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VIEW POINTS FROM ACROSS THE STATE

Needed: Reform of the state tax code

by Jeff McLynch

With the release of Governor Romney's House One budget proposal at the end of January and the start of the fiscal year 2005 budget debate, the Massachusetts fiscal crisis will have entered its fourth consecutive year. While the ongoing crisis has led some to question the manner in which the Commonwealth spends its money, it should also prompt a renewed focus on the way in which Massachusetts generates those funds.

In fact, the Massachusetts tax system suffers from three major flaws. First, it is **inadequate**. Simply put, the state's tax system does not generate sufficient revenue to support essential public services, as evidenced by the hundreds of millions of dollars in cuts to health care, education and human services over the past several years. Due to numerous tax cuts in the 1990s, state and local taxes now comprise a smaller share of the Commonwealth's economy (as measured by personal income) than they did, on average, during the 1970s, the 1980s or the 1990s. More to the point, if state taxes had attained the same share of personal income in FY 2003 as they had averaged during the 1990s, Massachusetts would have collected an additional $2 billion.

Secondly, the Massachusetts tax system is ***inequitable***. At present, the state's tax system imposes a larger burden on lower-income families than on upper-income ones.

An Institute on Taxation and Economic Policy study found that non-elderly families in Massachusetts earning less than $19,000 per year—the bottom 20 percent of taxpayers in the Commonwealth— pay 9.3 percent of their incomes, on average, in state and local (i.e. income, property and sales) taxes. In contrast, the top one percent of taxpayers—families earning in excess of $413,000 annually—pay 6.8 percent of their incomes in taxes.

Finally, the Massachusetts tax system is ***inefficient***. In the words of one expert, Massachusetts' corporate income tax "leaks like a sieve," permitting large, multi-state companies to shift profits out-of-state to avoid paying their fair share of the state's tax burden. As a result, locally-owned/operated businesses are at a significant disadvantage as are "Main Street" businesses since federal court rulings essentially prohibit Massachusetts from collecting sales taxes for on-line transactions.

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These problems, however, are not without solutions. Policymakers could resolve them by:

• ***Restoring the personal income tax***. From 1992 to 1999, the personal income tax rate in Massachusetts was 5.95 percent, and the economy boomed. Today, the rate is 5.3 percent. Returning it to its prior level would generate $1 billion in additional revenue, funds that would not only forestall further cuts in vital programs but could also lead to the restoration of some of the most painful cuts made in recent years. It would also make the tax system more progressive, as the wealthiest 20 percent of taxpayers in Massachusetts would bear nearly two-thirds of the change.

• ***Closing corporate tax loopholes***. Fixing the corporate income tax would not only address the adequacy and equity of the Massachusetts tax system, but it would also help to create a more level economic playing field. Instituting what is known as "combined reporting" would prevent companies from artificially-shifting income out-of-state to reduce their tax liabilities. This could generate upwards of $200 million for the state.

• ***Permitting taxation of sales made via the Internet***. Research suggests that Massachusetts loses more than $600 million per year due to its inability to tax electronic commerce. Ultimately, resolution of this problem will require federal action. Massachusetts Congressman William Delahunt is the lead co-sponsor of legislation that would accomplish this goal.

In the coming months, various government reforms proposals will be discussed in hearing rooms, board rooms and living rooms across the state. Reform of the Massachusetts tax system should be chief among them since no other reform measure will have as strong an impact on the Commonwealth's budget, its economy and its citizens.

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