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Ballot Question #1: What it Does and Doesn't Do

Introduction

This November, voters will decide whether or not to approve a ballot initiative that would impose a new tax on income over a million dollars. If approved, this change to the state's constitution takes effect on January 1, 2023. MTF does not support this initiative out of concern for its fiscal and economic impact. This analysis further explains why we are opposed.

What the Ballot Initiative says

The following language is the proposal in its entirety.

"Article 44 of the Massachusetts Constitution is hereby amended by adding the following paragraph at the end thereof:-

To provide the resources for quality public education and affordable public colleges and universities, and for the repair and maintenance of roads, bridges and public transportation, all revenues received in accordance with this paragraph shall be expended, subject to appropriation, only for these purposes. In addition to the taxes on income otherwise authorized under this Article, there shall be an additional tax of 4 percent on that portion of annual taxable income in excess of $1,000,000 (one million dollars) reported on any return related to those taxes. To ensure that this additional tax continues to apply only to the commonwealth's highest income taxpayers, this $1,000,000 (one million dollars) income level shall be adjusted annually to reflect any increases in the cost of living by the same method used for federal income tax brackets. This paragraph shall apply to all tax years beginning on or after January 1, 2023."

Revenue Estimate

According to the Department of Revenue, this tax law change is projected to raise approximately $2 billion from 19,000 taxpayers, or about a $100,000 tax increase per affected taxpayer on average. This estimate is based on data from 2014 and is a static estimate, meaning that it measures only the impact of the tax increase, assuming all else remains unchanged.

Per the DOR estimate, about one-third of the $2 billion will come from additional taxes on wages and salaries, with the remaining two-thirds of revenue coming from non-withholding income. This includes Schedule E income (30%), interest and dividends (8%) and capital gains (26%). Non-withholding revenue is closely tied to the economic cycle, meaning that tax revenue collections are strong during good economic times and fall off considerably during economic downturns. This high degree of volatility and variability in annual collections makes it an unreliable source of operating revenues to sustain state spending.

What this Initiative Does

1) *Question #1 Embeds A Tax Rate In The State Constitution.*

This ballot initiative embeds a 4% surtax into the constitution. Proponents of Question #1 have taken this novel approach because five previous attempts to impose a graduated income tax in Massachusetts were resoundingly defeated by voters. In those previous attempts, proponents proposed eliminating the uniformity clause in the constitution that requires all like types of income to be taxed the same, thereby enabling the legislature to set different tax rates on different income levels. Voters rejected providing the legislature with such wide discretion over tax rates. To avoid that concern, Question #1 puts the tax rate directly into the Massachusetts constitution, stripping the legislature of authority to adjust the tax rate while giving them no ability to respond to changing economic circumstances.

2) *Question #1 Provides The Legislature With Discretionary Authority Over This Revenue*

The language in Question #1 explicitly states that the revenues are subject to appropriation. That means the legislature retains authority over how the money will be spent. This is not merely MTF's interpretation of the language, as the Attorney General's Office affirmed this to be the case in its brief filed in the 2018 lawsuit challenging the petition's validity.[1]

3) *Question #1 Adds a 4% Surcharge On **All** Income In Excess Of $1 Million.*

The wording of the ballot initiative subjects **all** income taxable in Massachusetts to its provisions. This means that wages & salaries, capital gains, interest and dividends and all Schedule E income (rental real estate, royalties, estates, trusts, real estate mortgage investment conduits, etc.) that exceed $1 million will now be taxable. Because many unincorporated businesses, such as sole proprietorships, partnerships, and S-corporations, pay taxes under the personal income tax code (M.G.L.c. 62), they will be subject to this new surtax, too. Contrary to the widely held notion that this will only impact the "uber wealthy," many other taxpayers, including small businesses, retirees, and sellers of homes and other real estate, will be affected.

What this Initiative Doesn't Do

1) *Question #1 Does Not Improve Massachusetts's Competitive Position*

As MTF's recent report "*Heeding the Warning Signs*" documents, Massachusetts is facing some economic headwinds. Structural changes to our economy since the pandemic and demographic trends which have resulted in a labor shortage threaten pose threats to Massachusetts economic vitality. So, too, does our high cost structure. With people no longer

[1] Excerpt from the Brief of The Appellees Maura Healey as Attorney General And William F. Galvin, As Secretary of The Commonwealth in Case No SJC-12422, page 24 – "this proposed amendment would keep "public monies, and the decision how to spend them" within the control of the Legislature."

tethered to their workplace, Massachusetts employers face stiffer competition to attract and retain talent given the state's high cost structure. Businesses also have more locational options since they are able to access talent from anywhere in the world. These factors, in combination, present serious challenges for Massachusetts to overcome in the near term. Imposing a 4% tax increase will only compound this problem by giving people another reason to leave Massachusetts. Recent data indicate that this is already happening. Massachusetts lost 46,000 people since 2021, and is the only New England state to lose population during this period. Discouraging entrepreneurs, innovators and investors from operating here is not a smart strategy for Massachusetts when such people are integral to our innovative economy and long-term economic vitality.

2) *Question #1 Does Not Guarantee More Money For Education And Transportation.*

The estimated $2 billion in new tax revenues from Question #1 will be deposited into the General Fund and be subject to appropriation each year by the Legislature. Even if all the money from the surtax is earmarked for transportation and education to comply with the spirit of the law, that doesn't mean there will be a net increase in the amount spent on either education or transportation, because the money that is currently being spent can be redeployed for other expenses. During the Great Recession, for example, the legislature spent more on MassHealth and other social services, and less on education and transportation.

Massachusetts now spends much more on education and transportation than it did when Question #1 was first introduced in 2014. Massachusetts passed the Student Opportunity Act in 2020. When fully implemented, this law will provide an additional $1.5 billion in state aid for K-12 education, at a time when school enrollment is declining. The federal government has targeted billions more dollars for education. Through the American Rescue Plan Act (ARPA) and Elementary and Secondary School Emergency Relief (ESSER) laws, cities and towns have received approximately $6 billion in federal monies, a large portion of which is available for educational spending. Thus, it is hard to argue that Massachusetts schools are underperforming due to lack of resources. Improving school performance will require more accountability and better metrics for measuring outcomes.

While transportation will likely require additional resources, taxpayers should know that the MBTA has doubled its annual capital investments from $1B to $2 Billion in recent years, but without more staff to do and oversee this work, they are having difficulty spending it. Rather than relying on anticipated revenues from Question #1 that can fluctuate greatly from year-to-year, a dedicated revenue stream that can be leveraged to issue bonds would be a preferable way to fund future investments in transportation infrastructure. Given changing commuting patterns, an FTA investigation of the MBTA and uncertainty about the full extent of investments required to get our public transit in a state of good repair, it would make better sense to develop a detailed plan for how to fix it, along with a cost estimate, before asking a small group of taxpayers to blindly contribute more.

With respect to roads and bridges, the federal Infrastructure bill provided Massachusetts with $5.2 billion in resources for FY 2022 – FY 2026 to make improvements and the Commonwealth can apply for millions more from $25 billion in federal funded programs through a competitive application process.

3) *<u>Question #1 Does Not Address Income Disparity.</u>*

While income disparity in Massachusetts is a growing problem, Question #1 does not address it. Unlike other proposals being considered on Beacon Hill that provide targeted tax relief to individuals of modest means, such as increasing the earned income tax credit, increasing the no tax threshold, amending the renter's deduction and the senior property tax circuit breaker, and expanding the dependent care deduction, Question #1 does not provide any sort of direct relief to those in need. Rather, it simply provides the state with more tax dollars to expend as the legislature deems appropriate.

4) *<u>Question #1 Does Not Ensure Millionaires Pay Their "Fair Share."</u>*

Question #1 is often referred to as the "fair share" amendment by proponents who explicitly state that millionaires do not pay as much in taxes compared as their low and middle income counterparts. This is very misleading. The top quintile of taxpayers (the top 20%) pay 72% of all income taxes in Massachusetts. The top 1% of taxpayers in Massachusetts pay about 20% of all income taxes. In contrast, the bottom quintile pays no taxes at all because of a number of progressive features of the state income tax, including the No Tax Threshold, the refundable earned income tax credit, and the personal deduction. Thus, in absolute terms, high income earners pay materially more of the income tax burden than other taxpayers.

Conclusion

In summary, the fiscal picture of the Commonwealth is far different than it was in 2014 when Question #1 was first introduced. Back then, the state had annual operating budget deficits of $1 billion or more. Today, we have $4 billion in tax surpluses, a healthy reserve in the Stabilization Fund of almost $7 billion (a 350% increase since 2014) and billions of dollars in federal monies at our disposal. MTF has concluded that not only is Question #1 unnecessary, but it is also harmful to the long-term economic outlook for Massachusetts. Imposing an 80% tax increase on some taxpayers will cause outmigration to continue and potentially accelerate, at a time when Massachusetts desperately need to retain and grow its workforce. Imposing significant additional taxes on a group of taxpayers who are increasingly mobile will likely do more harm than good.