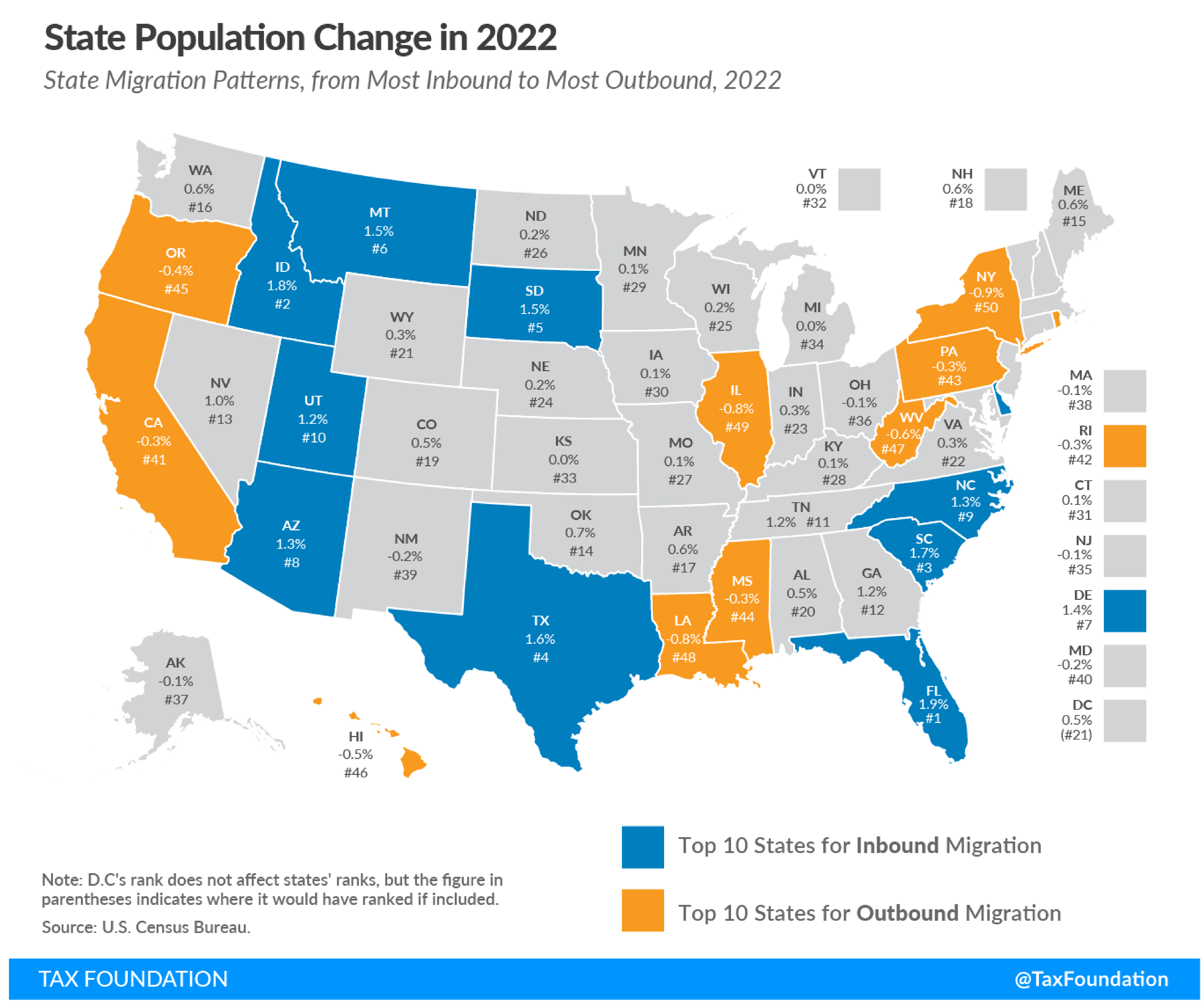
Massachusetts is Ready for Proactive Tax Reform

State and local revenues are at record levels following three years of explosive growth and nearly a decade of strong growth.

- The state should use its strong revenue gains to strengthen its competitiveness so it can continue to ensure jobs and opportunities are available to all residents.
  - Between FY 2019 and FY 2022, state spending grew by $10 billion - 25% - from $42 billion to $52 billion.
  - Halfway into FY 2023, preliminary state tax collections are $333 million, or nearly 10 percent, ahead of DOR’s benchmark.

Massachusetts can't afford to keep losing residents & employees.

- From July 2020 through July 2021, the Greater Boston MSA shrunk by more than 35,000 people at a time when every industry is searching for workers. That number would have been greater but the red-hot housing market in southern New Hampshire offset regional losses.
- Of the country's 20 largest metro areas, Greater Boston has the smallest share of population under age 18.
- We rely on domestic and international migration to increase our workforce. A less competitive tax environment, combined with high costs of living, makes the state less attractive to potential movers.



Source: [2022-State-Population-Change-2022-state-migration-trends.-Americans-moving-to-low-tax-states-united-van-lines-u-haul-census-data.png (1355×1167) (taxfoundation.org)]

Trend: States Are Reducing or Eliminating Taxes

Several states have moved to reduce or eliminate individual and/or corporate income tax rates over the last few fiscal years.

- At least 10 states reduced their personal income tax rate on Jan. 1, 2023, including 3 that are switching to a flat income tax. Massachusetts is the only state to implement an income tax increase on Jan 1 and to shift from a flat to graduated structure.
- At least 5 states reduced their corporate income tax rate on Jan 1, 2023.
- Some reductions are the result of triggers tied revenue collections and were put in place over the last decade.
- Others are phased-in plans to reach a lower tax rate or implement a flat tax.

Tax Reform Proposal Goals

In the attached proposal, we focus on several goals that ultimately will ensure there are jobs and opportunities for economic growth available to Massachusetts residents. Jobs and opportunities are critical factors to achieve an inclusive economy.

- Mitigate the negative effects from tax policy on employers, job creators, and economic decision makers
- Correct policies for which Massachusetts is an outlier
- Stimulate new economic activity and protect the economic activity we already have
- Address millionaire’s tax unintended consequences

	Estate tax reforms	Reduce capital gains tax rates	Eliminate the sting tax	Single Sales Factor Apportion.	PTET changes	163(j)
Protect the economic activity we already have and stimulate new economic activity	✓		✓	✓		✓
Mitigate the negative effects from tax policy on employers, job creators, and economic decision makers	✓	✓	✓	✓	✓	✓
Correct policies for which MA is a negative outlier	✓	✓	✓	✓		
Address unintended consequences from the new tax on income > $1m	✓	✓	✓		✓	

Additional items

- Clarifications and technical guidance for tax practitioners and others as the new tax on income over $1 million is implemented. This includes but isn't limited to:
  - Credit for taxes paid in other states
  - IRC conformity
  - Withholding process for employers
  - Whether the threshold applies to each return, e.g. married filing separate
- Data & tracking to allow for robust analysis on the new tax's effects on economy, employment, and state spending. The state can consider engaging a third-party to study and quantify impacts. Additionally, data made publicly available should include but not be limited to:
  - Number of filers with AGI over $1m and revenue collected from such filers
  - Total tax revenue collected from surtax
  - Migration of MA taxpayers
  - Employer/business address and employer/business headquarters location
- When implementing tax policy, Massachusetts should prioritize practical administration, legislative intent, and accurate collections over maximizing revenue generation.

ESTATE TAX

Proposal

- Increase threshold to $5 million and increase annually based on CPI measure
- Shift to marginal tax to eliminate the cliff effect
- Technical changes for clarity and to reflect case law

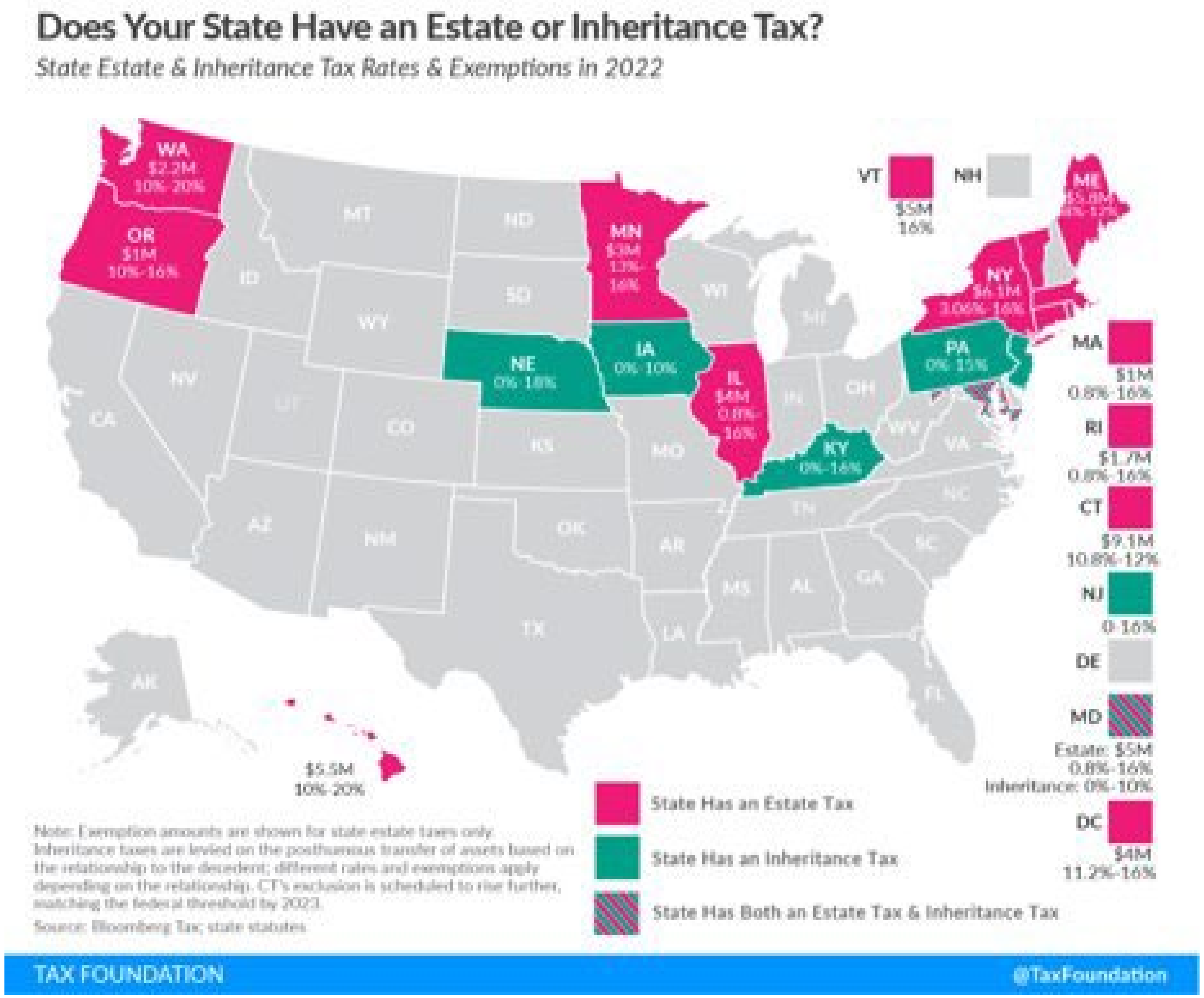
Need & Impact

- Legal and technical tax practitioners recommend the state raise the threshold to $5 million to prevent taxpayers leaving the state, given the new tax on income over $1 million.
- Massachusetts is a clear outlier on the estate tax.
  - Massachusetts is one of only 12 states that impose an estate tax.
  - Massachusetts has the lowest estate tax exemption threshold in the country, along with Oregon, currently set at $1 million.
  - Massachusetts is the only state to apply the tax to the full value of the estate once the $1 million valuation threshold is triggered.
- The static budget impact of estates under $5 million in CY 2020 was $243 million, less than half the total estate tax collections that year.

50 State Comparison

Estate tax reform is overdue

- If the estate tax reform proposal is adopted, the estate tax threshold will still be lower than the thresholds in New York ($6.1m), Maine ($5.8m), and Connecticut, and the same as Vermont.
- Estate tax rates would remain similar to border states, and higher than top rates in Maine and Connecticut (12%).



Note: Iowa is phasing out its inheritance tax by 2025 and Nebraska is reducing its inheritance tax rate.

CAPITAL GAINS

Proposal

Short-term

- Reduce short-term capital gains tax rate to 5%

Long-term

- Reduce long-term capital gains tax rate to less than 5% *or* return to pre-2002 long-term capital gains tax rate structure that phased the tax out the longer the asset is held.
- Create exclusion for sales of in-state primary residences and businesses held for a minimum time period. This would mitigate *some* of the unintended effect from the millionaire's tax.

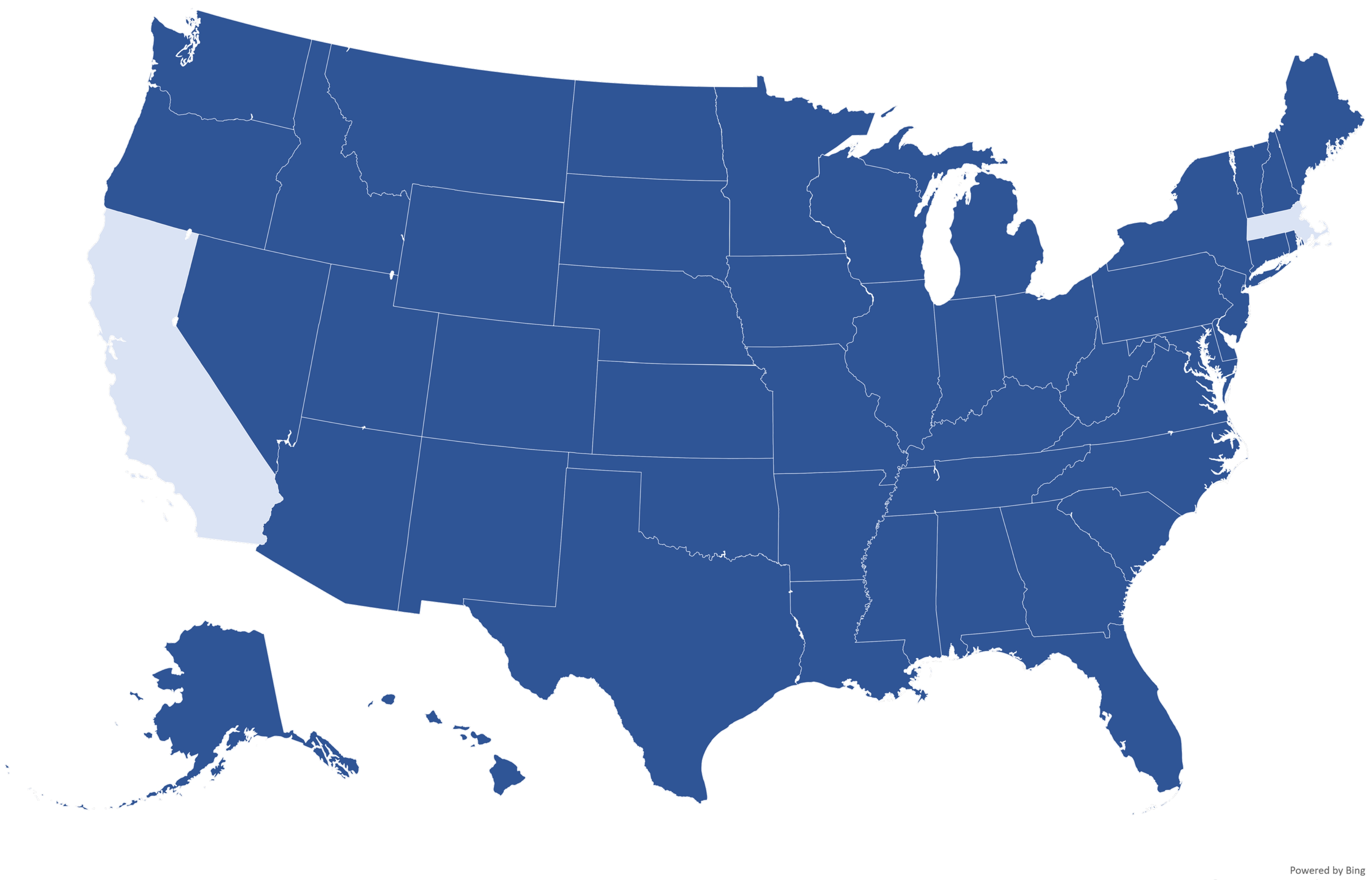
Need & Impact

- Massachusetts has the 2nd highest short-term capital gains tax rate in the nation.
- Massachusetts limits its reliance on capital gains to below actual collections. This means only a limited portion of capital gains revenues are in the state's operating budget structure which mitigate or eliminates state budget impact from reducing capital gains rates.
    - Capital gains are a volatile revenue source, often rising or falling with general economic conditions, so in 2012 the state changed its reliance on capital gains for budget purposes. Excess capital gains, defined as revenues over $1.5 billion for FY 2023, must be siphoned into the state's stabilization fund.
    - Short-term capital gains are not included in the consensus revenue forecast or operating budget at all. Revenues are fully distributed to the stabilization fund.
- The static budget impact to reduce short-term capital gains tax rate to 5% is ~$167 million.

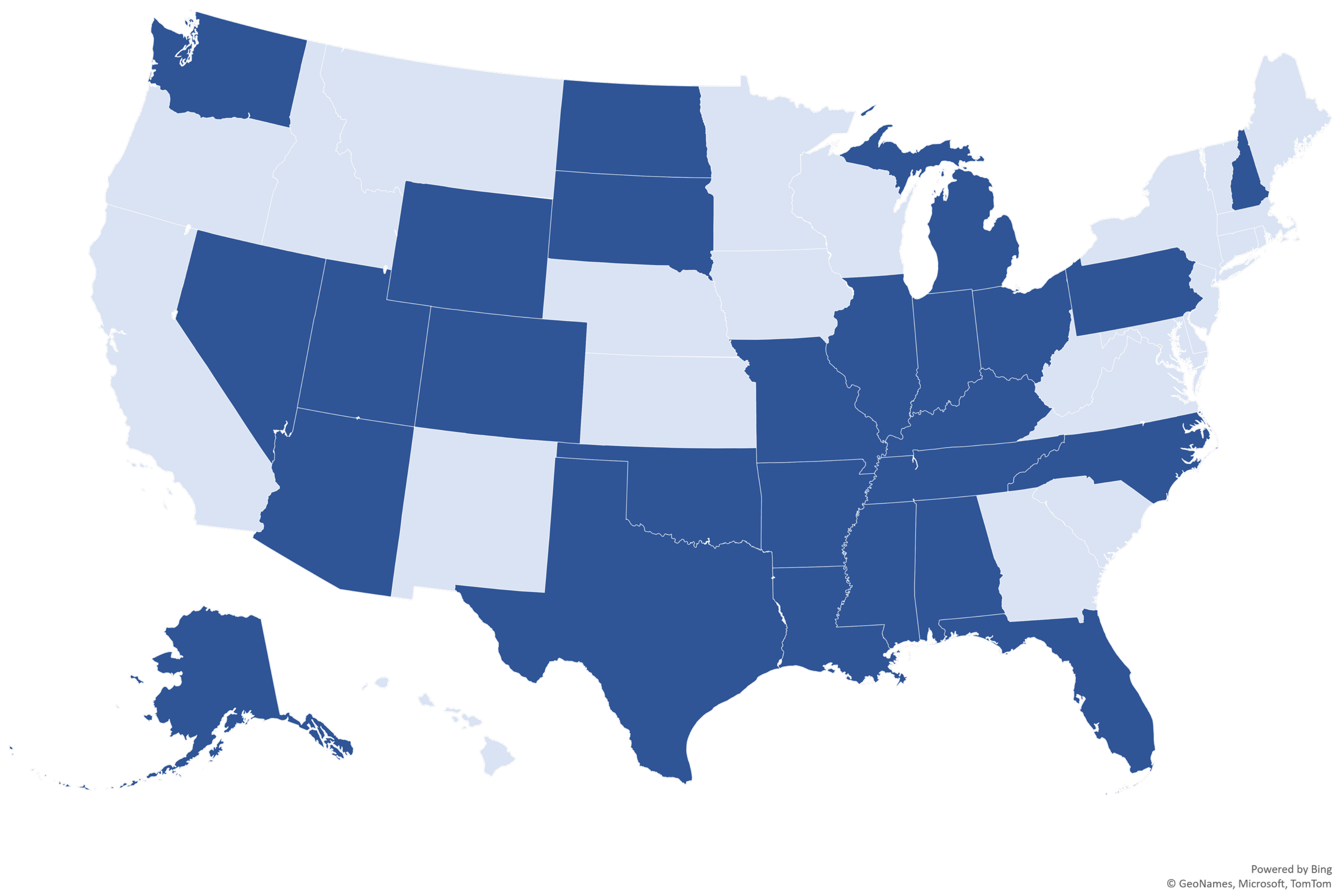
50 State Comparison

If the short-term capital gains rate drops to 5 percent, Massachusetts would be among 26 states that tax short-term gains at 5 percent or lower.

States with a Short-Term Capital Gains Tax Rate Lower Than MA's 12%



States with a Short-Term Capital Gains Tax Rate at 5% or lower



50 State Comparison

- Most states tax long-term capital gains at the same rate as personal income, but some offer full or partial exclusions/exemptions or deductions to reduce the tax base.
  - Exclusions/exemptions and deductions are typically for long-term capital gains related to the sale of an in-state business and/or the sale of a primary residence.
  - Some require minimum time periods for which the asset must be held, for example, Vermont requires 3 years.

STING TAX

Proposal

- Eliminate sting tax *or* increase thresholds to which sting tax applies from $6 and $9 million and reduce to a flat rate.

Impact & Need

- Massachusetts applies an additional tax on S-corps with gross receipts over $6 million. The rate applies to net income and increases based on income and/or business type.
- This form of additional taxation doesn't exist in most other states.

SINGLE SALES FACTOR APPORTIONMENT

Proposal

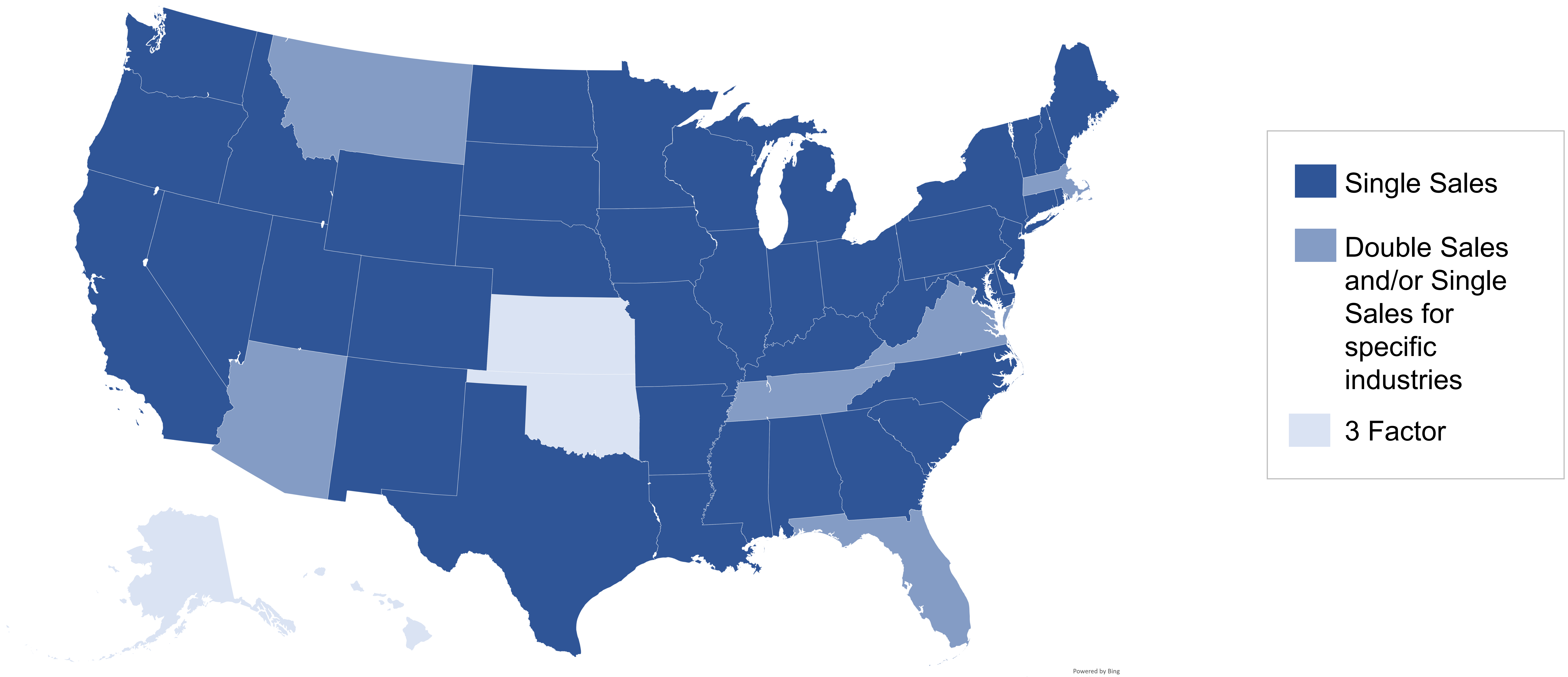
- Expand use of single sales factor apportionment for multi-state employers.

Need & Impact

- The state's double-weighted sales factor apportionment penalizes multi-state companies that choose to establish large operations in Massachusetts.
- Recognizing the imbalance and penalties that three factor and double-weighted apportionment imposes on employers, most states have moved to a form of single sales factor apportionment.

50 State Comparison

Apportionment Formulas



PASS THROUGH ENTITY EXCISE

<u>Proposal</u>

- Increase the credit for PTE Excise paid to 100%
- Increase the PTE Excise rate to 9% rate for income over $1 million

<u>Need & Impact</u>

- Massachusetts adopted a law to mitigate the effect of the federal cap on state and local tax (SALT) deductions for pass-through entities.
- With the new 4 percent tax enshrined in the constitution rather than statute, it is not reflected in the PTE Excise rate that was created.
- PTEs can claim only a 90% credit for the share of PTE Excise paid.

IRC Sec. 163(j) INTERST DEDUCTION LIMITATION

Proposal

- Decouple from federal law on 163(j) which places limits on deducting interest paid

Need & Impact

- This issue arises out of the 2017 federal tax law changes and the interaction of how MA couples with some sections of the federal corporate tax code but not others.
- The effect is that some companies based in Massachusetts pay a significant tax penalty compared to other states for borrowing. Borrowing is often used for investment – including expanding employment and operations. As interest rates rise and borrowing becomes more expensive, the burden MA places on taxpayers by its automatic conformity to 163(j) also increases.
- There are more than 20 states that either actively decoupled from 163(j), never adopted it, or otherwise have limits on its reach. There are another 6 states with no corporate income tax, including Texas and Washington, so there is no adverse impact from 163(j) in those states.
  - As part of the overall tax system, this can make investing in MA more costly when compared to other states. For example, California never adopted 163(j) and uses SSF apportionment. If a company wants to borrow to add employees or expand its operations, it's penalized twice if it occurs in Massachusetts rather than California: (1) with the limits on deducting interest and (2) with the apportionment formula.

Additional Tax Reforms

The following tax reforms were approved but not passed by the Legislature last year. These are outside the scope of this proposal and we urge you to consider these in addition to, rather than in place of, this proposal.

- Increase the rental deduction from $3,000 to $5,000
- Increase the adjusted gross income threshold for “no tax status” to $12,400 for individuals, $24,800 for joint filers, and $18,650 for heads of households
- Increase the maximum senior circuit breaker credit from $750 to $1775 ($2340 when adjusted to inflation)
- Increase the family dependent care credit from $240 to $480 for 1 qualifying individual, and to $960 for 2 or more, and the household care credit from $180 to $360 for 1 qualifying individual, and $720 for 2 or more
- Increasing the earned income tax credit

Greater Boston Chamber of Commerce

MassCPAs™ Massachusetts Society of CPAs

Proposal Working Group Participants

Representatives from the following organizations participated in developing this proposal:

- EY
- KPMG
- Deloitte
- PWC
- Nutter
- Sullivan
- MA CPA Society
- Greater Boston Chamber of Commerce