massbudget
Massachusetts Budget & Policy Center

February 22, 2022

To: Joint Committee on Revenue Chairman Cusack, Chairman Hinds, Committee members, and Committee staff
Re: The Governor's FY 2023 revenue proposals in H.4361, with suggestions for alternatives

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Chairman Cusack, Chairman Hinds, and members of the Committee,

Thank you for this opportunity to submit the Massachusetts Budget and Policy Center's analysis of the proposed tax changes in H.4361, "An Act to improve Massachusetts' competitiveness and reduce the cost of living."

MassBudget believes it is important to view the FY 2023 state budget in the context of declining federal COVID relief dollars. Massachusetts received more than $115 billion in the form of direct payments to individuals, support for businesses and organizations, and grants to state agencies and community groups. All of this federal support has put money in people's pockets and in turn buoyed our economy and helped boost the amount of taxes coming into the state's coffers. But much of this federal money is temporary and the related tax surplus is also likely temporary. **It is unwise to assume that the state has more revenue than it needs based on temporary pandemic relief**, meaning this is not the time for the deep and lasting tax cuts proposed in this bill. Moreover, the majority of the revenue loss and by far the most generous tax breaks in the bill come from changes that concentrate benefits to the state's wealthiest residents—the people who need them least.

The Governor's proposed legislation includes two changes to the state's tax code that primarily benefit the state's highest-income residents and that together will cost the state $348 million in lost revenue annually. (This is in addition to the regressive impact of the restoration of the charitable deduction, as discussed below). Unfortunately, these measures would cut revenue at a time when the state needs it to sustain investments beyond the pandemic as it moves towards an equitable recovery.

1) The first proposal reduces the state tax rate on **short-term capital gains**, cutting the current rate from 12 percent to 5 percent which will cost the Commonwealth $117 million and directly affect 150,000 people. A short-term capital gain is the profit made from selling an investment (like a stock) that has been held for less than a year.

Approximately 80 percent of the tax break will go to the state's highest income 1 percent of residents, while only about 3 percent will go to middle- or low-income people- who represent the bottom 80 percent of households.

2) A second proposed tax change would modify the **state tax on estates** and would cost the Commonwealth an estimated $231 million in forgone revenue each year. Estate taxes are paid by an estate of a high-wealth individual at the time of death. The current estate tax threshold is $1 million, and estates below the million-dollar threshold are fully exempt from the tax. Estates above the threshold currently pay a tax on the full value of their estate, which is sometimes referred to as the "estate tax cliff." The Governor's proposal would increase the threshold to $2 million and change the structure of the tax so that it would apply only to the value of the estate above the threshold.

   The Governor's estate tax proposal is an expensive tax break for the Commonwealth, and this money would be going back to the holders of these large estates who are some of the wealthiest families in the Commonwealth. Any reduction to the estate tax by definition only benefits people who hold enough wealth (above $1 million currently) when they die that they are subject to an estate tax. The Massachusetts estate tax is graduated, and under current law the rates rise from 4 percent of the value of estates of about $1 million to 16 percent for larger estate amounts.

   - According to a recent analysis prepared by the Mass. Department of Revenue for the Senate Revenue Working Group, there were 4,274 estates taxed in Massachusetts in 2017, a year in which the state registered close to 58,900 deaths. According to the figures in that analysis, **almost two-thirds of the value of the Governor's proposed estate tax break would go to the wealthiest two-fifths of the estates that are currently subject to tax.** These are estates valued over about $2.25 million. In other words, the benefits of the proposal are not even targeted to lower-value estates nearer the current threshold. The disproportionate benefit to larger estates is because the estate tax is a graduated tax. For larger estates, the proposal would remove from taxation $2 million that would have otherwise been taxed at higher rates, making the exclusion worth more for those estates.
   - The Governor's proposed estate tax change is not needed to eliminate one of the Governor's concerns with the current estate tax: the abrupt onset of the Massachusetts estate tax. **The so-called "estate tax cliff" could alternately be eliminated with only a few million dollars of total revenue loss by instead creating a small tax credit just above the tax threshold that phases out quickly** (for example as set out in H.3038/S.1884). This would eliminate the current situation where some estates would have a higher after-tax value if their pre-tax value had been smaller. The approach would ensure that estates right above the threshold would pay less tax,

and this goal would be accomplished without providing large tax benefits to the biggest estates.

In addition to the Administration’s proposals for capital gains and estate taxation, the Governor’s budget proposal would also make the tax system more regressive because it does not include language further delaying the FY 2023 implementation of a tax deduction for **charitable contributions.**

- Large contributors generally already receive a federal tax break on their contributions. **Slightly more than half of the value of tax breaks from a state charitable tax deduction going into effect in FY 2023 would go to the tiny minority of tax filers with income over $1 million. Once in effect, the full year’s revenue loss would be about $300 million annually.**
- The benefit of this tax break would flow mostly to taxpayers whose incomes are so large that they choose not to take a standard deduction and choose instead to itemize their deductions. **If Massachusetts lawmakers want to establish a state charitable deduction that would be targeted to middle- and lower-income taxpayers, they could do so by making the state deduction available *only to tax filers not also claiming the deduction on their federal taxes*.** This would also retain most of the revenue that would otherwise be lost to this tax cut.

In contrast to these three tax breaks for the state's highest-income households, the Governor proposes other tax changes that would spread benefits across *all* income levels:

- Double the value of the refundable tax credit for families with children under 12 years of age or dependent adults in the household. This change would cost the state $142.3 million in FY 2023, providing benefits to 627,000 tax filers—an average of $227 per eligible tax filer.
- Double the business-related dependent care expense credit, a credit that tends to be used more by middle- or upper-income families who can afford professional child care, with a cost to the Commonwealth of $24.3 million provided to 74,000—an average of $328 per eligible tax filer.
- Increase the maximum allowable renters’ deduction from $3,000 to $5,000, which would provide tax benefits to renters at all income levels. **Because low-income tax filers are more likely to rent than upper-income tax filers they would benefit from this increase in the rental deduction amount. But this is not a refundable credit, so renters may be less able to apply this additional deduction against other taxable income.**

There are two tax proposals in the Governor's budget that are truly targeted to low-income tax filers, though their total benefits are a small fraction of the tax cuts proposed, especially in contrast to the tax breaks that would chiefly benefit high-income filers:

- First, the Governor proposes a $41 million tax break that aligns the state's income threshold "no tax status" with the higher federal levels, which would provide an average benefit of $175 for low- and moderate-income filers. The total value of this tax break is not larger because many low-income people currently receive a refund and will continue to file income taxes to collect that check.
- Second, the Governor proposes doubling the value of the refundable senior circuit breaker credit for low- and moderate-income elders who have especially high housing costs. This change would cost the state an additional $60 million annually in forgone revenue.

MassBudget also has concerns about the Governor proposed changes to the income tax code that would bring the state into conformity with the federal code. The intent of this change is to simplify tax filing and is projected to bring in about $27 million in additional revenue in FY 2023. We are concerned however that over time bringing in some of the federal tax features, especially recently enacted changes in the Trump tax cuts such as so-called "Opportunity Zones," are designed in such a way to create much larger revenue losses in later years. We would urge a thorough prior study of the longer term consequences of this major potential change to state tax code with the intent of decoupling from select measures.

Finally, although the proposal appears in the outside sections (70 and 71) in the Governor's budget proposal rather than the associated tax bill under discussion in this specific hearing, we wish to note that **MassBudget supports the Governor's proposal to end the practice of charging fees to individuals convicted of crimes as part of their parole or probation which results in an estimated $4 million less in fees**. These individuals and their families often face financial struggles that are compounded by these fees which make it more difficult to transition successfully from incarceration.

FY 2023 BUDGET REVENUE INITIATIVES ($ millions)	
TAX REVENUES	
Lowering the Tax Rate on Short-Term Capital Gains	(117)
Reducing the Number of Households Subject to the Estate Tax	(231)
Doubling the Dependent Household Member Tax Credit	(142)
Doubling the Child Care Expenses Tax Credit	(24)
Increasing the Rental Deduction	(77)

Increasing Threshold for No Tax Status to Align with Federal Threshold	(41)
Doubling the Senior Circuit Breaker Credit	(60)
Tax-Related Settlements and Judgments	50
Federal Conformity and Other Statutory Updates	27
TOTAL	(616)