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A Blast from the Past: Reagan-Era Tax Law Hits Hard

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You are not alone if you had never heard of the Massachusetts "tax cap law," or what is also known as "62F." This Reagan-era law sets an artificial limit on how much tax revenue Massachusetts can collect, regardless of the current needs of the Commonwealth.

While this law may sound like something only budget nerds would care about, we've seen that it has the power to short-circuit efforts to move important policies forward. Consider some of the important initiatives legislators abandoned at the chaotic end of the 2022 legislative session due to the threat of 62F being triggered this year, including increases in the Earned Income Tax Credit (EITC) and the dependent tax credits.[1]

Not only that, this law in effect transfers to higher income households tax revenue paid by lower-income households. This occurs under income tax credits that do nothing to improve racial or economic equity in our state.

Like a Bad Suit: Outdated and Constricting

As debates about this law emerge, we need to keep in mind its origins and how things have changed since 1986. While the law was passed by ballot initiative, it passed by a slim majority[2] in a low-turnout election[3] during a high-water mark of anti-tax and anti-government sentiment. Our understanding of what state government can and should do has also changed since 1986. For example, we have made collective commitments to universal health insurance coverage and school funding reform since then, both of which require resources. The 62F law handcuffs the Commonwealth from making decisions about spending priorities and what is fiscally possible.

In addition, the law's calculations are problematic and don't align with today's economy, and the required tax credit is regressive and favors the state's higher-income taxpayers.

So, 62F emerged from a unique moment in recent history, but it is obsolete and built on an understanding of our economy and government that is decades out of date. Is this how we want to make crucial policy today?

Does it "Walk the Walk?"

The 62F law fails on multiple counts. The law measures how much the state can afford to raise in taxes by looking at the average growth in wages and salaries across the Commonwealth. This is flawed because it does not consider **all** of people's income. In fact, more of some people's income—typically wealthier people— now comes from capital gains, which are profits made from selling assets like stocks or real estate. There are huge racial disparities in wealth, which means that an important source of income for many white households and higher income households does not count as part of the state's "ability to pay."[4,5]

Another flaw in the design of the law is that when 62F calculates the related tax credit, the amount of the credit is based only on the amount of *income tax* someone has paid. Lower income households in Massachusetts pay a higher share of their income in taxes compared to higher income households.[6] This is largely due to money spent on non-income taxes such as sales taxes and the gas tax. A low-income family that paid sales and gas taxes would not get a 62F credit if they were not required to pay income tax, and they might not receive a credit if low-income credits like EITC or dependent tax credits reduce the income tax they owe to $0.[7] These households would be excluded from 62F tax credits despite contributing significantly to the state's total tax revenue via sales, gas, and other non-income taxes and fees.

Finally, the law creates a problem when there has been a recent, substantial change in the economy. In particular, the law will likely be triggered when there is a surge in inflation. While 62F measures tax collections in the current year, growth in total wages and salaries are averaged over the prior three years. Consider that inflation increased dramatically in the past year. So, this year we are comparing tax revenues from a high inflation year to wage and salary growth in prior years with much lower inflation.

Sure, thinking about 62F includes a lot of budget nerdiness, but the implications are real. This law limits our ability to use the revenue we raise to address critical needs for the Commonwealth. Think about our burning MBTA trains, our broken child care system, our affordable housing crisis, and our commitments to universal health insurance coverage and school funding reform. We should pay close attention to how 62F calculates the balance between the state's income and the state's tax collections and whether it distributes any tax credits equitably. And perhaps we should ask ourselves if we are comfortable with having our ability to address our needs limited by such a formula in the first place.

[1] https://commonwealthmagazine.org/state-government/groggy-lawmakers-pull-the-plug-on-1b-tax-package/
[2] https://electionstats.state.ma.us/ballot_questions/view/5510/
[3] https://www.sec.state.ma.us/ele/elevoterturnoutstats/voterturnoutstats.htm
[4] https://www.cbpp.org/research/state-budget-and-tax/state-taxes-on-capital-gains
[5] https://massbudget.org/2020/11/05/raising-rates-on-unearned-income-an-equitable-way-to-avoid-cuts-and-support-a-robust-and-just-recovery/
[6] https://itep.org/whopays-map/
[7] 830 CMR 62F.6.1(2) defines income tax liability as "…a taxpayer's liability to the state for taxes under M.G.L. c. 62, after allowing for any credits."