Report of the Tax Fairness Commission

Commonwealth of Massachusetts

March 1, 2014

I. Executive Summary

Introduction

The Tax Fairness Commission was established by the Massachusetts Legislature in 2013 as part of the Act Relative to Transportation Finance. The Commission was charged with analyzing a broad array of the Commonwealth's tax laws and focused on the equity of current tax policies.

The fifteen member bipartisan Commission met publicly eight times from September 2013 until February 2014. The Commission reviewed data and analysis prepared by the Department of Revenue, the Institute on Taxation and Economic Policy, the Joint Committee on Revenue, Massachusetts Budget and Policy Center, the Massachusetts Taxpayers Foundation, the Pioneer Institute, and others. After fully engaging in a broad, comprehensive, and lively debate, the Commission now issues this report.

Finding

The Commission concluded the following:

> That the overall tax system in Massachusetts is regressive, meaning middle- and low-income taxpayers pay a larger share of their income in taxes than high-income taxpayers.

Recommendations

The Commission voted on a number of proposals that strive to make the overall tax system fairer in Massachusetts. By majority vote, the Commission recommends the following:

- Institute a graduated income tax through a Constitutional amendment.
- Institute the following package proposal:
  - Increase the state funded match of the federal EITC from its current 15% rate and retain its refundability.
  - Expand the property tax circuit breaker, which is currently limited to senior citizens, to make all low-income individuals and families eligible.
  - Raise the current personal exemption on single filers, heads of households, and married filing jointly.
  - Increase the flat income tax rate from its current 5.2% rate to a rate that will at least offset the revenue loss due to the change in the EITC, the expansion of the property tax circuit breaker, and the increased personal exemption, so long as 80% of taxpayers experience a tax cut or at least no significant tax increase.
- Enact legislation allowing DOR to make administrative changes and enabling the Commonwealth to collect online and remote order sales tax once Congress grants states the ability to do so.
- That the Legislature and Governor explore ways in which the Commonwealth's economic competitiveness can be advanced, including but not limited to addressing specific tax policy regarding research and development activities, including:

    - Considering adopting the Super Research and Development Tax Credit and the Alternative Simplified Research and Development Tax Credit;
    - Reducing or eliminating the minimum corporate excise tax;
    - Reducing the overall corporate excise tax rate; and
    - Adopting a separate reduced small business corporate tax rate.
        - All proposals should be consistent with enhancing the fairness of our tax system, and having the resources to build and sustain roads, public schools, and other public services that are the essential underpinnings of the Commonwealth's vitality.
- Commission members believe that any tax policy changes should be made in both a fiscally responsible and fair way. The Commission urges the Legislature and Governor to critically evaluate any proposal to increase or decrease revenue with an eye to enhancing, or at least not diminishing, tax fairness in the Commonwealth.

II. THE TAX FAIRNESS COMMISSION

A. Genesis and Mandate of the Commission

The Tax Fairness Commission (the "Commission") was established in 2013 pursuant to an Act Relative to Transportation Finance.[1] The Act established the Commission's mandate, mission, and composition, as follows:

> There shall be established, pursuant to section 2A of chapter 4 of the General Laws, a tax fairness commission to study the federal, state and local tax laws applicable to residents of the commonwealth. The commission shall review and evaluate the equity of historical tax rates and methods in relation to the changing income and wealth of residents of the commonwealth since 1990. The commission shall examine the experiences and policy efforts of other states relating to tax fairness.
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> The commission shall file a report with the clerks of the senate and house of representatives not later than March 1, 2014. The report shall include, but not be limited to: (i) the total amount of taxes currently paid by individuals at various income levels; (ii) the effects that changes to tax laws would have on individuals of all income levels; (iii) the changes in revenue collected by the commonwealth as a result of tax law revisions; (iv) the adequacy of revenue generated by individuals, businesses and any other tax types; (v) tax rates necessary to fund investment in public infrastructure; (vi) tax rates necessary to promote prosperity for all residents; (vii) restrictions on tax changes under Article XLIV of the Amendments to the Constitution; (viii) recommendations for changes in laws to achieve an equitable and adequate system of taxation; (ix) the best practices of other states; (x) tax rates necessary to ensure economic competitiveness with peer and competitor states; (xi) tax rates necessary to avoid destabilization of household budgets or undue hardships for citizens; and (xii) tax rates necessary to foster and encourage robust private sector investment in capital equipment and the state's work force.
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> The commission shall consist of the house and senate chairs of the joint committee on revenue or the chairs' designees, who shall serve as co-chairs of the commission; secretary of administration and finance or the secretary's designee; the minority leader of the house of representatives or a designee; the minority leader of the senate or a designee; the chairs of the house and senate committees

[1] Mass. Session Laws ch. 46, § 77, 2013.

on ways and means or the chairs' designees; a representative of the Massachusetts Budget and Policy Center; a representative of the Massachusetts Taxpayers Foundation; a representative of the Kitty and Michael Dukakis Center for Urban and Regional Policy; a representative of the Pioneer Institute; and 4 members to be appointed by the governor, 1 of whom shall represent labor and 2 of whom shall have expertise in economics or tax policy.

B. Commission Members and Staff

Pursuant to the terms of the legislation establishing the Tax Fairness Commission (above), the members of the Commission are:

- Representative Jay Kaufman, Co-Chair of the Joint Committee on Revenue, *Co-Chair of the Commission*
- Senator Michael Rodrigues, Co-Chair of the Joint Committee on Revenue, *Co-Chair of the Commission*
- Glen Shor, Secretary of Administration and Finance, or designee David Sullivan, General Counsel of Administration and Finance
- Representative Randy Hunt, designee of Bradley Jones, House Minority Leader
- Senator Bruce Tarr, Senate Minority Leader
- Marita Callahan, designee of Brian Dempsey, Chair of the House Committee on Ways and Means
- Stephanie Gunselman, designee of Stephen Brewer, Chair of the Senate Committee on Ways and Means
- Noah Berger, President of the Massachusetts Budget and Policy Center or designee Kurt Wise, Senior Policy Analyst of the Massachusetts Budget and Policy Center
- Michael Widmer, President of the Massachusetts Taxpayers Foundation
- Barry Bluestone, Director of the Kitty and Michael Dukakis Center, or designee Alan Clayton-Mathews, Senior Research Associate of the Dukakis Center
- Gregory Sullivan, Research Director of the Pioneer Institute
- Navjeet Bal, Counsel at Nixon Peabody, designee of Governor Deval Patrick with expertise in tax policy
- Philip Edmundson, Chairman of the Alliance for Business Leadership, designee of Governor Deval Patrick
- Harris Gruman, Executive Director of SEIU Massachusetts State Council and the SEIU Massachusetts Political Director, designee of Governor Deval Patrick representing labor
- Robert Tannenwald, Professor of Economics at Brandies University, designee of Governor Deval Patrick with expertise in economics

The Commission would like to thank Commissioner Amy Pitter of the Department of Revenue (DOR), and her staff, Kazim Ozyurt, Director/Chief Economist of DOR's Office of Tax Policy Analysis (OTPA), Fushang Liu, Supervising Economist of OTPA, and John Paul Murphy, Senior Economist of OTPA, who were instrumental in preparing, analyzing, and presenting data on the Massachusetts tax code and explaining the Institute on Taxation and Economic Policy (ITEP) data on other states' tax codes.

Staffing for the work of the Commission was provided by several different sources. The Chairmen of the Commission, Representative Kaufman and Senator Rodrigues, were assisted by the staff of the Joint Committee on Revenue, Jessica Seney, Research Director and Legal Counsel, Paola Maynard-Moll, Legal Counsel, Lisa Ugelow, Senior Research Analyst, Jeremy Spittle, Legislative Director for Senator Rodrigues, Ashley McCormack, Legal Intern from the Northeastern University School of Law, and Heather Sit, Legal Intern from New England Law Boston. The staff assisted with the organization of the Commission meetings, prepared and compiled data, which was disseminated to Commission members and made publicly available, and was responsible for Commission communications. Additionally, the staff drafted this Report under the direction of the Commission Co-Chairs.

Public agendas, detailed minutes of the meetings, and recordings of votes taken (included in Appendices 1 and 2 to this report) were prepared by Heather Sit under the supervision of Ms. Maynard-Moll. Data and other information with respect to the Massachusetts and other states' tax codes were provided by the Department of Revenue, Meg Wiehe from ITEP, and Joint Committee on Revenue staff.

C. Meetings of the Commission

The Commission conducted its work over a span of seven months, from September 2013 through February 2014, with the report due on March 1, 2014. In the course of its work, the Commission held eight formal meetings, on the following dates:

- September 17, 2013 – Introduction and Overview of Tax Policy
- October 1, 2013 –Presentation by DOR
- November 12, 2013 – Presentation by DOR, A&F
- December 3, 2013 – Discussion of Remedies for Individuals
- January 7, 2014 – Economic Competitiveness
- February 4, 2014 – Review of Remedies
- February 12, 2014 – Voting on Recommendations
- February 25, 2014 – Voting on Outstanding Recommendations & Final Report

D. Scope of the Commission Meetings

While it would have been ideal to debate all issues set forth in the Commission's charge, the Commission did not have the time, resources, or ability to report on the charge in its entirety. Of particular note, Commission members concluded that the determination of tax rates and adequacy of revenue is outside of the scope of the Commission and involves policy decisions best left to the Legislature and Governor.

Specifically, Commission members believe the Legislature and the Governor should work to determine the appropriate tax rates necessary to fund investment in public infrastructure, promote prosperity for all residents, ensure economic competitiveness, avoid destabilization of household budgets, encourage robust private sector investment in the state's work force, and achieve the greatest measure of fairness possible. As such, the Tax Fairness Commission is expressly not making recommendations on the extent to which revenue should be increased or decreased to achieve the goals outlined in the Commission's charge.

E. Materials of the Tax Fairness Commission; Availability

In the course of the Commission's work, the Commission requested and reviewed extensive data and other information relating to the structure and rates of Massachusetts and neighboring and competitor states' sales tax, excises taxes, personal income tax, corporate tax, and property tax.

In addition, a number of presentations were made to the Commission over the course of its deliberations, beginning with a presentation at the Commission's second meeting by Massachusetts Commissioner of Revenue Amy Pitter and Kazim Ozyurt, Director of DOR's Office on Tax Policy Analysis, concerning the amount of taxes paid by individuals at varying income levels broken down by quintile (see Section V of this Report below).

At the third meeting, Commissioner Pitter presented ITEP data on how the Massachusetts tax code compares to our neighboring and competitor states' tax codes and, using Massachusetts DOR data, further explained the amount of taxes paid by individuals by dividing the top quintile into the top 1%, 4%, and 15%. (See Appendix 4.) Also at this meeting, David Sullivan presented the metric used by the Administration to compare states' levels of progressivity based upon the amount of taxes paid by individuals at varying income levels. (See Appendix 4.) Lastly, Alan Clayton-Matthews presented an economic analysis of sales tax incidence by education level. (See Appendix 4.)

At the fifth meeting, Commission members heard presentations on economic competiveness from Mike Widmer, Gregory Sullivan, Noah Berger, and Bob Tannenwald. Mr. Widmer presented employment, revenue, and population data to illustrate certain aspects of the business climate in Massachusetts. (See Appendix 6.) Mr. Sullivan shared Professor Michael Porter's 2012 Survey on Competitiveness, and presented six recommendations to enhance economic competitiveness. (See Appendix 6.) Mr. Berger presented data comparing Massachusetts' business climate with other states. (See Appendix 6.) Mr. Tannenwald presented "Three Myths and Truths about State Tax Competitiveness," concluding that all widely circulated indicators of competitiveness are biased; there is little evidence that the impact of interstate differences in income and estate taxes significantly impact out-of-state migration; and state & local business taxes are a relatively small share of total business costs. (See Appendix 6.)

All of the data and other information, literature, reports, and presentations compiled and reviewed by and on behalf of the Commission are set out in the Appendices to this Report. An index of those Appendices immediately follows this summary of the Commission's work and its recommendations. All of this information was circulated to Commission members and available to the public upon request to the Joint Committee on Revenue staff since the Commission's inception.

*Disclaimer: Please note that while every reasonable effort was made to ensure that the data from outside organizations provided in this report is wholly accurate, the Commission cannot fully guarantee the accuracy of the data provided. This data was used for comparison and reference, and any minor inaccuracies would not affect the remedies provided by the Commission.

III. General Tax Policy Definitions; Tax Policy Principles; and Assessing Tax Systems

A. General Tax Policy Definitions

In order to provide context to the data provided below and ultimately, the recommendations of the Commission, it is imperative to provide a generally accepted definition of certain tax policy terms:[2]

1. Regressive
   A regressive tax causes middle- and low-income taxpayers to pay a larger share of their income in taxes than high-income taxpayers.
2. Flat/Proportional
   A flat or proportional tax applies the same tax rate to taxpayers of all income levels, regardless of how much or how little they earn.
3. Progressive
   A progressive tax is one in which high-income taxpayers pay a larger share of their income in taxes than do middle- and low-income taxpayers.

B. Tax Policy Principles

The Commission began with a discussion of general tax policy principles to determine what an optimal tax system should look like. The Commission unanimously voted in favor of an amended version of general tax policy principles (shown below) from the Tax Expenditure Commission, which issued its report in April 2012. (See Appendix 2.)

A tax system should, in its entirety:

a. Provide adequate revenue to consistently support a desired level of government services;
b. Promote economic growth and overall economic welfare and opportunity;
c. Be as equitable as possible, including recognition of differences in taxpayers' capacity to pay taxes;
d. Reflect our values and our public policy objectives;
e. Be as simple, administratively efficient, and cost-effective as possible; and
f. Be as predictable as possible.

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[2] *Fair State and Local Taxes: Fairness Fundamentals, Institute on Taxation and Economic Policy*, INST. ON TAXATION AND ECON. POLICY, 1 (2011), http://www.itep.org/pdf/guide1.pdf.

C. Assessing Tax Systems

The Tax Fairness Commission assessed the Massachusetts tax code through the lens of each Commission member. Representing a diverse mix of academia, business, government, and tax policy professionals, the bi-partisan Commission consisted of different constituencies with differing values and ideals. As a result, Commission members engaged each other in vibrant debate when assessing the tax code and attempting to define fairness and identify inequities.

Throughout deliberation and discussion, this diverse group of Commission members shared their beliefs about what fairness means in the context of their own thinking. Some Commission members believe that the term fairness is synonymous with, or closely linked to, the term progressive. Other Commission members are wary of defining fair by utilizing the term progressive, believing that it is possible to attain a fair tax code without the use of a graduated or progressive tax. Others point out that another definition of fairness balances ability-to-pay with the benefit principle, meaning that those who benefit from spending should pay for it (one example of the benefit principle is the gas tax).

Nonetheless, it is important when considering the issue of tax fairness to consider it wholly through the prism of all taxes within the overall tax code structure. As fellow Commission member, Kurt Wise, has noted in the past: "A tax system typically is composed of a variety of different types of taxes. Usually, the system will include some taxes that are progressive and some that are regressive. Regressive taxes sometimes meet other criteria of a good tax, such as enhancing stability of the overall tax system, and thus may be a valuable part of the overall system. When considering progressivity and regressivity, it therefore is important to examine not just individual taxes, but rather the overall tax system in a state."[3]

Various metrics are used to make determinations about the overall tax system in a state. Certain metrics are indisputable facts, such as the type of tax structure (i.e. flat or graduated) and the rate. Some determinations are based on subjective terms, such as fair, equitable, or adequate. Such determinations are based on value judgments, which may differ depending on the organization or individual assessing the system. What is fair to one might not be considered fair to all.

For example, some people believe that flat taxes are the most fair because, regardless of a taxpayer's income, s/he is subject to the same tax rate as everyone else. Others believe that the only way to achieve a fair tax system is with graduated taxes, which are progressive, where a taxpayer who earns more pays a higher tax rate while a taxpayer who earns less pays a lower tax rate. The debate over which system of taxation is fairer is ongoing and revolves around a subjective value judgment.

It is important to note, however, that it is generally accepted that all state tax codes are regressive because the lowest-income taxpayers pay a greater share of their income in taxes than the highest-income taxpayers. Therefore, when evaluating tax policy, one might look for ways to make a system less regressive or more progressive rather than making it, by definition, outright progressive.

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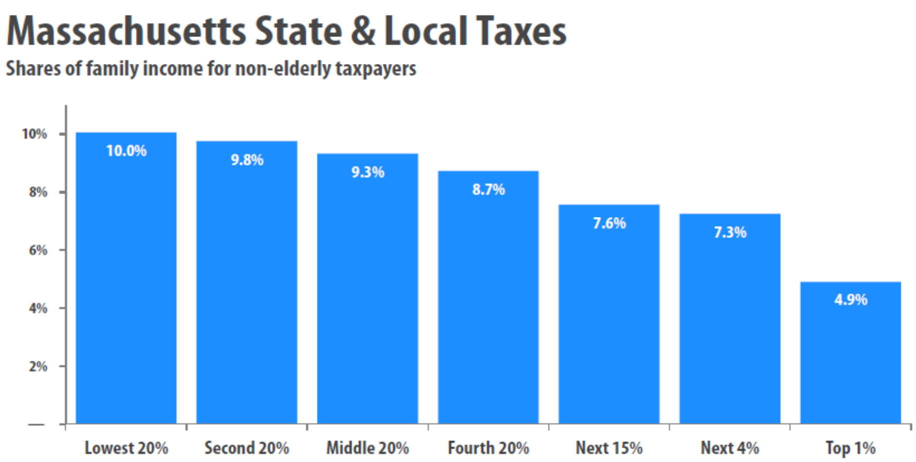
[3] Kurt Wise, *Examining Tax Fairness*, MASSACHUSETTS BUDGET AND POLICY CENTER (March 12, 2013), http://massbudget.org/report_window.php?loc=tax_fairness.html&utm_source=cc&utm_medium=email&utm_campaign=budget.

IV. THE COMMONWEALTH OF MASSACHUSETTS TAX CODE

The Commission examined the amount of state and local taxes paid by individuals and families in the Commonwealth with differing incomes, from those with the lowest income to those with the highest. As illustrated by the figure below, the overall Massachusetts tax system is regressive, meaning low-income taxpayers pay a larger share of their income in taxes than high-income taxpayers. The regressivity in the overall system is largely associated with factors relating to the property tax and the sales tax.

The personal income tax, however, is the one major tax that works to reduce the regressivity of the overall system. Although the Commonwealth levies a flat income tax, the effect of the tax is progressive because of a number of exemptions, deductions, and credits for low-income taxpayers, including a provision that exempts very low-income individuals from paying any income tax, a substantial personal exemption available to all taxpayers, and a state administered Earned Income Tax Credit.



Note: Figures show permanent law in Massachusetts enacted through January 2, 2013 at 2010 income levels. Top figure represents total state and local taxes as a share of income, post-federal offset. [4]

[4] *Massachusetts State & Local Taxes*, INST. ON TAXATION AND ECON. POLICY, (2013), http://www.itep.org/pdf/ma.pdf. Note that if the "federal offset" is taken into account, the Massachusetts tax code is even more regressive. The offset allows taxpayers to deduct their state income taxes from their federal taxable income, which reduces the federal tax liability of taxpayers paying state-level income taxes. Naturally, the value of this deduction depends upon the amount of state-level income tax paid; the types of income (unearned/investment or wage/salary); and the top marginal rate at which a taxpayer pays federal taxes. Therefore, the offset is of great value for high-income taxpayers, who pay federal income tax at the top marginal rate of 39.6%, but of little to no value for low-and-middle-income taxpayers. Wise, *supra* note 3.

Massachusetts State & Local Taxes

Details, Tax Code Features, & Recent Developments

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than $21,000	$21,000 – $42,000	$42,000 – $68,000	$68,000 – $111,000	$111,000 – $229,000	$229,000 – $780,000	$780,000 or more
Average Income in Group	$11,700	$31,600	$54,000	$87,100	$149,700	$346,700	$2,168,000
Sales & Excise Taxes	**5.0%**	**3.8%**	**2.9%**	**2.3%**	**1.7%**	**1.1%**	**0.5%**
General Sales—Individuals	2.1%	1.8%	1.5%	1.3%	1.0%	0.7%	0.3%
Other Sales & Excise—Ind.	1.4%	0.9%	0.6%	0.4%	0.3%	0.1%	0.0%
Sales & Excise on Business	1.5%	1.1%	0.8%	0.7%	0.5%	0.3%	0.2%
Property Taxes	**4.4%**	**3.3%**	**3.1%**	**3.3%**	**3.1%**	**2.6%**	**1.5%**
Property Taxes on Families	4.3%	3.3%	3.1%	3.2%	3.0%	2.3%	0.7%
Other Property Taxes	0.1%	0.0%	0.1%	0.1%	0.1%	0.3%	0.8%
Income Taxes	**0.7%**	**2.8%**	**3.8%**	**4.1%**	**4.2%**	**4.5%**	**4.5%**
Personal Income Tax	0.7%	2.8%	3.8%	4.1%	4.1%	4.4%	4.3%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.3%
Total Taxes	**10.1%**	**9.9%**	**9.8%**	**9.7%**	**9.0%**	**8.2%**	**6.5%**
Federal Deduction Offset	0.0%	-0.2%	-0.5%	-1.0%	-1.5%	-1.0%	-1.6%
OVERALL TOTAL	**10.0%**	**9.8%**	**9.3%**	**8.7%**	**7.6%**	**7.3%**	**4.9%**

Note: Figures show permanent law in Massachusetts enacted through January 2, 2013 at 2010 income levels. Top figure represents total state and local taxes as a share of income, post-federal offset.[5]

A. Personal Income Tax

In Massachusetts, throughout the nineteenth century, income from professions, trades, or employment was taxed under the local property tax. In 1915, Article 44 of the Amendments to the Massachusetts Constitution was enacted, which allowed the Legislature to directly tax residents' income.[6] The following year, the legislature utilized Article 44 to levy an income tax on individuals, partnerships, trusts, estates, and other fiduciaries. Article 44 requires that income from the same class of property be taxed at the same rate, which means that the Commonwealth must levy a flat tax on the same type of income.

Current Rates

- The tax rate on income from wages, pensions, business income, rents, etc. as well as interest and dividend income is 5.20%;
- The tax rate on income from long-term capital gains, except for collectibles and pre-1996 installment sales is 5.20%.[7]
- The tax rate on income from short term capital gains, long term gains resulting from the sale of collectibles and pre-1996 installment sale is 12%;
    - Note: A 50% deduction is allowed on gains from the sale of collectibles and pre-1996 installment sales.

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[5] *Id.*

[6] M.A. Const. amend. XLIV.

[7] *Frequently Asked Questions: What are the Massachusetts income tax rates for tax year 2013?* MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/individuals/filing-and-payment-information/personal-income-tax-faqs/personal-income-tax-faqs.html.

Note that taxpayers have the opportunity to elect to pay a tax rate of 5.85% on taxable income, which would otherwise be taxed at 5.20%. This option is not applicable to short term gains and gains on collectibles.[8]

The income tax rate has changed several times over the last decade. As of September 1, 1999, the rate was 5.95%. In the Fiscal Year 2000 Budget,[9] the rate was to be reduced according to the following schedule for tax years beginning on or after January 1, 2000:

1999 . . . . . 5.95% [existing rate before passage of FY2000 Budget]
2000 . . . . . 5.85%
2001 . . . . . 5.80%
2002 . . . . . 5.75%

However, the above rate reduction schedule was superseded by the Nov. 7, 2000 ballot Initiative Petition, which repealed the law setting the tax rate at 5.95% and lowered the rate according the following schedule:[10]

2001 . . . . . 5.60%
2002 . . . . . 5.30%
2003 . . . . . 5.00%

The Initiative Petition also provided that if the Legislature set a lower rate for any of those years, the lower rate would apply.[11] At the time of the Initiative Petition, the rate reduction was estimated to cost the Commonwealth $2.7 billion over four years.[12]

In 2002, legislation passed over the Governor's veto that superseded both of the above rate reduction schedules.[13] The new law froze the income tax at the then existing rate of 5.3%, to be subsequently reduced to 5.0% by .05% increments if certain economic triggers were met.[14] The economic triggers, rather than automatic decreases, were used in order to be fiscally responsible by temporarily suspending the rate decreases if the economy faltered. The triggers were utilized to reflect the Commonwealth's economic health and its ability to fulfill its obligations to the people.

The economic triggers were met, first, in calendar year 2012. As a result, the income tax rate was reduced from 5.3% to 5.25%. DOR estimated that the reduction would cost the Commonwealth $60 million in fiscal year 2013 and thereafter.[15] The triggers were met again in calendar year

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8 *Id.*
9 An Act Making Appropriations for the Fiscal Year 2000, Mass. Session Laws ch. 127, 1999.
10 An Act Enhancing State Revenues, Mass. Session Laws ch. 186, 2002.
11 *The Official Massachusetts Info. for Voters: The 2000 Ballot Questions*, SEC'Y OF THE COMMONWEALTH 1, 8 (2000), http://www.sec.state.ma.us/ele/elepdf/IFV2000.pdf.
12 *Id.*
13 An Act to Roll Back the State Income Tax Rate to 5 Percent by the Year 2003, Mass. Session Laws ch. 343, 2000.
14 See the Remedy for the Institution of a Graduated Income Tax in Section VII, page 24.
15 Letter from Comm'r Amy Pitter, Massachusetts Dep't of Revenue, to Sec'y Glen Shore, Exec. Office for Admin. & Finance, (Sept. 4, 2013) (on file with author).

2013. The rate for tax year 2014 and thereafter was further reduced to 5.2%.[16] DOR estimated that revenue collections for the remainder of fiscal year 2014 would drop by an estimated $65 million.[17] Even with the rate reductions, the personal income tax is the state's largest revenue source, accounting for $12.831 billion or 58% of state-only tax revenue for Fiscal Year 2013.[18]

Proposed Constitutional Amendments to allow for a graduated income tax were rejected at the ballot in 1962, 1968, 1972, 1976, and 1994.

A Massachusetts full-year and/or part-year resident is required to file a tax return with the Commonwealth if his/her Massachusetts gross income exceeds $8,000.[19] A Massachusetts nonresident is required to file a nonresident tax return if his/her Massachusetts source income exceeds the smaller of $8,000 or the prorated personal exemption (the personal exemption times the Massachusetts source income divided by the amount that would be Massachusetts gross income if the taxpayer were a full-year resident.)[20]

The amount of the personal exemption allowed varies depending on taxpayer status. The exempted amounts are considered to be outside of the generally accepted tax base because they reflect the notion that income needed for bare subsistence should be free from tax. The personal exemption amounts, effective for the 2013 taxable year, are as follows:

Filing Status	2013 Exemption Amount
Single; Married filing Separate	$4,400
Head of Household	$6,800
Married filing Joint	$8,800

Massachusetts also allows exemptions for adoption, blindness, dependents, medical and dental expenses, and seniors age 65 and over.[21]

Additionally, a $1,000 exemption is allowed for each dependent claimed that qualifies for a federal dependent exemption under the Internal Revenue Code. This exemption does not include taxpayer or spouse.[22]

Massachusetts also offers numerous income tax deductions and credits to help offset personal income tax liability.[23] These reductions in tax liability, and those that particularly serve low-and-middle income tax payers, lessen the regressivity of the personal income tax in Massachusetts.

[16] *Id.*
[17] Press Release, Massachusetts Dep't of Revenue, Nov. Revenue Collections Total $1.572 Billion: Revenue Collections Meet Final Threshold to Lower Income Tax Rate (Dec. 4, 2013).
[18] *See* Appendix 3.
[19] *Frequently Asked Questions: When am I Required to File a Tax Return in Massachusetts?* MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/individuals/filing-and-payment-information/personal-income-tax-faqs/personal-income-tax-faqs.html.
[20] *Id.*
[21] *Form 1 and 1-NR/PY Exemptions,* MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov /dor/individuals/filing-and-payment-information/guide-to-personal-income-tax/exemptions/form-1-and-1-nrpy-exemptions.html.
[22] *Id.*

B. Sales and Use Tax

Massachusetts first enacted its sales and use tax in 1966 at the rate of 5% of the purchase price of tangible personal property. The rate was raised from 5% to 6.25% in the Fiscal Year 2010 budget.[24] An Initiative Petition to lower the rate from the heightened 6.25% to 3% appeared on the November 2010 ballot but was not approved by voters. The rate remains 6.25% as of calendar year 2014.

The sales tax is levied on the price or rental charge of tangible personal property,[25] or certain telecommunications services[26] sold or rented in the Commonwealth. The tax is applied to the sale of most tangible goods; most non-essential items are subject to the tax while essential items, such as groceries, clothing[27], health care items, and home energy supplies, are not.[28] There are numerous sales tax exemptions to help offset the tax's regressivity. Consumers pay the sales tax directly to the vendor at the time of sale, in addition to the purchase price; the vendor then remits the tax to the Commonwealth.[29]

The use tax rate is also 6.25% of the sales price or rental charge on taxable tangible personal property (including phone and mail order items or items purchased over the Internet) or certain telecommunications services on which no sales tax, or a sales tax rate less than 6.25%, was paid and which is to be used, stored or consumed in the Commonwealth.[30] The use tax, unlike the sales tax, generally is paid directly to the Commonwealth by the consumer.

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[23] *See Tax Expenditure Budget: Fiscal Year 2013*, EXEC. OFFICE OF ADMIN. AND FINANCE OF THE COMMONWEALTH OF MASSACHUSETTS 1, 10 (2012), available at www.mass.gov/dor/docs/dor/stats/teb/teb2013.pdf (For a complete list of the credits and deductions).

[24] *Id.* at 65.

[25] Tangible personal property includes electronically transferred software. *See* Mass. Gen. Laws ch. 64H, § 1; Technical Information Release, MASSACHUSETTS DEP'T OF REVENUE, 05-15: Transfers of Prewritten Computer Software (Feb. 10, 2006) available at http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/2005-releases/tir-05-15-transfers-of-prewritten-computer.html (for more detailed definition**)**; *See also A Guide to Sales & Use Tax*, MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor /individuals/filing-and-payment-information/personal-income-tax-faqs/personal-income-tax-faqs.html.

[26] Telecommunications services include telephone and other transmissions of information (such as beeper services, cellular telephone services and telegram services). Cable television and internet access are exempt from the sales tax. Generally, the tax on the sale or use of telecommunications services is a tax on the transmission of messages or information by various electronic means, but not on the sale or use of information itself. *See* Technical Information Release, MASSACHUSETTS DEP'T OF REVENUE, TIR 05-8: Taxation of Internet Access, Electronic Commerce and *Telecommunications Services: Recent Federal Legislation*, MASSACHUSETTS DEP'T OF REVENUE (July 14, 2005), available at http://www.mass.gov/dor/ businesses/help-and-resources/legal-library/tirs/tirs-by-years/2005-releases/tir-05-8-taxation-of-internet-access.html); *See also A Guide to Sales & Use Tax*, *supra* note 25. (For a list of taxable telecommunications services).

[27] Sales of individual items of clothing costing $175 or less are exempt from the sales tax. The tax is due only on the amount over $175 per item.

[28] Kurt Wise and Noah Berger, *Understanding Our Tax System: A Primer for Active Citizens*, MASSACHUSETTS BUDGET AND POLICY CENTER (Sept. 9, 2010, updated Dec. 1, 2010), http://massbudget.org/report _window. php?loc=Tax_Primer_83110.html.

[29] *A Guide to Sales & Use Tax*, *supra* note 25.

[30] *Id.*

Massachusetts is not able to collect sales tax from out of state vendors who sell online or over the phone to Massachusetts residents.[31] Although residents are required to pay the use tax, enforcement is nearly impossible, and the Commonwealth loses hundreds of millions of dollars in uncollected revenue. Federal legislation allowing states to collect taxes due on online sales passed the Senate 69 in favor, 27 against, with 4 abstaining, and is currently pending in the House of Representatives.[32]

Although the sales tax produces the second largest share of tax revenue for the Commonwealth (after the personal income tax), accounting for $5.164 billion or 23.34% of state-only tax revenue for Fiscal Year 2013,[33] annual growth in sales tax revenues diminish yearly.[34] This is likely due to the shift in the economy from the purchase and sale of goods toward the purchase and sale of services, and the increase in online shopping.[35]

C. Excise Taxes

The Commonwealth levies an excise on fuel, alcohol, and tobacco products. The excise is applied to each unit of a good and reflected in the price of the good, whereas the sales tax is applied as a percentage of the price when purchased.

Gasoline

Massachusetts began levying a tax on fuel in 1928. Gasoline was taxed at a fixed price per gallon from the time that it was imposed until 1980. In that year, the tax was changed from a fixed excise to an ad valorem tax of 10% of the average wholesale price. At that time, the equivalent tax per gallon was $0.11 per gallon at the prevailing price of gasoline.[36]

In 1983, the tax rate was changed to the current structure with the tax equal to the greater of an ad valorem tax of 10% of the average wholesale price, or $0.11 per gallon. In effect, it was the easing of oil prices in the 1980's that caused the Legislature to impose the price floor, because in 1983 the average wholesale price dropped the gallon equivalent of the ad valorem tax to about $0.09 per gallon.[37]

The gasoline tax was further raised as part of the 1990 tax package in two phases: the tax was raised to the greater of 15.5% of the average wholesale price or $0.17 per gallon effective 7/28/90 to 12/31/90. The tax was further raised to the greater of 19.1% of the average wholesale price or $0.21 per gallon effective January 1, 1991.[38]

[31] As a result of the Supreme Court case, *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992), retailers are only required to collect sales tax in states in which the retailer has a "physical presence." Therefore, states are unable to require out of state retailers to collect sales tax on purchases made by residents online, over the phone, and through mail-order catalogs.

[32] Marketplace Fairness Act of 2013, S. 743, 113th Cong. (2013).

[33] *See* Appendix 3.

[34] Wise and Berger, *supra* note 28.

[35] *Id.*

[36] Internal Memorandum of the Joint Comm. on Revenue (March 29, 2000) (on file with author).

[37] *Id.*

[38] *Id.*

The 2013 Act Relative to Transportation Finance[39] increased the gasoline excise from $0.21 to $0.24 per gallon with annual adjustments for inflation beginning in 2015. There is an additional $0.025 cent per gallon fee for the Underground Storage Tank Fund. This latest increase will bring in an estimated $110 million a year, while costing the average driver $12 to $30.[40]

<u>Tobacco Products</u>
Massachusetts has levied an excise tax on cigarettes and tobacco products since 1996. The excise rate has increased over the years as public health concerns grow. The 2013 Act Relative to Transportation Finance increased the excise on cigarettes from $2.51 per pack of 20 cigarettes to $3.51 per pack of 20.[41]

Massachusetts also levies an excise on smokeless tobacco, smoking tobacco, and cigars. The 2013 Act Relative to Transportation Finance also increased the rate on smokeless tobacco from 90% of the price to 210% and for smoking tobacco and cigars from 30% of the price to 40%.[42]

<u>Alcohol</u>
Alcohol excise rates vary according to type of alcohol. The rates range from $0.03 per gallon on cider to $4.05 per gallon for alcoholic beverages that are 15% or more alcohol by volume. (See Appendix 7 for full chart of alcohol excise rates.)

D. Corporate Tax

The corporate excise was enacted in 1919, replacing a corporate franchise tax, which was levied on the value of capital stock. Initially, the corporate excise was imposed on corporate excess and on net income.[43]

Since 1962, the Massachusetts corporate excise is levied on tangible property or net worth (depending on the mix of property held by the corporation) and on net income. The income measure is equal to 8% of the corporation's taxable net income. The property/net worth measure is levied at the rate of $2.60 per $1,000 of either a corporation's taxable Massachusetts tangible property or its taxable net worth. The total excise is the combination of the property/net worth and net income measures, or the minimum corporate excise, whichever is greater. The minimum corporate excise is $456.[44]

Since January 1, 2009, Massachusetts requires certain corporations engaged in a unitary business to calculate their income on a combined basis. A corporation is subject to combined reporting if it is subject to the corporate excise and is engaged in a unitary business with one or more other

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[39] An Act Relative to Transportation Finance, Mass. Session Laws ch. 46, § 77, 2013.
[40] Erin Aliworth, *Mass. House Looking at a 3-cent Hike in Gas Tax*, THE BOSTON GLOBE, Apr. 10, 2013.
[41] *Massachusetts Tax Rates*, MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/all-taxes/tax-rate-table.html.
[42] *Id.*
[43] *Tax Expenditure Budget 2013: Corporate and Other Business Excise Description*, MASS.GOV (2012), http://www.mass.gov/bb/h1/fy13h1/tax_13/htaxexpcorptext.htm.
[44] *Id.*

corporations under common control, whether or not the other corporations are taxable in Massachusetts. Combined reporting does not apply to the non-income measure of corporate excise.[45]

To help alleviate the impact of increased taxation as a result of combined reporting, the legislature reduced the corporate excise rate from 9.5% in 2008 to 8.75% in 2010, 8.25% in 2011, and 8% in 2012. The corporate tax produces the third largest share of tax revenue for the Commonwealth (after the personal income tax and sales and use tax), accounting for $2.262 billion or 10.22% of state-only tax revenue for Fiscal Year 2013.[46]

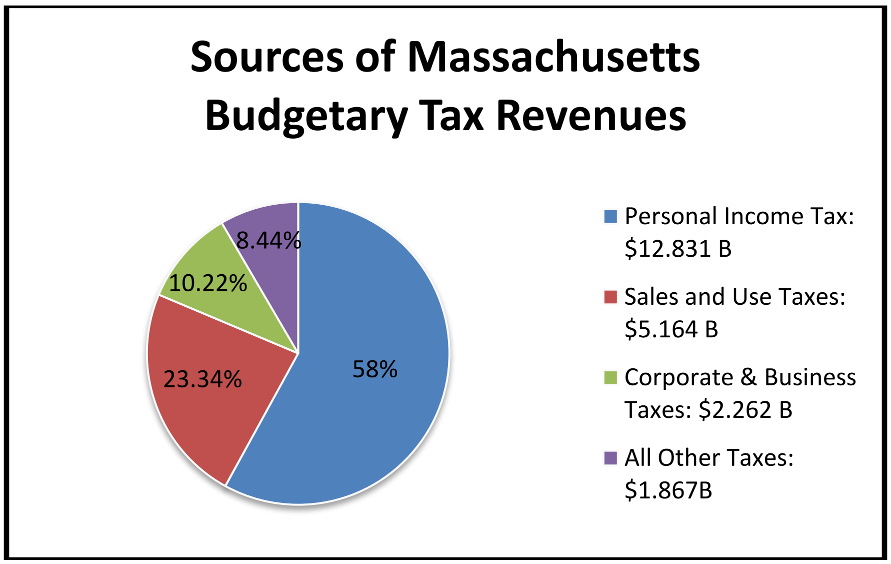
[45] *Corporate Excise: Basic Structure*, MASS.GOV (2014), http://www.mass.gov/bb/h1/fy12h1/ prnt_12 / tax _ 12/ptaxexpcorptext.htm.
[46] *See* Appendix 3.

V. ASSESSING THE MASSACHUSETTS TAX CODE

A. Taxes Directly Impacting Individuals

The Commissioner of the Department of Revenue, Amy Pitter, presented a wealth of data on the Massachusetts tax code to provide context for the discussion of fairness. Specifically, Commissioner Pitter detailed the sources of Massachusetts tax revenues and how much taxpayers of different incomes pay toward each tax source. (See Appendix 3.)

The Commonwealth receives the majority of its tax revenue from the personal income tax.[47] In fiscal year 2013, the personal income tax generated $12.831 billion, or 58% of the overall tax revenue collected. The second largest share of revenue collected is the sales and use tax, which generated $5.164 billion or 23.34% of overall revenue. The third largest share of revenue is generated by corporate and business taxes, which account for $2.262 billion, or 10.22% of overall revenue.



Personal income tax revenues are further broken down into the following categories: withholdings ($10.015 billion, 78.06%), capital gains ($1.468 billion, 11.44%), and “other income” including business, interest, and dividend income ($1.348 billion, 10.5%).[48]

Sales and use tax revenues are further broken down into the following categories: “regular” sales and use taxes ($3.596 billion, 69.6%), meals taxes ($0.901 billion, 17.5%), and motor vehicle sales taxes ($0.667 billion, 12.9%).

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[47] For more information on who pays the personal income tax, please see Appendix 8.
[48] Also note, “All Other Taxes” includes: motor fuels, cigarettes, estate, room occupancy, deeds, alcoholic beverages, division of insurance, unemployment insurance, Beano 3/5ths, raffles/bazaars, miscellaneous.

Corporate and business taxes are further broken down into the following categories: corporate, financial institutions, and public utilities (83.5%) and insurance (16.5%).

DOR also provided the Commission with a calculation of the effective tax rate for taxpayers of different incomes (broken down by quintile) for each tax type noted in the table below.[49] The effective tax rate indicates the average rate at which a taxpayer is taxed, and is calculated by dividing the total amount of tax paid by adjusted gross income.

Effective tax rate for income tax and selected consumption taxes*

Quintile	Tax Category							Total
	Income Tax	Regular Sales Tax	Meals Tax	MV Sales Tax	Alcohol Tax	Motor Fuel Tax	Tobacco Tax	
Lowest 20%	0.61%	4.97%	1.76%	0.77%	0.13%	1.14%	2.86%	12.24%
Second 20%	2.40%	2.68%	0.81%	0.41%	0.07%	0.61%	1.06%	8.04%
Third 20%	3.60%	1.36%	0.50%	0.30%	0.04%	0.36%	0.51%	6.68%
Fourth 20%	4.20%	0.91%	0.38%	0.25%	0.03%	0.24%	0.24%	6.25%
Highest 20%	4.75%	0.47%	0.19%	0.11%	0.02%	0.09%	0.06%	5.69%
Total	4.36%	0.82%	0.31%	0.18%	0.03%	0.18%	0.23%	6.11%

* Due to lack of data on non-filers, above table includes only tax filers in 2011 who represent 6.7 million people.

The effective tax rates above point to a system that is by definition regressive; the lowest 20% of income earners pay 12.24% of their income in taxes, while each successive quintile pays a smaller share of their income in taxes, with the highest 20% of income earners paying a 5.69% effective tax. Notably, as has been mentioned previously in this report, the income tax is the only progressive tax, with high income taxpayers paying a greater percentage of their income to the tax than low income taxpayers. The other taxes identified above are consumption taxes, which are inherently regressive.

B. Taxes Impacting Economic Competitiveness

Presentations on economic competitiveness were delivered by Commission members Mike Widmer, Gregory Sullivan, Bob Tannenwald, and Noah Berger. Ultimately, business costs, and not the corporate tax rate in isolation, drive economic competitiveness. Business costs include but are not limited to health insurance, unemployment insurance, energy, property, and the high-

[49] Due to the reasons detailed below, this analysis is not a full-scale tax incidence analysis, which would require making many more assumptions and should be used with caution.

- This analysis covers only people who filed Massachusetts income tax returns in 2011 and the dependents claimed by filers. Non-filers are excluded due to lack of data immediately available to DOR.
- DOR assumed the pattern of expenditures for Massachusetts income tax filers follows that for U.S. consumers.
- DOR focused only on income tax and select consumption taxes.

salary workforce. While overall business costs are high in Massachusetts, there are conflicting reports on how Massachusetts business taxes compare to other states.[50] The Commonwealth also has a number of advantages that add to its value such as quality higher education and a well prepared workforce, strong economic well-being, and significant funding for research and development. Although the Commission heard presentations detailing business costs generally, the Commission is focused on tax policy affecting economic competitiveness. Commission members believe that policy on business costs outside of the tax code would be more appropriately determined by other policy makers such as the Governor and Legislature.

On average, the cost of state and local taxes in Massachusetts is 2% of the total cost of business, while employee compensation is 40-80%.[51] Therefore, a simple reduction in the corporate tax rate is unlikely to lead to significant change in the Commonwealth.

Note that it is difficult to determine which business costs, including taxes, are the driving forces behind corporate decision-making. There are numerous studies that rank states according to business competitiveness, business costs, or the tax burden. Each study uses different variables and figures, and often places different weight on various factors, resulting in differing results.[52] For example, when analyzing the corporate tax rate alone, Massachusetts ranks near the national average of 7%. However, when several other factors are included, Massachusetts usually ranks in the middle or further to the bottom of the list of states.

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[50] *See* MassBudget Facts At A Glance, *How Do Massachusetts Business Taxes Compare to Other States?*, January 2014: http://massbudget.org/report_window.php?loc=mass_business_taxes.html, which reviews state and local business taxes. *See also* Greater Boston Chamber of Commerce, *Making the Massachusetts Tax Code More Competitive*, January 2013; Liz Malm and Richard Borean, *Map: Share of State Tax Revenues from Corporate Income Tax*, Tax Foundation, November 5, 2013, http://taxfoundation.org/blog/map-share-state-tax-revenues-corporate-income-tax, which review specific business taxes.

[51] *See* Appendix 6.

[52] *See* Peter Fisher, "Grading Places", May 2013: http://www.goodjobsfirst.org/gradingplaces.

VI. Recommendations of the Tax Fairness Commission

The Commission closely examined fifteen proposed changes to the Massachusetts tax code. Ultimately, Commission members voted on five recommendations, described below. A detailed explanation of each of the remedies that were considered is provided in Section VII.

A. Instituting a Graduated Income Tax by Means of a Constitutional Amendment

Reforming our tax system is complicated by Article 44 of the Massachusetts Constitution, which requires a uniform rate. A majority of Commission members recommend amending the state Constitution to allow for a graduated income tax. This will allow us to reduce taxes on lower-income taxpayers, provide greater fairness for middle-income taxpayers, and establish appropriate rates for higher-income taxpayers.

This recommendation was adopted by a 9-4 vote.

Votes in Favor:	**Votes in Opposition:**	**Absent:**
Navjeet Bal	Rep. Randy Hunt	Marita Callahan
Barry Bluestone	Greg Sullivan	Stephanie Gunselman
Phil Edmundson	Sen. Bruce Tarr	
Harris Gruman	Mike Widmer	
Rep. Jay Kaufman		
Sen. Michael Rodrigues		
David Sullivan		
Bob Tannenwald		
Kurt Wise		

Please see Appendix 10 and Appendix 14 for commentary.

B. Addressing Inequities for Low- and Middle-Income Taxpayers

As proposing a Constitutional amendment is a slow process with an uncertain fate, a majority of Commission members embraced this package of reforms to address inequities for those with low- and middle-incomes.

1. Increase the state funded match of the federal EITC from its current 15% rate and retain its refundability.
2. Expand the property tax circuit breaker, which is currently limited to senior citizens, to make all low-income individuals and families eligible.
3. Raise the current personal exemption on single filers, heads of households, and married filing jointly.

4. Increase the flat income tax rate from its current 5.2% rate to a rate that will at least offset the revenue loss due to the change in the EITC, the expansion of the property tax circuit breaker, and the increased personal exemption, so long as 80% of taxpayers experience a tax cut or at least no significant tax increase.

This recommendation was adopted by a 9-4 vote.

Votes in Favor:	**Votes in Opposition:**	**Absent:**
Barry Bluestone/Alan Clayton-Matthews	Navjeet Bal	Marita Callahan
Phil Edmundson	Greg Sullivan	Stephanie Gunselman
Harris Gruman	Sen. Bruce Tarr	
Rep. Randy Hunt	Mike Widmer	
Rep. Jay Kaufman		
Sen. Michael Rodrigues		
David Sullivan		
Bob Tannenwald		
Kurt Wise		

Please see Appendix 10 for commentary.

C. Online Sales Tax

See the Remedy to Ready Massachusetts for Congressional Action Allowing States to Require Sales Tax Collection From Out of State Retailers ("The Online Sales Tax") in Section VII, page 32.

This recommendation was adopted by a 12-0-1 vote.

Votes in Favor:	**Votes in Opposition:**	**Abstain:**	**Absent:**
Navjeet Bal		Sen. Bruce Tarr	Marita Callahan
Barry Bluestone			Stephanie Gunselman
Phil Edmunson			
Harris Gruman			
Rep. Randy Hunt			
Rep. Jay Kaufman			
Sen. Michael Rodrigues			
David Sullivan			
Greg Sullivan			
Bob Tannenwald			
Mike Widmer			
Kurt Wise			

D. Addressing Economic Competitiveness

While there was general support for measures that would increase economic competitiveness in Massachusetts, there was no agreement that the remedies proposed were the right ones. This was true in part because there were questions about the efficacy of each of the remedies and in part because of our disagreements about whether and how to offset the revenue losses associated with them.

We recommend that the Legislature and Governor explore ways in which the Commonwealth's economic competitiveness can be advanced, including but not limited to addressing specific tax policy regarding research and development activities, including considering adopting the Super Research and Development Tax Credit and the Alternative Simplified Research and Development Tax Credit; reducing or eliminating the minimum corporate excise tax; reducing the overall corporate excise tax rate; and adopting a separate reduced small business corporate tax rate.

This recommendation was adopted by a 11-2 vote.

Votes in Favor:	**Votes in Opposition:**	**Absent:**
Barry Bluestone/Alan Clayton-Matthews	Navjeet Bal	Marita Callahan
Phil Edmundson	Harris Gruman	Stephanie Gunselman
Rep. Randy Hunt		
Rep. Jay Kaufman		
Sen. Michael Rodrigues		
Mike Widmer		
David Sullivan		
Greg Sullivan		
Bob Tannenwald		
Sen. Bruce Tarr		
Kurt Wise		

Please see Appendix 11 and Appendix 12 for commentary.

E. Addressing Fiscal Responsibility

The Commission did not consider whether the Commonwealth realized adequate revenue or whether revenue receipts should be increased or decreased. Commission members believe that any tax policy changes should be made in both a fiscally responsible and fair way. We urge the Legislature and Governor to critically evaluate any proposal to increase or decrease revenue with an eye to enhancing, or at least not diminishing, tax fairness in the Commonwealth.

This recommendation was adopted by a 13-0 vote.

Votes in Favor:	**Votes in Opposition:**	**Absent:**
Navjeet Bal		Marita Callahan
Barry Bluestone/Alan Clayton-Matthews		Stephanie Gunselman
Phil Edmunson		
Harris Gruman		
Rep. Randy Hunt		
Rep. Jay Kaufman		
Sen. Michael Rodrigues		
David Sullivan		
Greg Sullivan		
Bob Tannenwald		
Sen. Bruce Tarr		
Mike Widmer		
Kurt Wise		

Commission members suggested and discussed a wide variety of other recommendations to the Commonwealth's tax code, which ultimately did not merit a vote to recommend. These remedies are outlined in the next section.

VII. Proposed Changes to the Massachusetts Tax Code

Several of the proposals listed in this section received limited, if any, attention from the Commission and therefore, the information listed in this section is not comprehensive. The Commission elected not to vote on those proposals that received limited attention.

A. Remedies Impacting Individuals

1. Institute a Graduated Income Tax

Massachusetts has a flat income tax, which is mandated by Article 44 of the Massachusetts Constitution.

- The tax rate on Part B income, which includes income such as wages, pensions, business income, rents, etc. as well as Part A interest and dividend income is 5.20%;
- The tax rate on Part A income, which includes short term capital gains, long term gains resulting from the sale of collectibles and pre-1996 installment sale is 12%;
    - Note: A 50% deduction is allowed on gains from the sale of collectibles and pre-1996 installment sales.
- The tax rate on Part C income, which includes long-term capital gains, except for collectibles and pre-1996 installment sales is 5.20%.[53]

Taxpayers have the opportunity to elect to voluntarily pay tax at a rate of 5.85% on taxable income, which would otherwise be taxed at 5.20%. This option is not applicable to short term gains and gains on collectibles.[54]

> M.G.L. Chapter 62, §1 and §4 provide a mechanism to lower the Part B individual income tax rate by increments of 0.05 percentage points each year (until the Part B individual income tax rate is 5%), upon certain revenue growth conditions being met. M.G.L. chapter 62, §4 provides that for each tax year in which the inflation-adjusted baseline revenue growth requirements are met, the Part B income tax rate will be reduced by 0.05 percentage points, until the Part B income tax rate is 5%. In order for the Part B income tax rate to be reduced by 0.05 percentage points, the inflation adjusted growth in baseline taxes for the preceding fiscal year has to exceed 2.5%, ***and*** the inflation-adjusted growth in baseline taxes for each consecutive three month period between August and December of the current calendar year compared to the prior calendar year has

[53] *Frequently Asked Questions: What are the Massachusetts income tax rates for tax year 2013?* MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/individuals/filing-and-payment-information/personal-income-tax-faqs/personal-income-tax-faqs.html.
[54] *Id.*

> to be greater than zero. It should be noted that pursuant to M.G.L. chapter 62, §4, if the inflation adjusted baseline tax revenue growth for any of the consecutive 3 month periods noted above is zero or less, then the Part B income tax rate reduction will not take effect for the following tax year. (*emphasis added)*[55]

The Part B rate is currently 5.20% after declining by 0.05 percentage points from 5.25% due to a 2013 rate reduction trigger and by 0.05 percentage points from 5.3% due to a 2012 rate reduction trigger.[56]

Forty-three states, including Massachusetts, have a personal income tax.[57] Of those states, thirty-four have a graduated tax structure.[58] Seven states, including Massachusetts, have a flat tax on personal income.[59] Two states, Tennessee and New Hampshire, tax only certain forms of investment income; they do not tax wage and salary income.[60] Seven states do not tax any personal income.[61]

Massachusetts should institute a graduated income tax to help alleviate the disproportionate tax burden on low- and middle-income taxpayers.

There have been five failed attempts to amend Article 44 to eliminate the constitutionally mandated uniform tax rate and institute a graduated income tax. The legislature routinely receives proposals for a constitutional amendment for a graduated income tax but takes no action.[62] Opponents of a constitutional amendment worry that the amendment is a carte blanche for the legislature to set the tax rates at whatever rate they wish – which could be unreasonably high. Some opponents may be able to support a constitutional amendment if the amendment specified the rates at which certain income brackets would be taxed.

Neighboring or Competitor State	Graduated Income Tax?	Bracket Levels Adjusted for Inflation?
California	Yes	Yes
Connecticut	Yes	No
Massachusetts	**No**[63]	**No**
Maine	Yes	Yes
New Hampshire	N/A, no income tax	---
New Jersey	Yes	No

[55] Letter from Comm'r Amy Pitter, Massachusetts Dep't of Revenue, to Sec'y Glen Shore, Exec. Office for Admin. & Finance, (Sept. 4, 2013) (on file with author).
56 *Id.*
[57] Chris Gustafson and Kurt Wise, *The Income Tax in Massachusetts*, MASS BUDGET (April 3, 2013), http://www.massbudget.org/report_window.php?loc=income_tax_primer.html.
[58] *Flat income Tax? Progressive Tax? No State Income Tax? A Nationwide Overview*, THE HUFFINGTON POST: CHICAGO (July 19, 2013, 5:30 PM), http://www.huffingtonpost.com/reboot-illinois/flat-income-tax-progressi_b_3625561.html.
[59] *Id.*
[60] Gustafson and Wise, *supra* note 57.
[61] AK, FL, NV, SD, TX, WA, WY do not tax personal income.
[62] *See e.g.*, S. 18, 187th Gen. Ct. (Mass. 2011).
[63] Flat tax of 5.2%

New York	Yes	No
North Carolina	Yes[64]	Yes
Ohio	Yes	Yes
Pennsylvania	No	No[65]
Rhode Island	Yes	Yes
Vermont	Yes	Yes

2. Increase the Massachusetts Match of the Federal Earned Income Tax Credit ("EITC")

Neighboring or Competitor State	Percentage of EITC Match	Refundable vs. Non-refundable
California	No match	---
Connecticut	25%	Refundable
Massachusetts	**15%**	**Refundable**
Maine	5% [66]	Not Refundable
New Hampshire	No match	---
New Jersey	20%[67]	Refundable
New York	30%[68]	Refundable
North Carolina	No match[69]	---
Ohio	No match	---
Pennsylvania	No match	---
Rhode Island	25%[70]	Refundable
Vermont	32%	Refundable

The federal EITC is an income tax refund offered to low-income workers and working parents. The federal government offers this credit to incentivize work.[71] Those who are working but remain below certain income thresholds are eligible to receive a tax credit when they file their personal income taxes.[72] The EITC is phased out as income increases.

Many states also offer a state funded EITC, which individuals may claim in addition to the federal EITC.[73] Most states simply "piggyback" on the federal EITC using the same eligibility requirements but set the state-level credit at a fraction of the federal EITC. The EITC is refundable in most states, which means that if the credit exceeds the amount of total income tax due for the year, the excess amount of the credit will be refunded to the taxpayer without interest. This is

[64] Starting in tax year 2014, North Carolina will transition to a modified flat tax system with a rate of 5.8%.
[65] Flat tax of 3.07%
[66] Credit may not reduce the state income tax to less than $0.
[67] If married but filing separately, cannot claim.
[68] However, taxpayers who do not claim the state EITC may be eligible for the state's Noncustodial Parent EITC. This credit is the greater of 20% of the Federal EITC that could have been claimed if the noncustodial child met the qualifying child definition, computed as if the filer had one qualifying child, or 2.5 times the Federal EITC that could have been claimed if the filer met eligibility requirements, computed as if the filer has no qualifying child.
[69] State used to have a 5% refundable match, but it sunset in December 2013.
[70] In the event that the Rhode Island EITC exceeds the amount of Rhode Island income tax owed, a refundable EITC is allowed in the amount of 15% of the amount by which the Rhode Island EITC exceeds the taxpayer's state income tax liability.
[71] Eric J. Stokan, *Why All States Should Adopt a State-Level Earned Income Tax Credit*, POLICY PERSPECTIVES 54 (2013), http://www.policy-perspectives.org/article/view/11784.
[72] *Id.* at 55.
[73] *Id.* at 55-57.

especially beneficial for low-income individuals who will receive money back rather than just a credit to offset taxes due.

Supporters argue that the credit "has been shown to incentivize employment, bolster urban areas, redress tax inequities, and reduce poverty and economic hardship. It accomplishes each of these goals in an administratively-efficient fashion."[74] Further, refundable credits improve the employment impacts over non-refundable credits.[75]

Opponents of raising the EITC match argue that taxpayers should be incentivized to work through a higher minimum or living wage, rather than through the EITC. The EITC may actually drive wages down because employers who pay poorly factor government assistance, including tax expenditures, into their wage scales.[76] Additionally, it's estimated that ¼ of eligible taxpayers are not claiming the EITC.[77] This is likely because the taxpayers either do not know about the credit or because they do not know if they qualify, or how to apply for the credit.

The Massachusetts EITC match is 15% and refundable. Massachusetts should increase the state match of the EITC beyond 15% to benefit working families and to help alleviate the disproportionate tax burden felt by low- and middle-income taxpayers.

3. Expand the Property Tax Circuit Breaker Program

"Many individuals and families who pay a high share of their income in property taxes are eligible for 'property tax circuit breakers'— refunds provided by state government to those whose property tax payments are deemed too great. Some 18 states deliver roughly $3 billion per year in circuit breaker programs."[78]

The "Circuit Breaker" was first developed in the 1960s and named such because it protects taxpayers from a property tax "overload," just as an electric circuit breaker stops the flow of electricity to prevent a circuit overload. These programs reduce the property tax liability for individuals and families whose property tax payments are a large percentage of family income.[79]

In Massachusetts, the Property Tax Circuit Breaker credit is for low- and middle-income seniors (65+) whose real estate tax payments are greater than 10% of their income. Homeowners and renters may claim the credit; for renters, real estate tax payments must exceed 25% of their

[74] *Id.* at 57.
[75] *Id.* (citing Sule Celik, *The Impact of the Earned Income Tax Credit on the Educational Investments of Single Mothers: Evidence from State EITCs*, UNIVERSITY OF HOUSTON (2011), http://www.sole-jole.org/11212.pdf.
[76] The Editorial Board, *The Case for a Higher Minimum Wage*, N.Y. TIMES: SUNDAY REVIEW (Feb. 8, 2014), http://www.nytimes.com/2014/02/09/opinion/sunday/the-case-for-a-higher-minimum-wage.html?emc=eta1&_r=1.
[77] Phyllis Furman, *One-fourth of low-income taxpayers miss out on Earned Income Tax Credits (EITC) worth up to $5,900*, NEW YORK DAILY NEWS (Jan. 24, 2013, 6:46 PM), http://www.nydailynews.com/new-york/one-fourth-low-income-taxpayers-earned-income-tax-credits-eitc-worth-5-900-article-1.1247242.
[78] Karen Lyons, Sarah Farkas, and Nicholas Johnson, *The Property Tax Circuit Breaker: An Introduction and Survey of Current Programs*, CENTER ON BUDGET AND POLICY PRIORITIES 1 (2007), http://www.cbpp.org/cms/?fa=view&id=51.
[79] *Property Tax Circuit Breakers*, TAX CREDITS FOR WORKING FAMILIES (2011), http://www.taxcreditsforworkingfamilies. org/property-tax-circuit-breaker.

income to qualify. The maximum credit for tax year 2013 was $1,030. Filers' total income may not be greater than the following limits for the 2013 tax year: $55,000 single; $69,000 head of household; and $82,000 married filing jointly.

Some people note that the Circuit Breaker is very complex – because of both eligibility requirements and administration. As a result, those for whom the credit is designed to benefit may not be able to take advantage of it because of its eligibility and application complexities.

It is important to point out the following:

> Several states offer property tax rebates or credits to taxpayers who have low incomes and pay property taxes. These programs are often described as circuit breakers and sometimes even have "circuit breaker" in their name, such as in Connecticut, Idaho and Utah. But they differ from true circuit breakers in this respect: the value of the credit or rebate is driven by a family's income without taking into account the *share* of the family's income that goes towards paying property tax.
>
> Some of these programs . . . provide flat payments that vary by income level. For example, in Utah, a family with an income of $10,000 qualifies for a $609 credit, while a family with an income of $15,000 qualifies for a $392 credit. . . .
>
> Other programs, such as those in Connecticut, Kansas, Iowa, Nevada, New Hampshire, North Dakota and South Dakota, rebate a percentage of property taxes paid that varies by income level. For example, a family earning $10,000 in Iowa qualifies for a rebate equal to 85 percent of property taxes paid, while a family earning $15,000 qualifies for a rebate equal to 35 percent of property taxes paid. . . .
>
> Unlike true circuit breaker programs, such credits are not targeted specifically to families with particularly high property tax bills relative to their incomes.[80]

[80] Lyons et al., *supra* note 78, at 4.

Neighboring or Competitor State	Circuit Breaker?	Renters Eligible?	Eligibility	Household Income Limit (Single/Joint)	Type of Rebate	Maximum Benefit
CA	No	---	---	---	---	---
CT	Yes	No	65+	$35,000	Income Tax Credit [81]	Married = $1,250 Single= $1,000
MA	**Yes**	**Yes**	**65+**	**$55,000 (single) $82,000 (joint)**	**Income Tax Credit**	**$1,030**
ME	No [82]	---	---	---	---	---
NH	Yes [83]	No	All	$20,000 (single) $40,00 (married)	Rebate Check	Varies
NJ	Yes	Yes	All, more $ if 65+	$200,000 (H) $100,000 (R)	Rebate check	H= $1,200 R=$825
NY	No	---	---	---	---	---
NC	Yes	No	65+	$42,900	Lien[84]	$2107.50 (5%)
OH	No	---	---	---	---	---
PA	Yes	Yes	For 65+	$35,000 (H) $15,000 (R)	Rebate Check	$650 (H) $500 (R)
RI	Yes	Yes	All	$30,000	Income tax credit (filers) or rebate check (non-filers)	$300
VT	Yes	Yes	All[85]	$47,000	Income tax credit (filers) or rebate check (non-filers)	No cap = VT rebates the difference between a max % of income claimant expected to pay in property taxes (3.5-5% depending on income) and the amount owed

[81] The credit amount is calculated by the local assessor and applied by the tax collector to the applicant's real property tax bill. Credit amounts are based on a graduated income scale.

[82] Repealed, effective FY 2014.

[83] Called "Low & Moderate Tax Relief Program." *See Low & Moderate Tax Relief Program*, NEW HAMPSHIRE DEP'T OF REVENUE (2007), http://www.revenue.nh.gov/forms/low_mod_program.htm.

[84] This is a property tax deferment program offered through counties in the state. *See e.g.*, *The Circuit Breaker Homestead Tax Deferment Program*, CATAWBA COUNTY, NORTH CAROLINA (2014), http://www.catawbacountync.gov /tax/circuitbreaker.pdf.

[85] Taxpayers must have paid rent in Vermont for all 12 months of the tax year and have been a legal resident of Vermont for the whole tax year. Filer cannot be somebody else's dependent. Only one member of the household can claim the credit.

4. Increase the Individual Income Tax Rate and Raise Personal Exemption

A Massachusetts full-year and/or part-year resident is required to file a tax return with the state of Massachusetts if his/her Massachusetts gross income is in excess of $8,000. The tax rate on income such as wages, pensions, business income, rents, etc. and interest and dividend income is 5.20%.

Massachusetts offers a personal exemption, which reduces an individual's taxable income, in the following amounts: $4,400 for single filers and married filing separately, $6,800 for heads of household, and $8,800 for married filing jointly. The personal exemption reflects the notion that income needed for bare subsistence should be free from tax.[86]

Massachusetts should increase the personal income tax rate while raising the personal exemption amounts to offset any tax increase for low-and middle-income individuals and families. This remedy would require income tax to be paid based on a taxpayer's ability to pay, which would help alleviate the disproportionate tax burden on low- and middle-income taxpayers.

Please note that Article 44 of the Massachusetts Constitution requires exemptions to be "reasonable". Since the enactment of Article 44, the Supreme Judicial Court has addressed the question of reasonableness and held, "the Legislature surely has a considerable range of discretion within the bounds of reason in establishing exemptions from the tax."[87] The Court determined that the ability to grant exemptions enables taxation to be apportioned among all the people so that the burdens of the government are met equally.[88] However, "although the 'constitutional requirement of a uniform rate… cannot be absolute, because it is impossible to achieve a uniform effective rate of taxation where exemptions are allowed,'[89] we require that there be a 'balance between uniformity and reasonableness' of the exemption."[90] When determining the balance, the Court must "consider the reasonableness of the exemption's deviation from the overarching requirement of uniformity, not just the rationality of the justification for the exemption viewed in isolation."[91] Therefore, if increased exemption amounts are challenged, it is currently unclear how the Supreme Judicial Court interprets the Constitutional requirement of "reasonable exemptions".

In the chart below, note that the information only focuses on personal income tax rates and "personal exemptions". Some states offer a standard deduction instead of a personal exemption and some states offer both. Please see the State Comparative Data handout, Appendix 7, for further information.

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[86] *Report of the Tax Expenditure Commission*, p. 7 (2012), *available at* http://www.mass.gov/dor/docs/dor/stats/ tax-expenditure-commission-materials/final-report/tec-report-with-appendices-new.pdf.
[87] *Massachusetts Teachers Ass'n v. Sec'y of Com.*, 384 Mass. 209, 242-43, (1981) (quoting *Daley v. State Tax Comm'n*, 376 Mass. 861, 865-66 (1979)).
[88] *See Opinion of the Justices,* 270 Mass. 593, 600-01 (1930); *cf. Opinion of the Justices,* 354 Mass. 792, 794 (1968).
[89] *Opinion of the Justices*, 386 Mass. 1223, 1226 (1982).
[90] *Peterson v. Commissioner of Revenue*, 444 Mass. 128, 134 (2005) (quoting *Massachusetts Taxpayers Found., Inc. v. Sec'y of Admin.*, 398 Mass. 40, 47 (1986)).
[91] *Id.*

Also note that some states use the personal exemption amount provided in the federal code, which is adjusted annually for inflation (VT). Several states phase-out the personal exemption based on a filer's income (CA, CT, and VT).

Neighboring or Competitive State	Personal Income Tax Rate	Personal Exemption Amount
California	Graduated income tax from 1% - 12.3%	$106 for single and head of household filers, $212 for married filing jointly
Connecticut	Graduated income tax from 3% - 6.7%	$14,000 for single filers, $19,000 for head of household, $12,000 married filing separate, $24,000 married filing jointly
Maine	Graduated income tax from 0% - 7.95%	$6,100 for single filers, $8,950 for head of household, $5,075 for married filing separate, $10,150 for married filing jointly
Massachusetts	**Flat income tax of 5.2%**	**$4,400 for single filers, $6,800 for head of household, $8,800**
New Hampshire	No personal income tax	No personal exemption
New Jersey	Graduated income tax from 1.40% - 8.97%	$1,000 for all filers
New York	Graduated income tax from 4% - 8.82%	No personal exemption
North Carolina	Graduated income tax from 6% - 7.75%	$2,500 for single filers making less than $60,000, head of household making less than $80,000, married filing separate making less than $50,000, married filing jointly making less than $100,000. $2,000 for filers making over those amounts in each category.
Ohio	Graduated income tax from 0.537% - 5.421%	$1,700 for all filers
Pennsylvania	Flat income tax of 3.07%	No personal exemption
Rhode Island	Graduated income tax from 3.75% - 5.99%	No personal exemption
Vermont	Graduated income tax from 3.55% - 8.95%	$3,900 for all filers

5. Ready Massachusetts for Congressional Action Allowing States to Require Sales Tax Collection From Out of State Retailers ("The Online Sales Tax")

As a result of the Supreme Court case, *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992), retailers are only required to collect sales tax in states in which the retailer has a "physical presence." Therefore, states are unable to require out of state retailers to collect sales tax on purchases made by residents online, over the phone, and through mail-order catalogs.[92]

Because of *Quill*, large online retailers like Amazon and Overstock.com do not have to collect sales tax on items shipped to consumers in states where the company is not physically present – where it has no employees or property, etc. While residents are supposed to pay use tax on these purchases, they often do not as enforcing payment is virtually impossible.

Massachusetts and other states across the country are losing hundreds of millions of dollars in uncollected tax from residents' online, phone, and mail-order purchases. Additionally, local retailers are struggling for business, as an increasing number of consumers prefer to shop online rather than in their communities. Local retailers favor states' ability to require this tax collection because they face an unfair advantage.

In Massachusetts, Amazon signed an agreement with the Governor to begin collecting sales tax on purchases made by Commonwealth residents on November 1, 2013. DOR expects the tax to raise $36.7 million before the fiscal year ends on June 30.[93] The tax applies to only items purchased from Amazon and not third-party vendors using the site.

Although Amazon has agreed to collect the tax, there are many other out of state retailers that have not and are not required to by law. Congressional action is needed to allow Massachusetts to require those retailers to collect the tax. Massachusetts would benefit from enacting state legislation to ready the Commonwealth for Congressional action. Such legislation would accomplish the following: allow DOR to administer and enforce the assessment and collection of sales and use taxes on out of state purchases once Congress grants such authority to the states; allow DOR to take necessary administrative actions to prepare for Congressional action.[94]

[92] David M. Steingold, *Massachusetts Internet Sales Tax*, NOLO (2014), http://www.nolo.com/legal-encyclopedia/massachusetts-internet-sales-tax.html.
[93] Taryn Luna, *Amazon to Begin Collecting Mass. Sales Tax Friday*, THE BOSTON GLOBE, Oct. 29, 2013.
[94] H. 3526, 188th Gen. Ct. (Mass. 2013).

6. Taxing Investment Income at Higher Rates

Neighboring or Competitor State	Long Term Capital Gains Rate 2013[95]
California	13.3%
Connecticut	6.7%
Massachusetts	**5.2%**
Maine	8.5%
New Hampshire	0%
New Jersey	9.0%
New York	8.8%
North Carolina	7.8%
Ohio	5.9%
Pennsylvania	3.1%
Rhode Island	6.0%
Vermont	9.0%

Investment income includes income from interest payments, dividends, capital gains collected upon the sale of a security, stock, or other asset, and any other profit that is made through an investment vehicle of any kind.

- The tax rate on interest and dividend income and long-term capital gains, except for collectibles and pre-1996 installment sales is 5.20%;
- The tax rate on short term capital gains, long term capital gains resulting from the sale of collectibles and pre-1996 installment sale is 12%;
    - Note: A 50 percent deduction is allowed on gains from the sale of collectibles and pre-1996 installment sales.[96]

Prior to 1999, Massachusetts taxed dividends and interest (Part A taxable income), other than from Massachusetts banks, at the rate of 12%.[97]

The average long-term capital gains rate among all 50 states, according to the Tax Foundation, is 5.1%.[98] Massachusetts' neighboring and competitor states either tax short-term capital gains at the same rate as long-term or include all capital gains as individual income and tax them at the individual rate.[99]

For more information on the degree to which different income quintiles pay investment income tax in Massachusetts, please see Appendix 3 and Appendix 8.

7. Stewardship Legacy Trust

The intersection of the effective tax rate on the Commonwealth's wealthiest residents and the state's failing infrastructure and high debt load suggest another potential remedy for consideration. The working name for this proposal is a Stewardship Legacy Trust, with an eye to

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[95] Note: If the state treats capital gains as individual income, the individual income rate is provided.
[96] *Frequently Asked Questions: What are the Massachusetts income tax rates for tax year 2013?, supra* note 7.
[97] *Prior Year Massachusetts Rates of Tax: Prior to 1999*, MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/individuals/filing-and-payment-information/guide-to-personal-income-tax/prior-law-and-massachusetts-differences/prior-year-massachusetts-rates-of-tax.html#Prior; *see also* Technical Information Release, MASSACHUSETTS DEP'T OF REVENUE, 99-17: Capital Gains and Losses: Massachusetts Tax Law Changes Retroactive to 1996 (Dec. 29, 1999) *available at* http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/1990-1999-releases/tir-99-17-capital-gains-and-losses.html.
[98] Kyle Pomerleau, *The High Burden of State and Federal Capital Gains Taxes*, THE TAX FOUNDATION FISCAL FACT No. 362 1, 5 (February 20, 2013), http://taxfoundation.org/article/high-burden-state-and-federal-capital-gains-taxes. (Chart data provided by THE FAX FOUNDATION).
[99] This is because most states utilize a graduated income tax.

creating a source of funds for the long-term investments that, right now, are frequently overlooked because of the demands on the state's revenues.

Envisioned is a surtax on income above a certain threshold, with revenue from this tax dedicated solely for capital investments or debt repayment. While the Commission did not discuss any details of such a proposal, there was an understanding that such a surtax would be a marginal tax rate applied on income above a high threshold, that the surtax rate would be specified, and that this formula would result in sufficient revenue to allow substantial investments in our future and/or avoid significant debt service costs.

Like the proposal for a graduated income tax, this income-related surtax would require a Constitutional amendment as it creates a new and differential tax on only the wealthiest among us.

8. Increase the Renter's Deduction

Typically, state renters rebate programs offer refunds or credits to eligible renters, based on the portion of rent paid that exceeds a percentage of household income. In Massachusetts, renters are able to deduct one-half of the rent paid for a principal residence located in the Commonwealth, up to $3,000.

Some opponents note that high income taxpayers are able to claim this credit because there is no means test or income threshold. Therefore, whether or not the renter's deduction is increased, some would recommend phasing out the deduction based on income.

Other opponents note that this deduction may have the unintended consequence of subsidizing landlords who raise rent because tenants may claim this deduction.

Neighboring or Competitor State	Renters Deduction?	Income Range	Type	Maximum Benefit
CA	Yes	$36,955 (single) $73,910 (married)	Non-Refundable Credit	$120
CT	Yes, 65+ and disabled	Graduated	Rebate	$900 (married) $700 (single)
MA	**Yes**	**---**	**Deduction**	**$3,000 Deduction**
ME	Yes[100]	$40,000	Credit	$300 (under 70) $400 (70+)
NH	No	---	---	---
NJ	Yes[101]	%	Deduction or	Either: (a) Deduction from

[100] State has a property tax refund/credit for which renters are eligible.

[101] When determined that property taxes are accounted for in rent amount. Also, annual deduction of up to $250 from property taxes for home-owners who are age 65+ or disabled who earn less than $10,000 excluding Social Security benefits and residency requirements.

			Refundable Credit	taxable income of the total amount of property taxes paid on principal residence (for tenants, 18% of rent) or $10,000, *whichever is less*; or (b) $50 refundable credit.
NY	Yes[102]	Income under $18,000	If your credit is more than the taxes you owe, you can claim a refund.	$75 (under 65) $375 (65+)
NC	No	---	---	---
OH	No	---	---	---
PE	Yes, 65+	$35,000 (homeowners) $15,000 (renters)	Rebate	$650
RI	Yes[103]	$30,000	Credit	$300
VT	Yes	Income under $47,000[104]	Rebate	---

9. Institute a Wealth Tax

The term "wealth tax" is used is used describe a tax on net worth, which may include real property, household assets, stocks, bonds, trusts, unincorporated businesses, etc. Such a tax would target individuals who are income poor but asset rich. Note that without an exemption for real property, this type of "wealth tax" would result in double taxation.

10. Extending Sales Tax to Services

Our sales tax code was originally developed for the commodities-based, manufacturing economy; however, it is now evolving into a highly service based economy. Currently, most states do not tax services or do so selectively.

In Massachusetts, sales of personal or professional services are not taxable;[105] however, tangible items sold in addition to services are taxable and must be itemized separately.

[102] State has a property tax refund/credit for which renters are eligible.
[103] State has a property tax refund/credit for which renters are eligible.
[104] Taxpayers must have paid rent in Vermont for all 12 months of the tax year and have been a legal resident of Vermont for the whole tax year. Filer cannot be someone else's dependent. Only one member of the household can claim the credit.
[105] With the exception of telecommunication services, which are taxable. *See Sales and Use Tax on Telecommunications*, MASSACHUSETTS DEP'T OF REVENUE (2014), http://www.mass.gov/dor/all-taxes/sales-and-use/telecommunications/.

Opponents of extending the sales tax to services assert that because the sales tax is inherently regressive, adding personal and professional services to the sales tax base will result in low income taxpayers paying a greater share of their income to taxes than they do currently. To account for this, some opponents argue that the sales tax could be extended to only luxury services, the definition of which would have to be clearly defined.

Studies that support extending the sales tax to services suggest that "[l]evying sales taxes on services makes state tax systems fairer, more stable… and easier to administer."[106] Additionally, as a general rule, it is good tax policy to broaden the tax base, which could be done by extending the sales tax to services, and lowering the sales tax rate.

Opposing studies argue that taxing business services violates the basic principle of tax policy that tax pyramiding should be avoided. Tax pyramiding occurs when a tax is levied at multiple stages of a production process —at each stage, the cost becomes slightly higher not only because of the tax on that stage, but compounding of taxes over several stages. For this reason, Massachusetts and most other states exempt business inputs for manufacturing, such as raw materials and energy. The same concept would apply to services—these are inputs to produce a final good.[107]

Neighboring or Competitor State	**Tax Services?**
Connecticut	Most Services[108]
Massachusetts	**No**
Maine	Limited Services[109]
New Hampshire	No
New Jersey	Most Services[110]

[106] *Tax Credits for Working Families*, *supra* note 79.
[107] *See* Scott Drenkard and Joseph Henchman, *2014 State Business Tax Climate Index*, 68 THE TAX FOUNDATION: BACKGROUND PAPER 1 (Oct. 2013), http://taxfoundation.org/sites/taxfoundation.org/ files/docs /2014%20State%20Business%20Tax%20Climate%20Index.pdf; *see also* Robert Cline, Andrew Phillips and Tom Neubig, *What's Wrong with Taxing Business Services? Adverse Effects From Existing and Proposed Sales Taxation of Business Investment and Services*, COUNCIL ON STATE TAXATION (COST) (Apr. 2013), http://www.cost.org/ WorkArea/DownloadAsset.aspx?id=83841.
[108] Connecticut Exemptions: barber shops, beauty parlors, and health clubs; cleaning storage and repair of shoes and clothing; business and legal services; amusement and recreational services; education services; finance, insurance, and real estate services; professional, scientific, and technical services; administrative and support services; information services; transportation and warehousing services; construction services; repair and maintenance services; basic cable and satellite TV service; telecommunication services; and certain services that are rendered at the residence of a disabled person.
[109] In Maine, certain services are specifically subject to sales tax. Specifically taxed services include the rental or lease of motor vehicles or motor homes, rental or living quarters in a hotel or trailer camp, transmission and distribution of electricity, and prepaid calling services. Other services are subject to a "service provider tax", including, installation and maintenance of telecommunication services, extended cable and satellite television service, audio and video equipment rentals, and furniture rentals.
[110] In New Jersey, the following notable services are subject to the sales tax: producing, fabricating, installing, maintaining, repairing, and storing personal property; maintaining and repairing real property (except for maintaining and repairing home residential heating system); sales of restaurant and catered meals; rental of hotel and motel rooms; certain admission charges; telecommunication services; and utility services.

New York	Limited Services[111]
North Carolina	Limited Services[112]
Ohio	Limited Services[113]
Pennsylvania	Limited Services[114]
Vermont	Most Services[115]
Rhode Island	Limited Services[116]
California	Yes, when utilized in the sale of real property[117]

11. Luxury Items Sales Tax

A luxury item sales tax is typically levied on items that are not considered essential. These taxes largely impact the wealthy, because they are levied on expensive items such as jewelry, cars, boats/yachts, or even real estate over a certain amount.

In the U.S., very few states impose a luxury items sales tax, the only neighboring or competitor state that does so is Connecticut. In some states, municipalities impose a luxury items tax, as is the case in New Jersey, with Atlantic City levying a luxury items tax on certain goods, like jewelry.

[111] In New York, the following services are taxable (not an exhaustive list): restaurant food and drink; utility and (intrastate) telecommunication services; mobile telecommunication services; certain information services; processing, fabricating, printing, or imprinting of tangible personal property for a customer who furnishes the tangible personal property and does not plan to resell it; maintaining, installing, servicing, and repairing tangible personal property; hotel occupancy; and admission charges to a place of amusement.

[112] In North Carolina, certain services are specifically taxable at varying rates. Laundry and dry cleaning services are taxable at the combined state and local rate of 6.75%. Additionally, telecommunication services, ancillary services, and video programming services are taxable at the combined rate of 7%.

[113] In Ohio, the following notable services are subject to the sales tax: rental of hotel rooms for less than 30 days; computer services or electronic information services provided for use in a business; certain telecommunication and satellite broadcasting services; landscaping, snow removal, and extermination services; physical fitness, recreation, and sports club services; washing, painting, and towing services for motor vehicles; and laundry and dry cleaning services. Exempt from tax are professional, personal, and insurance transactions when a small item of tangible personal property is included in the transaction cost.

[114] In Pennsylvania, certain services are specifically subject to tax, including: lobbying services, collection and credit reporting services, secretarial services, employment agency services, disinfecting and cleaning services, pest control and building management services, and premium cable services.

[115] In Vermont, most services are taxed, except: amusement charges, fabrication charges, and some public utility charges.

[116] In Rhode Island, certain services are specifically taxable. For example, a 7% sales tax is levied on taxicabs, limousine, charter bus, and other ground passenger transportation services.

[117] E.g. the sale of machinery that requires calibration.

B. Remedies Impacting Economic Competitiveness

1. Make the R&D Tax Credit the Most Favorable in the U.S.

The Pioneer Institute recommends making the Massachusetts R&D Credit the most favorable in the United States by:

- Adopting the Alternative Incremental Research Credit ("AIRC").
    - The AIRC is a credit allowed by the Internal Revenue Code ("IRC") that combines a three-tier credit rate ranging from 3% to 5% of the total amount of R&D expenditures above the base amount. Firms that have increased their R&D expenditures, but not their R&D intensity, are eligible for the AIRC. (Massachusetts currently does not offer this credit.)
- Adopting the Alternative Simplified Credit ("ASC").
    - The AIC is a credit allowed by the IRC that provides a 12% credit for R&D expenditures above 50% of the average qualified research expenditures over the three years before the credit year. The ASC was enacted in the Tax Relief and Healthcare Act of 2006. (Massachusetts currently does not offer this credit.)

- Adopting the Super R&D Credit.
    - A super-credit consists is an extra tax saving that can be claimed by companies with levels of research activity and/or a numbers of new employees over a set base amount. Russia adopted the measure in 2009, and in 2013 the United Kingdom just expanded its super credit scheme in 2013. Within the U.S., Maine and Wisconsin offer super credit schemes for firms with qualifying research and development expenditures, respectively 1.5 and 1.25 times over the base amount.

See Appendix 6, Appendix 11, and Appendix 12.

2. Reduce the Corporate Excise Rate to Below or Equal to the National Average

The Pioneer Institute recommends that Massachusetts should set the corporate excise rate at or below the national average.

Since 1962, the Massachusetts corporate excise is levied on tangible property or net worth (depending on the mix of property held by the corporation) and on net income. The income measure is equal to 8% of the corporation's taxable net income. The property/net worth measure is levied at the rate of $2.60 per $1,000 of either a corporation's taxable Massachusetts tangible property or its taxable net worth. The total excise is the combination of the property/net worth and net income measures, or the minimum corporate excise, whichever is greater. The minimum corporate excise is $456.[118]

[118] *Tax Expenditure Budget 2013, supra* note 43.

Since January 1, 2009, Massachusetts requires certain corporations engaged in a unitary business to calculate their income on a combined basis. A corporation is subject to combined reporting if it is subject to the corporate excise an is engaged in a unitary business with one or more other corporations under common control, whether or not the other corporations are taxable in Massachusetts. Combined reporting does not apply to the non-income measure of corporate excise.[119]

To help alleviate the impact of increased taxation as a result of combined reporting, the legislature reduced the corporate excise rate from 9.5% in 2008 to 8.75% in 2010, 8.25% in 2011, and 8% in 2012.

See Appendix 6, Appendix 11, and Appendix 12.

3. Adopt a Lower Small-Business Corporate Tax Bracket and a Lower Manufacturer Bracket

The Pioneer Institute recommends adopting a lower small-business corporate tax bracket and a lower manufacturer tax bracket.[120] The state of New York allows small business taxpayers and manufacturers to pay lower corporate tax rates. New York's default corporate tax rate is 7.1%, but lower rates apply to small business and manufacturing taxpayers, as follows:

- Entire Net Income base ("ENI") of $290,000 or less = 6.5% tax rate; and
- ENI base of more than $290,000 but not more than $390,000 = $18,850 plus 7.1% of the amount over $290,000 plus 4.35% of the amount over $350,000.
- Qualifying New York Manufacturers are taxed at the lower rate of 6.5%.

See Appendix 6, Appendix 11, and Appendix 12.

119 *Corporate Excise: Basic Structure*, MASS.GOV (2014), http://www.mass.gov/bb/h1/fy12h1/ prnt_12 / tax _ 12/ptaxexpcorptext.htm.

120 The Pioneer Institute believes that by adopting a lower tax rate for small businesses and manufacturers, Massachusetts would give its business owners a fairer chance to compete in the national marketplace. But see, The Small Business and Entrepreneurship Council ("SBE Council") ranked Massachusetts 31st in their Business Tax Index. The following neighboring and competitor states levy higher taxes than Massachusetts: New York, California, North Carolina, Rhode Island, Connecticut, Maine, Vermont, and New Jersey. The SBE Council noted several states pursuing more novel and creative approaches to tax policy favoring small businesses, including one competitor state, North Carolina. *See* Raymond Keating, *Business Tax Index 2013: Best to Worst State Tax Systems for Entrepreneurship and Small Business*, SBE COUNCIL 1, 2 (2013), http://www.sbecouncil.org/wp-content/uploads/2013/04/BusinessTaxIndex2013.pdf.

4. Eliminate the Minimum Corporate Excise Tax

The Pioneer Institute recommends eliminating the minimum corporate excise tax in Massachusetts.

Massachusetts mandates that all for-profit companies pay an annual minimum corporate excise tax of $456, whether or not the corporation had any income. Some argue that for a small start-up business, a temporarily inactive business, or a business with very little income, this tax is an unfair burden and should be reduced or eliminated. Only 13 states impose a minimum corporate excise tax.

However, DOR estimates a loss of revenue of $24 million - $30 million if in FY 2015 if the minimum corporate excise tax for all corporations is eliminated and a $21 million - $24 million loss in revenue if the tax is only eliminated for small businesses.[122]

Neighboring or Competitor State	**Minimum Corporate Excise Tax**
California	$0[121]
Connecticut	$250
Massachusetts	**$456**
Maine	$0
New Hampshire	$0
New Jersey	$500
New York	$25
North Carolina	$0
Ohio	$0
Pennsylvania	$0
Rhode Island	$500
Vermont	$250

In the 2012 Economic Development bill (H. 4352), a proposal was set forth to change the $456 minimum to a credit for certain start-ups. The Governor vetoed the credit on A&F's recommendation. This was done not necessarily because the credit would be bad tax policy, but because the credit would cost a significant sum.[123]

See Appendix 6, Appendix 11, and Appendix 12.

[121] Note: California imposes an $800 minimum if incorporated prior to Jan 1, 2000, but no minimum is imposed for companies incorporated after Jan 1 2000.
[122] For the small business calculation, DOR defines a small business as a corporation that grosses less than $1 million a year.
[123] *See* H. 4387, 187th. Gen. Ct. (Mass. 2012) (Governor describes the tax benefit as "unaffordable").

February 25th, 2014

Jay R. Kaufman	[illegible]
[illegible]	Michael J. Widmer
David E. Sullivan	[illegible]
[illegible]	[illegible]
Harris L. Gruman	Robert Tannenwald
Gregory W. Sullivan	
Navjeet K. Bal	
[illegible]	

We attest that this report accurately reflects the work of the Tax Fairness Commission pursuant to an Act Relative to Transportation Finance, Mass. Session Laws ch. 46, § 77, 2013.

VIII. Appendices

Appendix 1. Public Agendas

Appendix 2. Meeting Minutes

Appendix 3. DOR Presentation Second Meeting

Appendix 4. Third Meeting Presentations
DOR
David Sullivan
Alan Clayton-Matthews

Appendix 5. Economic Competitiveness Studies Handout

Appendix 6. Fifth Meeting Presentations
Mike Widmer
Greg Sullivan
Noah Berger
Bob Tannenwald

Appendix 7. Neighboring & Competitor States Comparison Data

Appendix 8. Dividend and Interest AIM Chart

Appendix 9. Commonwealth of Massachusetts Personal Income Tax Filers & Liability by Income Level

Appendix 10. Commentary on the Graduated Income Tax and Addressing Inequities for Low-and-Middle Income Taxpayers Proposals

Appendix 11. The Pioneer Institute's Economic Competitiveness Tax Proposals to Tax Fairness Commission Summary of Proposals

Appendix 12. MassBudget Response to the Four Economic Competitiveness Proposals Offered by the Pioneer Institute

Appendix 13. The Pioneer Institute's Statement upon Completion of the Work of the Tax Fairness Commission

Appendix 14. Rationale for Voting Against the Commission's Recommendation to Amend the Massachusetts Constitution to Implement a Graduated Income Tax, Michael J. Widmer, President, Massachusetts Taxpayers Foundation