

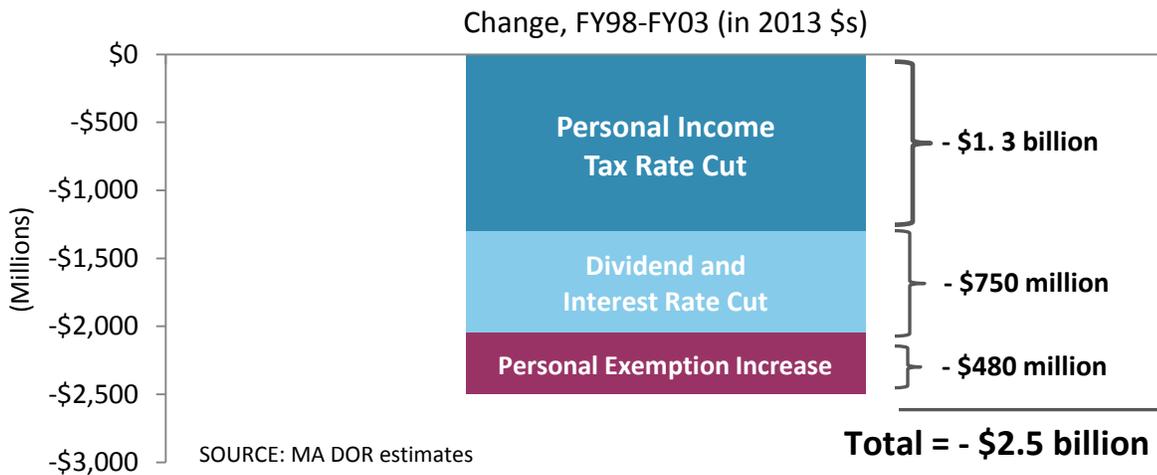
## Income Tax Cuts and the Budget Deficit in Massachusetts

The state budget, and the taxes that fund it, are the primary way we pay for the things that we do together through government. These includes things like police and fire protection; public education; roads, bridges and public transportation; a safety net for when people face hard times; and more.

Beginning in 1998, a number of significant changes were made to the state tax code, including a series of phased cuts to the state personal income tax. These cuts played a major role in reducing taxes, along with the capacity to fund essential services in the Commonwealth.

Three of these income tax cuts were particularly costly to the Commonwealth: 1) a cut from 5.95 percent to 5.3 percent in the tax rate applied to wage and salary income, 2) a cut from 12 percent to 5.3 percent in the tax rate applied to dividend and interest income, and 3) a doubling of the value of the personal exemption from \$2,200 to \$4,400 for single filers and from \$4,400 to \$8,800 for married couples. The combined effect of these three cuts is now a loss of some \$2.5 billion in annual revenue.

### Income tax changes account for \$2.5 B in annual revenue losses, FY98 - FY03

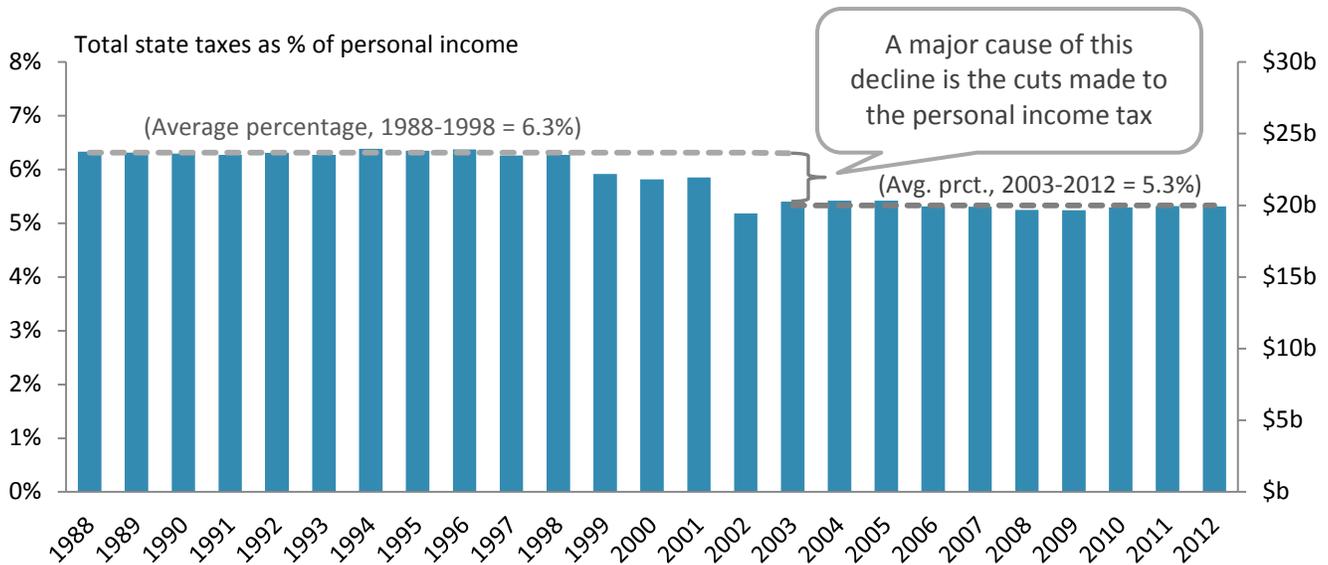


Other factors also have affected state revenue collections in the years since 1998. These include state-level tax policy decisions, along with other, related issues. First, the state has implemented a number of additional individual and corporate tax cuts. Simultaneously, the effectiveness of the sales tax as a stable source of revenue has declined; a growing share of consumer spending is no longer subject to the sales tax. This is due both to the increase in on-line commerce (where retailers often aren't required to collect and remit sales taxes to the Commonwealth) and to the increasing share of consumer spending that goes toward the purchase of services rather than goods (services generally are not subject to the sales tax).<sup>1</sup> Finally, the inflation-adjusted value of excise taxes has declined. For example, the real value of state gas tax collections has eroded substantially since 1991, the last time the gas tax rate was adjusted upward to account for inflation.

<sup>1</sup> The sales tax rate was increased in 2009, bringing in additional revenue to the state. This increase, however, did little more than temporarily offset a decade of revenue declines resulting from the two factors described here.

While there also have been several tax increases over this period - most recently to the state sales tax - the net effect of all increases and reductions since 1998 is that total tax revenue as a share of state personal income has declined by one percentage point (from 6.3 percent in FY 1998 to 5.3 percent in FY 2012). This amounts to a loss of \$3.8 billion in annual tax revenue for the Commonwealth.<sup>2</sup>

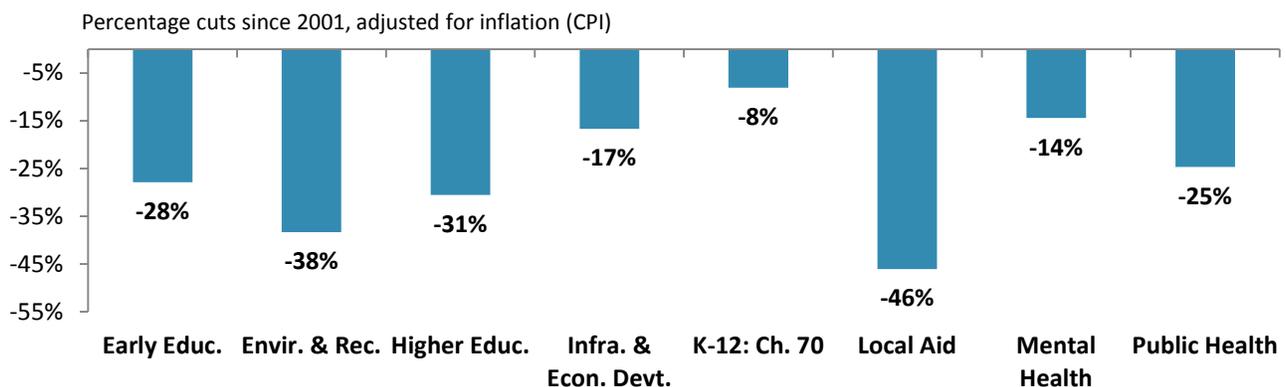
### Annual state taxes as share of personal income down \$3.8 billion since 1998



SOURCES: Personal Income from BEA, and includes capital gains. Tax data from MA Statutory Basis Financial Reports and MA DOR Blue Books.

This substantial decline in revenue has produced an ongoing fiscal crisis for the Commonwealth - and severe shortfalls during economic downturns. In response to these budget shortfalls, state lawmakers have made deep cuts to program areas across the budget. Deep cuts in funding for essential public investments can compromise the state's long term growth potential and harm the current and future well-being of the people who live and work here in Massachusetts.

### A decade of cuts across the state budget (FY2001 - FY2012)



\*Ch. 70 figures are adjusted using the inflation factor specified in Chapter 70

<sup>2</sup> U.S., BEA State Personal Income in Massachusetts (SPI) - adjusted to include capital gains income and the income earned in MA by non- MA residents - was \$223.8 billion in FY 1998. The state collected in taxes an amount equal to 6.27 percent (or \$14.0 billion) of this total. In FY 2012, MA adjusted SPI equaled \$402.3 billion. Had the state collected an amount equal to 6.27 percent of this total, taxes would have equaled \$25.2 billion in FY 2012. Instead, the state collected the equivalent of 5.32 percent or \$21.4 billion. This gives a tax loss estimate in FY 2012 of \$3.8 billion.