June 10, 2022

**To:** House and Senate Ways and Means Committee members and staff
**Re**: Options for Targeted Tax Relief and a Warning About Estate Tax Changes
**From**: Marie-Frances Rivera (mrivera@massbudget.org), Phineas Baxandall (pbaxandall@massbudget.org), Nancy Wagman (nwagman@massbudget.org), Kurt Wise (kwise@massbudget.org)

Chairman and Members of the House and Senate Committees on Ways and Means,

Tax collections have come in higher than estimated back when the FY 2022 budget was enacted. This is what people refer to as a tax "surplus." This surplus, however, does not mean that the state budget has already met the needs of the moment or that this is extra unneeded revenue.

Policymakers have three choices:

1. Invest these unobligated dollars in areas of the state budget and in communities where important needs are still unmet.
2. Make thoughtful changes to tax policy to support low-income residents who have been left behind during the pandemic.
3. Alternatively, put these dollars into the pockets of the people who need this money the least – with tax cuts for the state's wealthiest and highest-income residents. Permanent tax cuts for high-income residents from a temporary surplus would be risky, unwise, and unjust.

Which kinds of tax changes deliver proportionally greater relief to households that need it most? In general, it's those that provide a lump-sum of relief to a tax filer or that are based on family size. There are also tax policies available only for people below a certain income threshold or who have suffered certain economic misfortunes. Unlike tax deductions and exclusions, refundable tax credits put money in the pockets of even people whose income is so low they don't pay taxes.

These policies stand out:

- The **Earned Income Tax Credit** (EITC) provides support to almost 400,000 working households with incomes below about $60,000 depending on family size. In addition to helping families make ends meet, the EITC has been shown to improve educational and health outcomes for households that receive it. The Commonwealth currently matches 30 percent of the federal benefit, and could increase that to 50 percent at a cost of $175 million. State reforms could also extend eligibility to groups that have been federally excluded from the credit, such as adults under 25 and seniors. We could also follow seven other states that have ended exclusions of households who file income taxes with one or more members who are ineligible for a social security number.

- The **Household Dependent Tax Credit** and **Dependent Care Tax Credit** are refundable credits claimed for children under 12 or 13 respectively living in the household, or for work-related childcare expenses. The first credit can also be claimed for dependent adults living at home, such as those with disabilities. The second credit is for work-related formal child care expenses. It currently has a higher cap and tends to be used more by higher income families. Governor Baker proposed doubling both credits. An even better option would be to merge them at the higher dependent care level, then double the simplified resulting credit ($480 per dependent), and remove rules that penalize large families by limiting benefits to two children per family. Analysis by the Niskansen Center has shown these reforms to be very well targeted to those most in need and would cost between $162 million to $310 million depending on the option.
- Aligning the state's income threshold **"no tax status"** with the higher federal levels would allow some of the Commonwealth's lowest income residents not to file income taxes. which would provide an average benefit of $175 for low- and moderate-income filers at a revenue cost of $41 million.
- The **senior circuit breaker** credit helps low- and moderate-income elders for whom housing costs consume a large portion of their income. The maximum credit amount is indexed to inflation, but has not kept pace with faster increases in the cost of housing. Several generally whiter and wealthier municipalities have enacted local supplements for long-time residents because an increasing number of eligible applicants reach the maximum credit without bringing net housing costs in line with their income. The Governor proposed doubling the value of the benefit, a change that would cost the state an additional $60 million annually in forgone revenue.
- **Exempting unemployment insurance benefits from the income tax** or at least exempting benefits below a certain threshold would help those who have suffered from dislocation. Black and Hispanic workers suffer disproportionately from unemployment and thereby received a larger percent of UI benefits than their portion of the labor force. At the start of this calendar year, 76,626 Massachusetts workers were still receiving unemployment insurance, many of whom will be surprised that they must pay tax on that income.

### Most Proposed Estate Tax Cuts Would Be Costly and Highly Regressive

Meanwhile, some proposed tax cuts would be especially costly and worsen economic disparities. Particularly egregious in this respect are proposals to weaken the Commonwealth's state tax on large estates. 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 has proposed increasing the threshold to $2 million and changing 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 and this money would go to the **holders of large estates who are by definition the wealthiest families in the Commonwealth**. The Massachusetts estate tax is graduated, with rates that rise from 4 percent of the value of estates of about $1 million to 16 percent for larger estate amounts.

According to the Department of Revenue there were 4,274 estates taxed in Massachusetts in 2017, a year in which the state registered close to 58,900 deaths. **Claims about the prevalence of the estate tax are greatly exaggerated** by references made to the high average cost of recently-sold single family homes. Average figures get skewed by a few very high numbers and the cost of single family homes on the market do not necessarily represent the typical home value for an owner. The median owner-occupied housing unit in Massachusetts has a value of nearly $400,000 – a large sum, but far from $1 million, and the value counted in an estate is less for those with outstanding mortgages.

The recent analysis prepared by the Department of Revenue for the Senate Revenue Working Group shows that almost two-thirds of the value of the Governor's proposed estate tax cut would go to the wealthiest two-fifths of estates, those valued over about $2.25 million. The disproportionate benefit of exclusions to larger estates results from the higher graduated tax applied to these estates. For larger estates, the Governor's 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 approach is not needed to eliminate one of the concerns with the current estate tax: the abrupt onset of the estate tax. Any proposal that creates an exclusion for the first million or more of estates without completely restructuring estate tax rates at higher levels will **inadvertently provide the most benefit to the largest estates**. 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.

Thank you for your consideration of these comments. If you do choose to pursue a package of tax cuts, we urge you to choose options that are well-targeted toward low-income tax filers and not to weaken the estate tax. If you have any questions, need more information or would like to meet with us to discuss this further, please contact us at the emails we provided above.