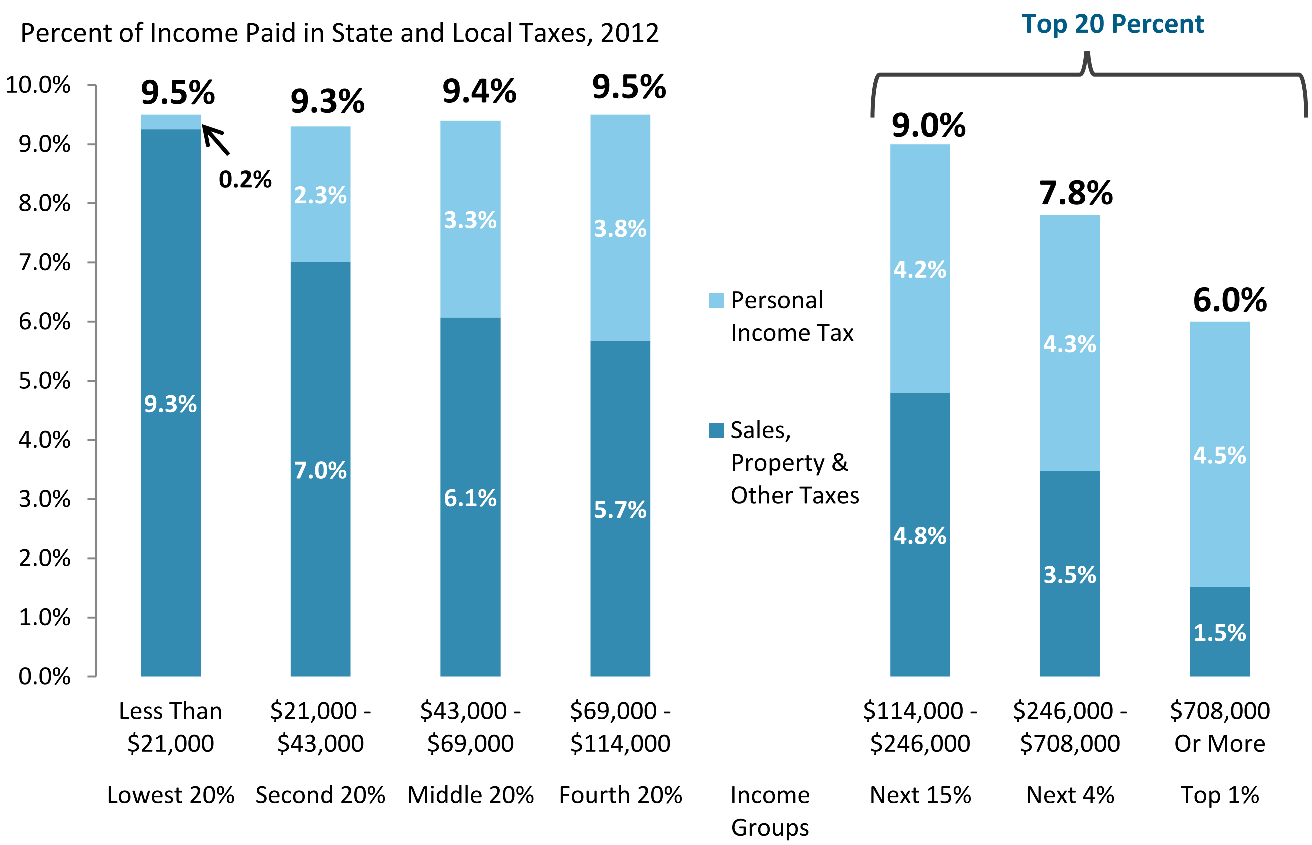
THE INCOME TAX KEEPS OUR TAX SYSTEM FROM BEING MORE REGRESSIVE

As noted, the overall tax system in Massachusetts is regressive because the sales and property taxes are regressive. The chart below shows the overall tax levels of families at different income levels in Massachusetts and, specifically, the share of family income that is paid in *income* taxes vs. other taxes. What we see is that low-income families in Massachusetts pay a significantly larger share of their household income (9.5 percent) toward state and local taxes than high-income people do (6.0 percent). Notably, however, those with high incomes pay significantly more of their income in *income* taxes (4.5 percent) than do low income households (0.2 percent).

As the chart below also shows, without the moderating effects of the state personal income tax, the overall state and local tax system would be significantly more regressive than it already is. (Compare the pattern formed by the lower, dark-blue sections of the bars with the pattern formed by the total height of each bar).

[1] MA Department of Revenue, Blue Books, June 2012: http://www.mass.gov/dor/docs/dor/stats/bluebook/fy2012/june.pdf
[2] For more information on Tax Fairness please see “Examining Tax Fairness” by the Massachusetts Budget and Policy Center: http://www.massbudget.org/report_window.php?loc=FactsTaxFairness.html

Top Earners in Massachusetts Pay Less of Their Personal Income in State and Local Taxes than Do Low Income Earners



WHAT MAKES THE INCOME TAX PROGRESSIVE?

While many states and the federal government use a graduated income tax (a structure that taxes high incomes at higher rates than low incomes), the Massachusetts Constitution prohibits the use of such a tax. Instead, Massachusetts has a "flat rate" structure, taxing both low and high incomes at the same 5.25 percent rate. The tax rate, however, is not the only element that determines how much income tax a filer owes. Several other elements of the Commonwealth's income tax structure make the net effect of the state's income tax quite progressive.

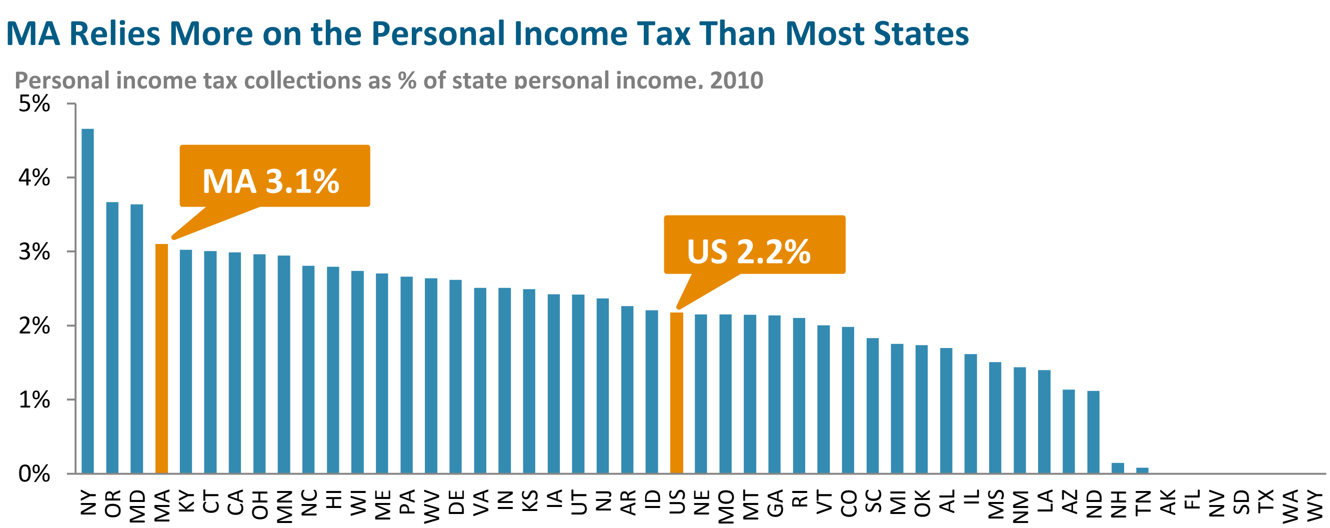
The Massachusetts income tax--despite its flat-rate structure--is progressive in its results primarily because of four provisions, each of which reduces the impact of the income tax on lower-income families and individuals:

- **No Tax Status:** When a taxpayer's income is under a particular threshold, the taxpayer qualifies for No Tax Status and pays no income tax for that year. The thresholds for Tax Year 2012 were $8,000 for single taxpayers and $16,400 for married couples filing jointly (plus $1,000 per dependent).

- **Low Income Credit:** Taxpayers who do not qualify for No Tax Status are eligible for a Low Income Tax Credit if their income does not exceed $14,000 for single taxpayers and $28,700 (plus $1,750 per dependent) for married couples filing jointly.
- **Earned Income Tax Credit (EITC):** The state provides a tax credit to lower-income filers based on eligibility for the federal EITC. The size of an individual's or family's credit is determined both by the amount of their earned income and the number of children in the tax filer's care. For the 2012 tax year, a married couple (filing jointly) with three children was eligible for some amount of credit if they had an income of less than $50,270 (the maximum credit would have been $884). A single filer with no children was eligible for some amount of credit if his/her income was below $13,980 (the maximum credit was $71).
- **Personal Exemption:** Massachusetts allows all residents to reduce their taxable income by a flat amount of $4,400 for individuals and $8,800 for joint-filing married couples. This exemption provides greater benefit (on a percentage basis) to lower-income earners than to higher-income earners, since the exemptions represent a larger portion of lower-income earners' incomes. The result is that the personal exemption adds to the progressivity of the state income tax.

WHERE MASSACHUSETTS TAXES RANK

Forty-three states, including Massachusetts, have a personal income tax.[3] Massachusetts, however, relies less on the sales tax (a regressive tax) to generate revenue and more on the personal income tax than do most states.[4] Largely as a consequence of this fact, and as shown in the chart below, a greater share of state personal income is collected in Massachusetts using the personal income tax than is collected in most other states.



Source: US Census (S&L taxes) and US Bureau of Economic Analysis (state personal income)

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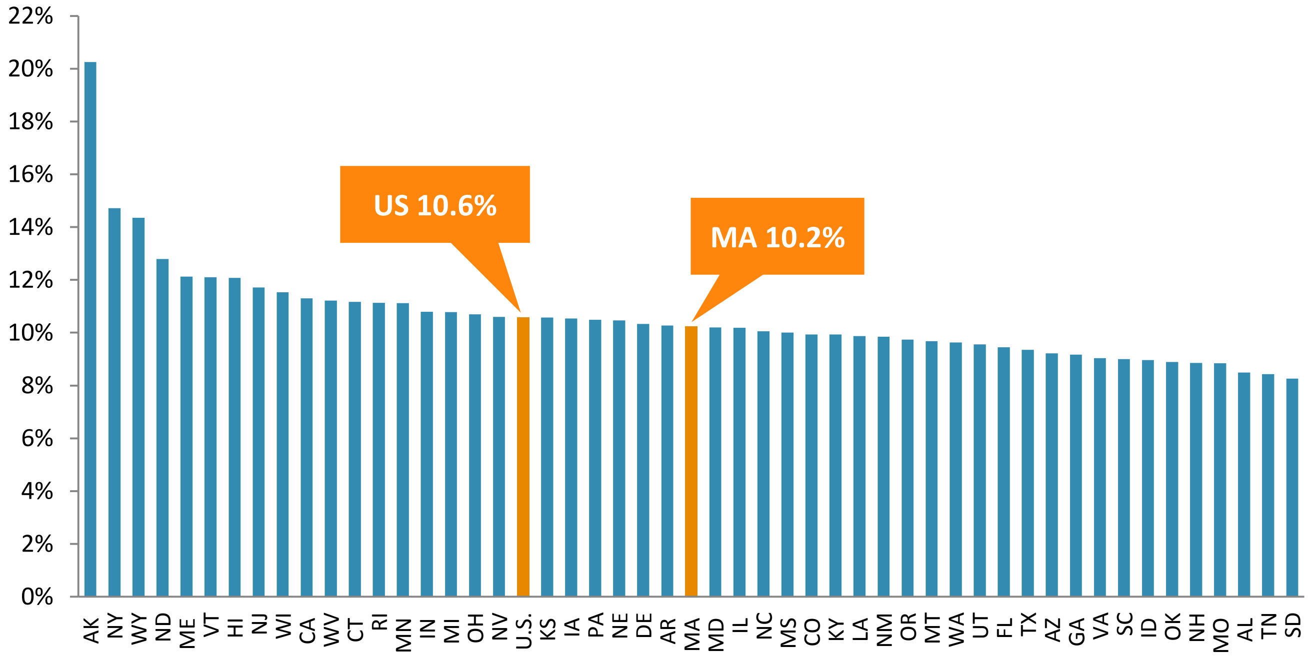
[3] Two states, Tennessee and New Hampshire, tax only certain forms of investment income. They do not tax wage and salary income. Seven states (AK, FL, NV, SD, TX, WA, WY) do not tax personal income.
[4] Urban Brookings Institute, Tax Policy Center (2010 data): http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=508

This does not mean, however, that Massachusetts is a high tax state. When one factors in *all* state and local taxes (not just *personal income* taxes), Massachusetts ranks below the national average. When we look at total taxes as a percent of state personal income (SPI), we find Massachusetts state and local governments collected an amount of tax equivalent to 10.2 percent of SPI in 2010 (the most current US Census data available for all 50 states). The national average, by comparison, was 10.6 percent.[5]

Massachusetts Taxes Are about at the National Average

State and local taxes as % of state personal income, 2010



Source: US Census (S&L taxes) and US Bureau of Economic Analysis (state personal income)

Massachusetts's heavier reliance on the personal income tax not only reduces the regressivity of Massachusetts's tax system, it also helps state tax collections keep pace with overall growth in the economy;[6] collections from some other important taxes - such as the sales tax - typically do not keep pace with economic growth.[7] When growth in tax collections tracks the state's overall economic growth, the Commonwealth is better able to maintain its investments in the physical and human capital that provide the basis for the state's long-term economic success.[8]

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[5] See MassBudget Factsheet, *Where Does the Taxachusetts Label Come From?*, September 2012: http://www.massbudget.org/report_window.php?loc=FactsTaxachusetts.html

[6] Personal income typically tracks growth in the economy (though during the last three decades, much of this growth has gone to upper-income households). See Institute on Taxation and Economic Policy, *The Progressive Income Tax*, July 2012: http://www.itep.org/pdf/pb41pit.pdf

[7] Institute on Economic Policy, *ITEP Guide to Fair State and Local Taxes* (see Chapter 3): http://www.itep.org/state_reports/guide2011.php

[8] Center on Budget and Policy Priorities, *State Personal Income Tax Cuts: A Poor Strategy for Economic Growth*, March 2013: http://www.cbpp.org/cms/index.cfm?fa=view&id=3936

In terms of top personal income tax *rates,* Massachusetts is again in the middle of the pack. As of 2012, Massachusetts' 5.25 percent top tax rate was 28th in the nation and well-below the highest top rate of 12.3 percent.[9] It is important to repeat, in this context, that Massachusetts applies a single, flat rate to almost all taxable income. Many other states instead use a progressive rate structure, applying different rates to different income levels. A state with a higher *top* rate than Massachusetts, therefore, also may apply a *lower* rate on some income than Massachusetts.

Massachusetts Top Tax Rate Ranks 9th Lowest When Compared with All Other States in 2012	
CALIFORNIA	12.30%
HAWAII	11.00%
OREGON	9.90%
IOWA	8.98%
NEW JERSEY	8.97%
VERMONT	8.95%
NEW YORK	8.82%
MAINE	7.95%
MINNESOTA	7.85%
NORTH CAROLINA	7.75%
WISCONSIN	7.75%
IDAHO	7.40%
ARKANSAS	7.00%
SOUTH CAROLINA	7.00%
MONTANA	6.90%
NEBRASKA	6.84%
DELAWARE	6.75%
CONNECTICUT	6.70%
WEST VIRGINIA	6.50%
GEORGIA	6.00%
KENTUCKY	6.00%
LOUISIANA	6.00%
MISSOURI	6.00%
RHODE ISLAND	5.99%
OHIO	5.93%
MARYLAND	5.75%
VIRGINIA	5.75%
OKLAHOMA	5.25%
MASSACHUSETTS	5.25%
ALABAMA	5.00%
ILLINOIS	5.00%
MISSISSIPPI	5.00%
UTAH	5.00%
KANSAS	4.90%
NEW MEXICO	4.90%
COLORADO	4.63%
ARIZONA	4.54%
MICHIGAN	4.25%
NORTH DAKOTA	3.99%
INDIANA	3.40%
PENNSYLVANIA	3.07%

Source: The Federation of Tax Administrators

WHAT WOULD BE THE REVENUE EFFECT OF AN INCOME TAX CHANGE?

The Tax Revenue Consensus Forecast for FY 2014 estimates income tax collections of $13.06 billion in that year.[10] Consequently, if the income tax rate were raised by one percentage point to 6.25 percent (or lowered by one percentage point to 4.25 percent), the state would gain (or lose) $2.5 billion in revenue.

COULD THE INCOME TAX BE MORE PROGRESSIVE?

The state's overall tax system results in lower-income people paying a larger share of their incomes in taxes than do higher-income people (when all state and local taxes, including sales and property taxes, are taken into account). Making the income tax more progressive would help to make the overall system more equitable.[11] This could be done by expanding any of the four items categorized above. Similarly, since the income tax is more progressive than our other major taxes, shifting our tax system towards greater reliance on the income tax also would make the overall system less regressive.

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[9] California raised income taxes on the top 1% of earners via ballot initiative in 2012.

[10] See Governor's FY 2014 budget proposal: http://www.mass.gov/bb/h1/fy14h1/exec_14/hbuddevchall.htm

[11] For more information on the regressivity of the Massachusetts tax system, see *MassBudget*'s Tax Fairness Fact Sheet: http://www.massbudget.org/report_window.php?loc=tax_fairness.html