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Massachusetts Budget & Policy Center

July 25th, 2023

Final Tax Package Can Improve Tax Fairness & Help Build Toward Shared Prosperity

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Key Takeaways

- The fairest tax package will be one that delivers its benefits overwhelmingly to low- and middle-income households and which greatly limits tax cuts for very high-income and wealthy households. This will help correct our upside-down state and local tax system.
- For the Child and Dependent Tax Credit, the House version will provide more meaningful relief to families who are struggling to afford Massachusetts' high cost of living.
- Closing the married filing separately loophole is a simple, evidence-based solution to eliminate an opportunity for tax avoidance available only to the state's highest-income married couples.
- Any estate tax cut will overwhelmingly benefit a small number of the state's wealthiest families, but the Senate's version is less costly and focuses benefits on estates valued at under $2 million.

The House and Senate each have offered their own package of proposed tax changes. Currently, a conference committee is working on a compromise package. While some elements are identical between the two packages, other elements differ significantly. Each package contains elements that deliver the bulk of their benefits to low- and middle-income households and other elements that focus benefits overwhelmingly on high-income and wealthy households.

Massachusetts suffers from high levels of income and wealth inequality. Our current state and local tax system makes these inequalities worse. Even with the new millionaire tax in place, Massachusetts still has an upside-down tax system, one in which low- and middle -income households pay a larger share of their household income toward taxes than high-income households do.

Tax policy changes can help correct our upside-down tax system if they deliver the bulk of their benefits to low- and middle-income households. Very high-income and wealthy Massachusetts households do not need tax relief – these households are doing very well already. To build on our state's economic successes, we need to address affordability issues for low- and middle-income households. One way to do this is by providing targeted tax relief to these households. Another way we can do this is by making public investments in affordable housing, childcare, higher education and transportation. By contrast, regressive tax cuts – ones that primarily benefit high-income and wealthy households - will act as a drain on state resources, reducing the Commonwealth's ability to make these important investments.

MAJOR PROGRESSIVE ELEMENTS

The following major elements, appearing in either or both the House and Senate tax package proposals, would improve tax fairness and help low- and middle-income households in Massachusetts. (Cost estimates are drawn from the Department of Revenue (DOR) tax package analyses released on July 17th, 2023. Because some elements are phased in over several years or are designed in such a way that costs grow significantly over time, we present here DOR's furthest out-year projections (for Fiscal Year 2029) to give the most complete view of how revenues would change over time.

- Increases to the state **Earned Income Tax Credit** ($89 million), the **Property Tax Senior Circuit Breaker** ($73 million), and the **Rental Deduction** ($46 million) would deliver their benefit primarily to low-and middlle-income households. The EITC and Senior Circuit Breaker increases each would deliver benefits of $200 to $300 per household per year, overwhelmingly to low-income households. The Rental Deduction increase would offer a benefit of only about $50 per year per household and would deliver a modest share of its benefits to middle-income households as well. Analysis by the Institute on Economic Policy and Taxation indicates that increases to the EITC and Rental Deduction would improve racial tax equity in Massachusetts, with a larger share of the benefits from these tax cuts going to households of color than the share of tax filers who are people of color. Benefits from increasing the Senior Circuit Breaker are skewed more to white households, largely a result of the fact that Massachusett's elderly population is disproportionately white.

- Both the House and Senate have proposed replacing two smaller credits with a larger **Child and Dependent Tax Credit**. The Senate would provide a credit of up to $310 per child or adult dependent over 65 years old or with disabilities. DOR estimates that the total cost of the Senate proposal would be $173 million per year. The House proposal would be phased in over three years, ultimately delivering a maximum credit of $600 per child/dependent and would be indexed to inflation. DOR estimates the House plan would cost $539 million a year in FY 2029. Both of these proposals would advance economic and racial tax justice in the Commonwealth. Neither is as weighted toward lower-income recipients as the proposed increases to the EITC and Senior Circuit breaker or even the Rental Deduction.

- As part of its Fiscal Year 2024 budget proposal, the Senate has recommended closing the **married filing separately loophole** that allows married couples to file jointly at the federal level but separately on their state taxes. Other states that apply different tax rates at high incomes either outright forbid this practice or discourage it by applying higher rates starting at lower income thresholds for single tax filers. Previously, such a safeguard was not relevant because Massachusetts did not apply different tax rates at different income levels. Now that Massachusetts has a voter-approved millionaires tax, this loophole in our tax code could have a major impact on revenue collections. DOR estimates that this loophole could cost the Commonwealth as much as $600 million annually – a top-end figure that corresponds to MassBudget's earlier maximum cost estimate of $200 million to $600 million per year. DOR emphasizes that its top-end estimate likely significantly overstates the impact of this loophole. Even were the actual cost only a third of DOR/Massbudget's top-end estimates, closing this loophole still would preserve some $200 million a year of very progressive state revenue. If left uncorrected, the benefits of this loophole will flow exclusively to the very highest-income households, those with incomes over $1 million. Approximately 90 percent the benefits from the loophole will flow to white households. Closing this loophole would improve racial equity and help ensure that millionaire-income households do not receive additional exemptions from the millionaire surtax.

MAJOR REGRESSIVE ELEMENTS

Other elements of the packages deliver their benefits overwhelmingly to the highest-income and wealthiest households. To the extent that these elements are included in the final package, they would worsen existing economic and racial inequities in Massachusetts.

- Both the Senate and House have proposed **substantial cuts to the state's estate tax**. The Senate proposal would provide a tax credit of up to $99,600 per taxable estate, thereby offsetting all estate taxes for estates valued at $2 million and less. (Estates valued at over $2 million would receive this maximum credit amount, zeroing out the tax obligation on the first $2 million of taxable estate value.) DOR estimates that the Senate proposal would cost $213 million per year. Rather than provide a credit, the House proposal would exclude the first $2 million of estate value from taxation. Though this sounds all but identical to the Senate approach, in fact, the House proposal provides far larger tax cuts to the largest estates and results in a larger overall loss of state revenue. Under the House proposal, the size of the tax cut would increase with increasing estate value above $2 million, reaching a maximum of $320,000 per estate. Taxable estates valued at $12 million and above each would receive this maximum tax cut. DOR estimates that the House proposal would cost $277 million per year, $60 million more than the Senate proposal. While the House proposal is more costly and focuses benefits on the largest estates, both proposals are highly regressive. The benefits of either proposal will go overwhelmingly to a small number of the state's wealthiest families, while few households of color will benefit from an estate tax cut.

- The House has proposed a cut in the tax rate applied to **short-term capital gains**, dropping the rate from the current 12 percent down to 5 percent. Short term capital gains are the income derived from the sale of assets held for less than one year. This form of income is extremely concentrated in the hands of very high-income households; over three-quarters of the benefits from this proposed rate cut would flow to the top 1 percent of Massachusetts households alone. Only three percent of the benefits would go to households in the bottom 80 percent of the income distribution. A disproportionate share of the total benefits would go to white households. DOR estimates a $150 million cost per year by FY 2029.

- The House has proposed extending a tax break called single sales factor apportionment (SSF) to all multi-state businesses operating in Massachusetts. For most large, profitable corporations with significant operations (offices, factories, warehouses and employees) in Massachusetts, this shift will result in a substantial tax cut. Businesses that do not have significant customer bases outside of Massachusetts – in other words, the vast majority of small businesses – will derive no benefit from the expansion of this corporate tax break. DOR estimates that moving to universal SSF will result in a loss of $92 million a year, the benefits of which will flow to large, multi-state corporations and their disproportionately high-income shareholders.

OTHER MAJOR ELEMENTS

The Senate has proposed raising the annual cap on two tax credit programs aimed at increasing the availability of affordable housing. The Senate package would raise the cap on tax credits available to developers through the Housing Development Incentive Program (HDIP) from $10 million to $30 million per year. This tax credit program is meant to incentivize the construction or rehabilitation of market rate housing in Gateway cities. DOR estimates the annualized cost of this cap increase at $25 million. (The House has matched this proposal in its recent supplement to the FY23 Budget.)

The Senate also proposes an increase in the annual cap on credits available to developers through the Low Income Housing Tax Credit (LIHTC) program, bumping up the cap from the current $40 million per year to $60 million per year. This program is intended to incentivize developers to build or rehabilitate affordable housing for the rental market. DOR estimates that the annual cost of this change would grow to $156 million by FY 2029. (DOR notes that credit recipients may claim their credits each year for five years. The annual cost of the Senate's cap hike therefore will grow over time, as existing credit recipients continue to claim their credits for up to five years, and new recipients are added each year. DOR notes that, under the Senate proposal, annual costs are likely to continue to grow significantly in future years, reaching $194 million by Fiscal Year 2031.)

Boosting the amount of credits available through these two tax break programs will almost certainly increase the amount of available housing stock in Massachusetts. An increase in housing stock, however, is not necessarily the same as an increase in affordable housing units. Massachusetts Law Reform Institute, for example, has raised concerns about the ultimate impacts of the HDIP program. MassBudget has not conducted an analysis of the impacts of either the HDIP or LIHTC programs.

CONCLUSION

As the House and Senate work toward a compromise tax package, the goals should be to improve tax fairness, make it easier for low- and middle-income households to afford to live in Massachusetts, and preserve the Commonwealth's ability to make key public investments. Including progressive elements in the final package will support these goals. Including regressive elements will work against them.