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MTF Bulletin

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Economic Development, Tax Relief & Surplus Conference Preview

Legislative leaders have less than a week to reconcile the House and Senate's differing $5 billion omnibus spending, tax and policy bills. This Bulletin identifies key fiscal and policy provisions to be negotiated by the Conference Committee tasked with reconciling the differences and makes recommendations to resolve major policy differences.

Fiscal Summary

The House and Senate proposals – which total $4.8 billion and $5.1 billion respectively – are both significantly less than the $6 billion included in Governor Baker's FORWARD Act and pending FY 2022 supplemental budget.

The biggest fiscal differences between the two bills are the different allocations for the surplus/ARPA spending and the implementation date of proposed tax changes. The final bill could accommodate all House and Senate unique spending and implement tax changes in TY 2022 and still use fewer resources than Governor Baker's legislation.

Administration, House and Senate Resource Comparison

	Governor	House	Senate
Surplus & ARPA spending	$3,953.9	$2,339.9	$2,492.4
Taxpayer rebates	$0.0	$510.0	$510.0
Direct spending	$3,954	$2,850	$3,002
Capital authorizations	$1,255.8	$1,430.3	$1,568.8
Tax changes	$741.0	$569.5	$522.0
Tax implementation date	TY 2022	TY 2023	TY 2022
Total	**$5,950.7**	**$4,849.7**	**$5,093.2**

$ in millions

Surplus and ARPA Differences

The House and Senate bills have $1.9 billion in common spending, with about $1 billion in spending unique to each proposal. If all spending in both bills is included in the final version, the bottom line would increase to $3.9 billion.

Analysis of House v. Senate Spending Composition

	Shared	House Unique	Senate Unique	Total
Earmarks	$5.8	$223.9	$70.3	$300.0
Small Business/hotels	$75.0	$128.0	$0.0	$203.0
Community supports	$15.0	$66.0	$8.5	$89.5
Deficiencies/other	$24.7	$0.0	$19.1	$43.8
Early childhood education	$0.0	$0.0	$150.0	$150.0
Hospital payments	$350.0	$0.0	$50.0	$400.0
Other health care	$290.0	$20.0	$7.5	$317.5
Housing	$100.0	$76.0	$303.5	$479.5
Human service rates	$100.0	$0.0	$150.0	$250.0
Broadband	$0.0	$50.0	$0.0	$50.0
Environmental/energy	$325.0	$175.0	$287.0	$787.0
Oversight	$5.0	$0.0	$0.0	$5.0
Rebates	$510.0	$0.0	$0.0	$510.0
UI trust fund	$100.0	$200.0	$0.0	$300.0
Workforce	$0.0	$0.0	$56.0	$56.0
Total	**$1,900.5**	**$938.9**	**$1,101.9**	**$3,941.3**

$ in millions

Local earmarks comprise $300 million in total spending, with most of the projects unique to either the House or Senate. Other major spending differences include:

- Energy & environment ($462 million total unique) – the House and Senate took very different approaches to spending on public spaces and environmental infrastructure. The only shared spending is $100 million for clean energy investments in port cities and spending for the Clean Water Trust. Unique spending includes:
    - The House bill includes $175 million for the purchase, upkeep and improvement of public spaces, with $25 million earmarked for projects in communities.
    - The Senate bill provides $125 million to the Clean Energy Center for clean energy investments and $100 million for electric car and charging station incentives.
- Housing ($379.5 million total unique) – each branch of the legislature includes at least to $100 million for the Affordable Housing Trust that provides low and moderate income-housing investments and supports. In addition:
    - The House includes Governor Baker's proposal to provide $75 million for a new Equitable Developers' Program which will support projects in Gateway Cities and developers in communities disproportionately affected by the pandemic.
    - The Senate includes an additional $50 million for the Affordable Housing Trust Fund, as well as $100 million for the Commonwealth Builder Program and $150 million for Workforce Housing.
- Unemployment insurance (UI) trust fund (House +$200 million) – both the House and Senate make contributions to the state's UI fund to account for ineligible overpayments made during the pandemic that have since been forgiven. The House matched the Administration's $300 million estimate of the net cost to the fund (otherwise paid for

through employer contributions) after contributions from the federal government and uncollectible payments are considered. The Senate provided $100 million.

- Early childhood education (Senate +$150 million) – the Senate bill provides $150 million from remaining ARPA Childcare Development Block Grant Funds to extend the existing Childcare Stabilization Grant program through the remainder of FY 2023. The FY 2023 conference budget, currently on Governor Baker's desk, includes funding to continue the program through at least the first half of the year.

In order to resolve the compromise bill, House and Senate conferees will need to first determine if they want to impose spending limitations as they did in last year's COVID recovery bill. To keep the total cost of the bill under $4 billion, millions of dollars were cut during conference. Similar cuts will be necessary if the final bill is to remain in the $3 billion range.

Governor Baker has recommended spending down the state's remaining $2.2 billion in FRF resources to maximize their impact, while also using about half of the estimated FY 2022 surplus to fund additional recovery investments.

The House and Senate may opt for a more conservative approach on FRF, saving a significant portion for next year. By using less in FRF, but additional surplus funds, the final bill could cover spending in both bills, retain significant FRF and surplus resources for the future, and keep spending under the level proposed by the Administration.

Tax Changes

House and Senate leaders announced a joint framework for approximately $500 million in tax relief, but there are other important differences between the two bills

Summary of Tax Provisions

Tax Proposal	House	Senate	House	Sen.
Dependent care/dependent	$310 credit per dependent/no cap	$310 credit per dependent/no cap	$130	$130
Rental deduction	50% of rent up to $4,000	50% of rent up to $4,000	$35	$35
Senior circuit breaker	Max credit ~$2,340	Max credit ~$2,340	$60	$60
Estate tax	$2M threshold; increase rate for $5M+ estates; Tax applies to threshold and above	$99,600 credit applied to all estates	$207	$185
Earned Income Tax Credit	Increase state credit to 40% of federal	Increase state credit to 40% of federal	$92	$92
Effective Date	TY 2023 (benefit when filed in 2024)	TY 2022 (benefit when filed in 2023)	NA	NA
Tax framework			**$524**	**$502**
Live performance credit	5 year pilot tax credit for theater/live performances	Not included	$5	$0
Rolling stock	Exempts rolling stock (trucking used for shipping) from sales and use tax	Not included	$5-$15M	$0
Qualified data center (QDC)	Exempts eligible purchases for use at QDC from sales tax	Not included	Unknown	$0

One of the differences between the House and Senate is their approach to estate tax reform. Under both proposals, estates under $2 million would no longer be subject to tax and the existing cliff effect would be eliminated or significantly mitigated.[1] However, the House approach would increase the top marginal tax rate and lower the threshold at which the top rate applies (to estate values that exceed $5 million). The Senate, on the other hand gives all estates a uniform credit of $99,600 and would not increase estate tax for any filers.

The House bill delays implementation of tax changes until tax year 2023, postponing tax relief until the spring of 2024 when 2023 taxes are due. The Senate bill, like Governor Baker, makes tax changes effective this year, which will provide relief in spring of 2023.

The House added several economic development tax provisions through amendment (summarized in the table above), two of which it has previously passed – a sales tax exemption for shipping trucks doing business in Massachusetts and a $5 million annual theater tax credit pilot program.

Policy Differences

There are 289 policy sections in one version or the other, of which almost half (126) are the same or similar. Major policy differences include:

House initiatives

- *I-Lottery* – the House bill authorizes the expansion of the state lottery to online and app-based platforms. The House estimates that i-Lottery will collect about $200 million in net profits, which it dedicates to an early education trust fund.
- *Natural gas pipeline facilities* – the House adopted language that would change how pipeline facilities are assessed for the purpose of local property taxes. Under the change, aboveground facilities would be credited to one municipality as opposed to shared among all the communities on the pipeline.
- *Public School Staff Diversity* – the House added a section creating a five year pilot program for an alternative educator licensure process. Under the pilot programs, alternate licensure could be used to attract teachers to improve the diversity of the teaching workforce, increase the number English-language learner instructors, and fill critical teacher shortages. The House also added sections requiring all public school districts and charter school to create diversity plans and have a diversity, equity and inclusion officer on staff.
- *Prohibition of mandatory arbitration* - the House adopts language prohibiting employers from requiring prospective hires to address employment claims through mandatory arbitration prior to or instead of pursuing claims through the court system.
- *HDIP minimum credit* – the House bill establishes a minimum amount of $3 million for Housing Development Incentive Program tax credits.

[1] For more information on the state's current estate tax and the need for reform read MTF's analysis here.

Senate Initiatives

- *Auto Body rate setting* – the Senate establishes a minimum hourly rate for auto body services related to insurance claims and creates a process to adjust those minimum rates going forward.
- *K-12 school spending* – the Senate bill allows districts to fall short of annual net school spending requirements in 2021-22 and the next two school years by up to 10 percent, provided the difference between the amount spent and the required level is deposited into a reserve and spent prior to the end of the 2026-27 school year. The purpose of this section is to provide spending flexibility to school districts that are running up against deadlines to spend federal ESSER funding, while also seeing state aid increases through the Student Opportunity Act.
- *HOMES Act* – the Senate adopted two sections to allow no-fault evictions to be sealed by the court and not show up in consumer credit reports.
- *In-law apartments* – the Senate bill prohibits local zoning ordinances from preventing the construction of in-law apartments (adjunct housing units), provided that the property and the new unit meet certain minimum requirements.
- *Devens growth cap* – the Senate expands the maximum amount of developable land at Devens from 8.5 million to 12 million square feet.
- *Childcare as campaign expense* – the Senate bill would allow political candidates to use campaign funds to pay for certain childcare expenses.
- *State employee health insurance* – this Senate provision allows state entities to offer health insurance to new employees as soon as employment starts. Currently, employees have to wait as long as 90 days for health insurance to begin.
- *Excess capital gains* – the Senate bill changes how excess capital gains are distributed in FY 2023. Under current law, 90 percent of all capital gains above a statutory threshold is deposited into the Stabilization Fund. The Senate lowers that to 80 percent and redirects that money to pension and OPEB liabilities.

Impact on Fiscal Picture

The final bill will use a significant portion of both the estimated FY 2022 surplus and remaining federal Fiscal Recovery Funds, but just how much depends on three things:

- The total level of spending – as noted above, the House and Senate bills both spend approximately $3 billion, but a final bill could grow to $4 billion;
- Final FY 2022 tax collections – MTF's FY 2022 surplus estimate of $3.6 billion could grow if June tax collections exceed benchmark.
- Placing a cap on FRF resources – the House bill caps the use of FRF at $1.43 billion, while the Senate does not limit FRF use.

Potential Resource Use

Resources				
Preliminary surplus	$3,523.0			
FRF remaining	$2,266.0			
Total available	**$5,789**			
Proposed Spending				
	Governor	**House**	**Senate**	**All Spending**
Surplus spending	$1,688	$1,427	NA	NA
FRF spending	$2,266	$1,427	NA	NA
Total spending	**$3,954**	**$2,854**	**$3,002**	**$3,942**
Total remaining	**$1,835**	**$2,935**	**$2,787**	**$1,847**
$ in millions				

If the conference committee opts to include all spending in both plans, there would still be at least $1.85 billion in remaining resources heading into FY 2023. This is essentially the same total level as assumed in Governor Baker's proposals, even though the Governor elected to use more in FRF and less from the FY 2022 surplus.

MTF Recommendations

Of the thousands of spending and policy differences between the House and Senate bills, several major differences standout that MTF wants to weigh in on:

- *Tax policy*
    - *Estate tax* – the Senate approach which raises the threshold, reduces the cliff effect and does not increase the estate tax on any filers, is the better approach to make Massachusetts less of an outlier and reduce incentives for high wealth individuals to relocate.
    - *Rolling stock* – Massachusetts' current approach to levying a sales tax on interstate shipping and other 'rolling stock' is out of line with tax treatment in most other states and ultimately adds to the cost of goods at a time when inflation and supply shortages causing price increases. The House rolling stock sales tax exemption should be included in the final bill.
    - *Effective date* – Tax relief measures should be effective as soon as possible, as proposed in the Senate bill.
- *Spending*
    - *Unemployment insurance overpayment* – the final bill should include a $300 million contribution to the state's unemployment insurance fund to offset UI overpayments that policymakers opted not to recoup. The state made the right decision to not penalize claimants for many of these payments, but must now ensure that employers do not foot bill by appropriating funds to cover the full $300 million in estimated costs as the House proposed.
- *Policy*

- *K-12 school spending* – the state should allow school districts some flexibility in delaying the use of state funding while federal resources are still available; however, that flexibility should be limited to the 2022-23 school year. Going forward, any flexibility should be contingent upon a district's commitment to use the funds to implement elements of their SOA improvement plans.
- *In-law apartments* – the Senate provision eliminating local zoning authority to prohibit in-law apartments is a small, but sensible policy change that can increase housing production.

Bottom Line

The state will end FY 2022 with unprecedented resource levels and some of those resources should be used to provide sustainable tax relief in conjunction with sound policies that ensure economic viability and important capital investments. While there are many spending differences to resolve before July 31st, a final bill that includes the full cost of UI overpayments and makes critical investments in housing, early childhood and environmental infrastructure should emerge from conference in time to get the bill enacted. Massachusetts businesses and taxpayers are counting on it.