

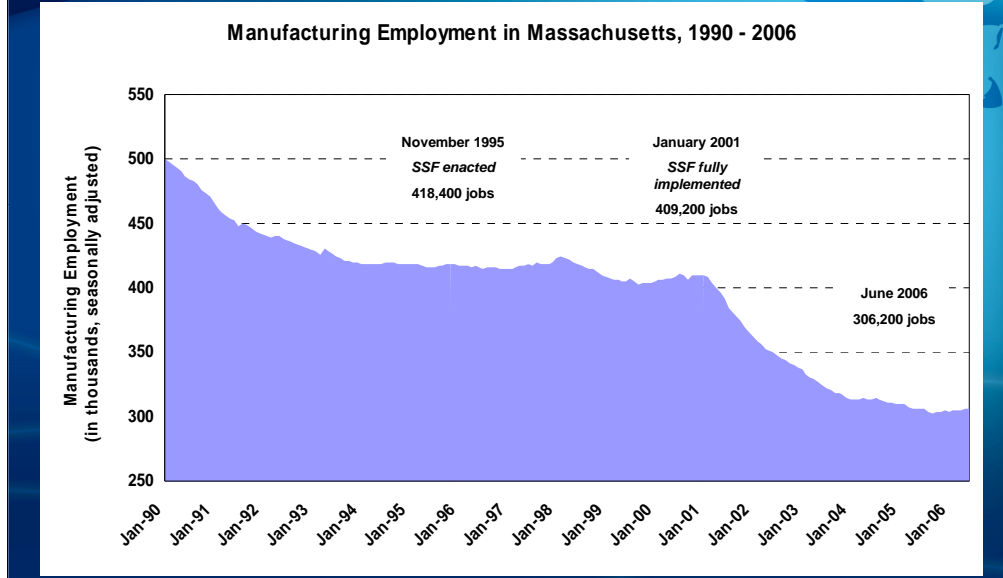
**Healthy
Communities
Economic
Growth
and Taxes**

ONE
Massachusetts.org

30 Winter Street Boston, MA 02108

*Sources provided by the Massachusetts Budget and Policy Center, MBPC

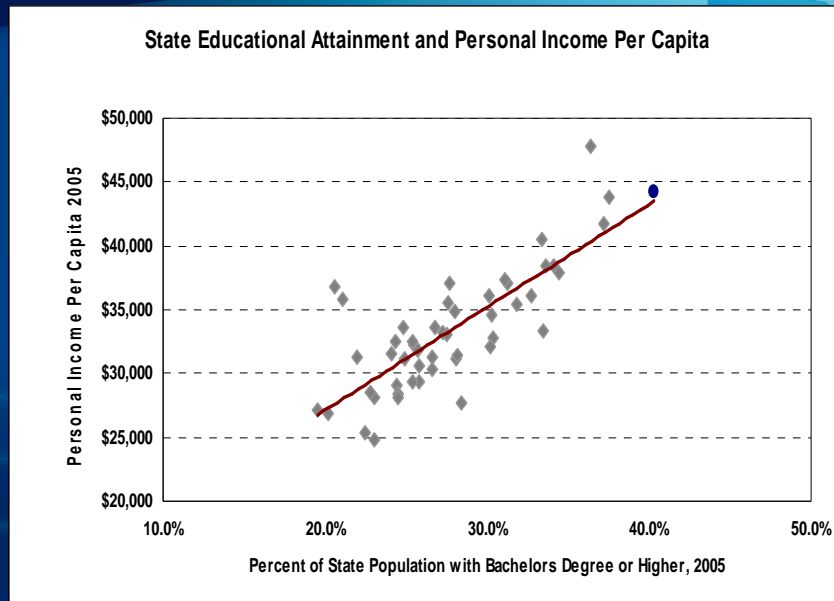
Old Economic Development Strategy: Tax Breaks to Chase Manufacturing Jobs



Facilitator's Note:

Early 90's manufacturing sector losing jobs. Manufacturers ask for, and receive, single sales factor (tax break). Despite tax break, continued to lose manufacturing jobs. Why? We're losing manufacturing jobs for reasons that have nothing to do with state taxes.

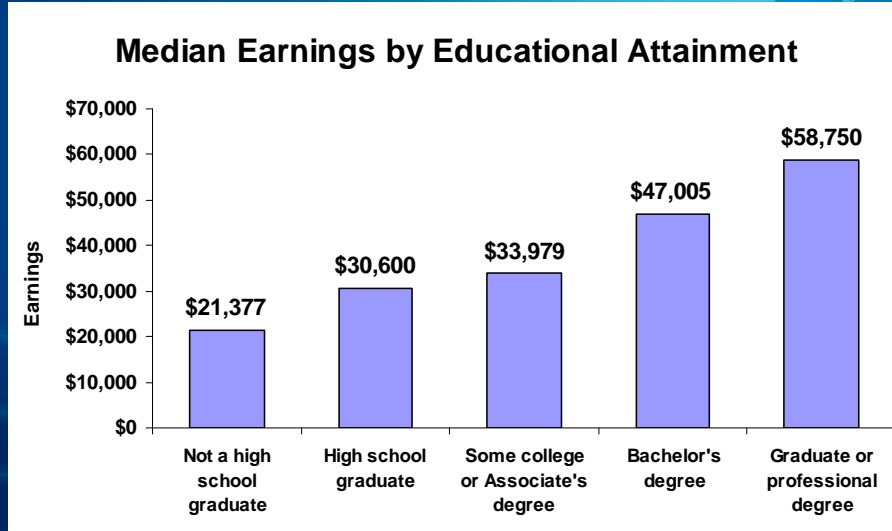
Education and Incomes: Strong Correlation



Facilitator's Note:

Very strong correlation between educational attainment and economic success of a state (good incomes). Note how large the difference is between low and high end, and how tight the correlation is. Also, caution that correlation does not equal causation.

Education and Incomes

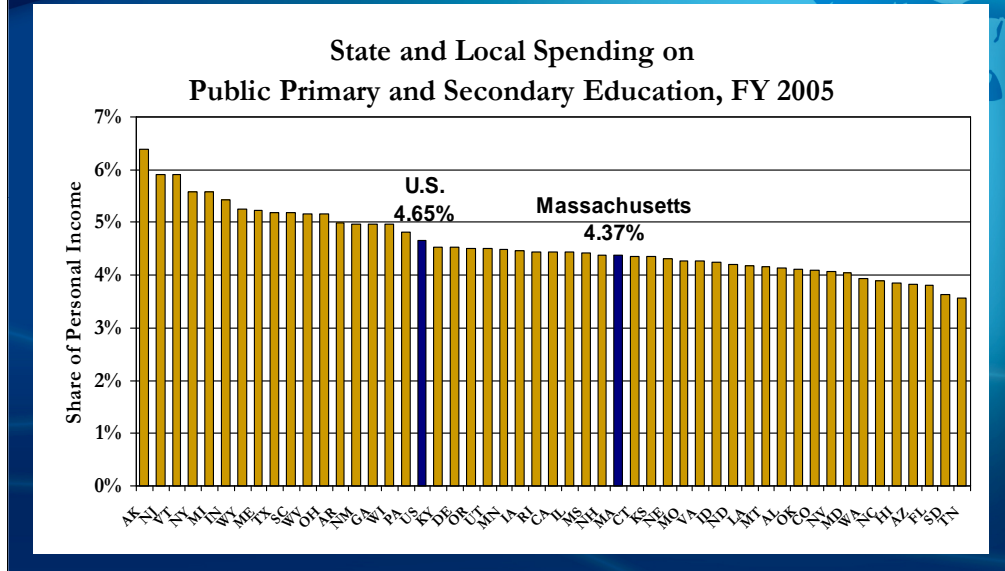


Facilitator's Note:

Since people who have higher education attainment earn more, it follows that states whose people have higher educational levels will also have more state income.

K-12 Share of Income:

\$750M below U.S. Average

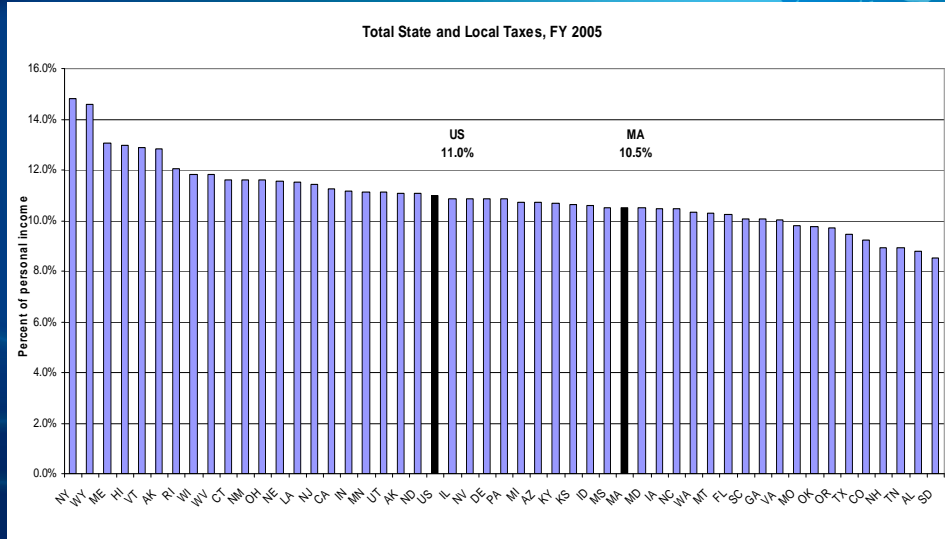


Facilitator's Note:

MA below average in support for public education.

If MA spent the same share of personal income as the US average, it would drive another \$750m to primary and secondary education. We are a wealthy state, much higher than New Hampshire, Kentucky, or Utah.

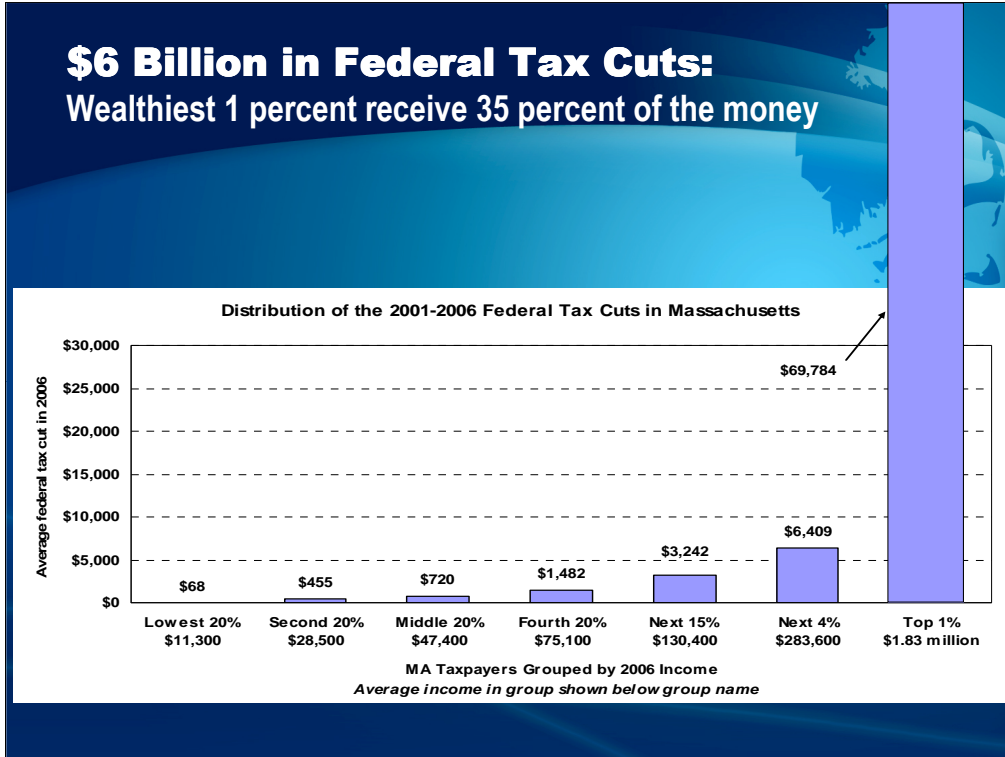
Taxes More Than \$1 Billion Below Average



Facilitator's Note:

And we tax below national average.

**\$6 Billion in Federal Tax Cuts:
Wealthiest 1 percent receive 35 percent of the money**



Facilitator’s Note:

Huge federal tax cuts are an ineffective use of resources.

Numbers at bottom axis are the average income of each quintile. Tax Cut amounts are annual.

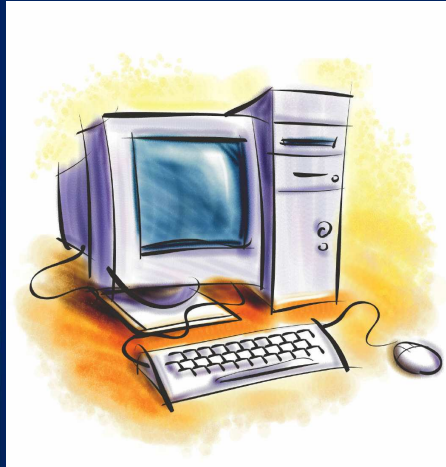
What Makes a Tax System...(good)

1. Fair
2. Adequate
3. Stable
4. Simple/Efficient

Facilitator's Note:

1. Fair—horizontal and vertical equity
 - A) horizontal—similarly situated people treated similarly
 - B) vertical—Issue of regressive v. progressive v. flat taxation (we'll go into this later)
2. Adequate—provide sufficient revenue for needed services
3. Stable—not prone to fluctuations due to recessions
4. Simple/Efficient—easy to understand, transparent

One Type of Fairness: Horizontal Equity
Why discriminate against local bookstores?



Facilitator's Note:

The principal of horizontal equity is violated when people who are alike, and are doing the same thing – like buying a book – are taxed at different rates. That's the case now because a book bought over the internet is often not taxed while a book purchased at a bookstore is.

“We work in a market-based economy that rewards [investors’] efforts far more bountifully than it does the efforts of others whose output is of equal or greater value [such as] marvelous teachers and terrific nurses. Taxation should, and does, partially redress this inequality.”

- Warren Buffet



Facilitator’s Note:

(show quote) Should all taxpayers pay the same share of their income in taxes?

Should higher income taxpayers pay more?

Should lower income taxpayers pay more?

This is a famous quote. Does anyone know who said it?

(press button) Warren Buffet is the richest man on Earth according to Fortune magazine.

(press button) ...and he’s not too bad looking either.

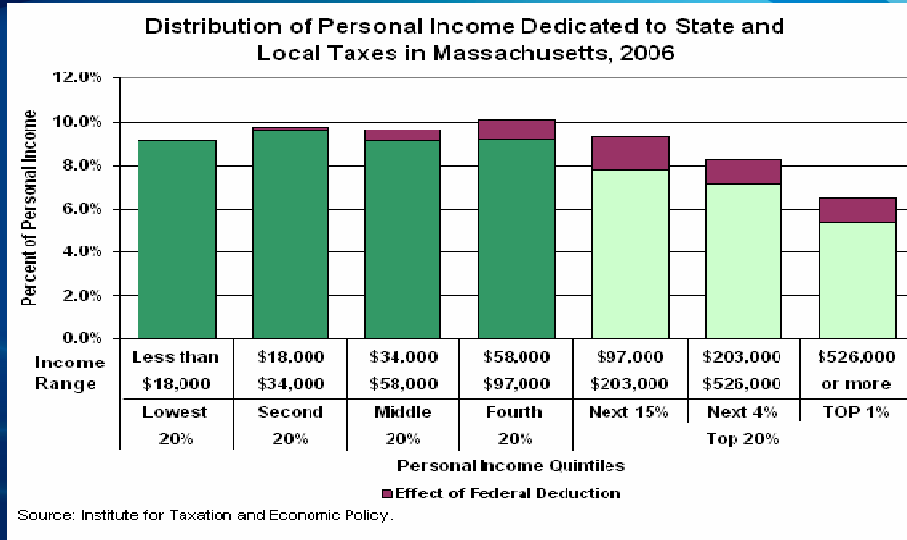
“At some point inequality in outcomes becomes so great that the quintessential American promise of equality of opportunity becomes unattainable.... [O]ur economy and society work best when more opportunities are available to all—a goal that progressive taxation can help serve.”

- Lawrence Summers
The Brookings Institute
(June 2007)



This is another quote from a famous economist who supports the idea that progressive taxation can support the promise of equality of opportunity.

State and Local Taxes are Regressive



Facilitator's Note:

At the state level the clearest reason why taxes should be more progressive is that they are now largely regressive. This chart shows that as a percentage of personal income lower income people pay more of a percentage of their income in state and local taxes. This dark cap on the top of each bar is the effect of federal deductions.

The Benefit Principle:

When is it really relevant?



Facilitator's Note:

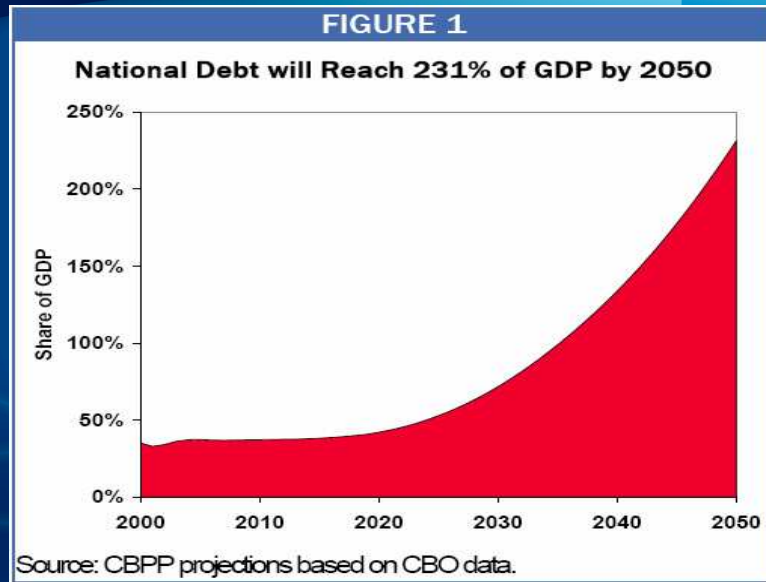
In general we don't believe that only the people who benefit from particular services should pay for them: we have a fire department to stop fires wherever they start; we have police to protect all of us; we have schools so everyone has the opportunity to succeed and give back; we have a safety net to spread risk.

The benefit principal is important, however, when we think about the relationship between our generation and others: are we consuming goods and services and expecting someone else to pay the bills (our children)?

In Europe in the 1800s, they only came to put out your fires if you paid an advance down payment to the local fire brigades.

The Benefit Principle:

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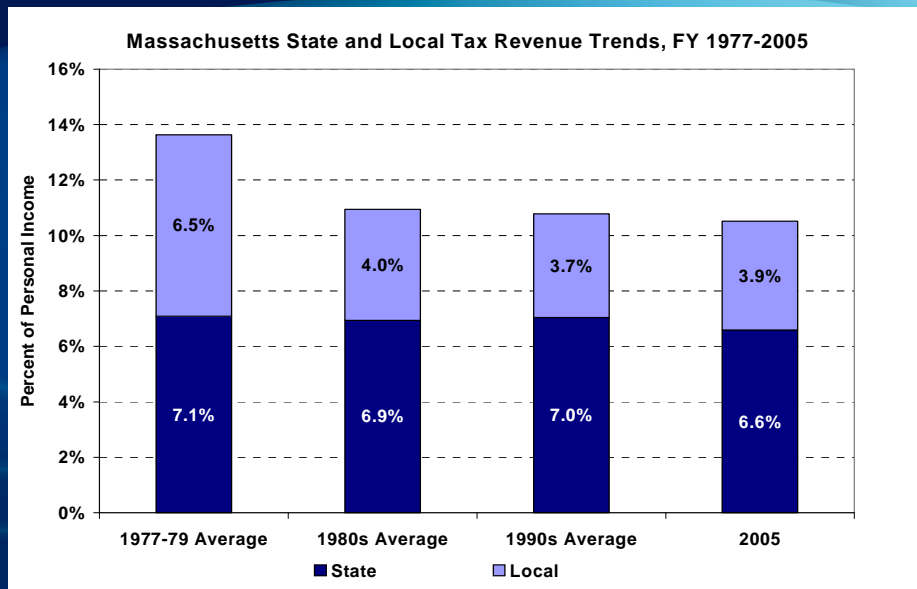
Adequacy: Choices and Values

- Income tax rate cut to 5.3%: \$ 1.4 Billion
- Cut for Dividends & Interest: \$ 534 Million
- Higher Personal Exemption: \$ 260 Million
- Business Tax Cuts: \$ 400 Million
- Business Tax Avoidance: ~\$500 Million
- Sales Tax Erosion: ?????

All state and local government are funded by different kinds of taxes. Some of the recent tax cuts have resulted in a decline in our revenue.

- We cut the income tax to 5.3%, and it has cost us \$1.4 billion. This is less revenue than we had.
- We cut dividends and interest and it has cost us \$534 million.
- We did higher personal exemption, which was for children and individuals, so this was helpful, but the result was \$260 million less to spend
- You've already seen the charts on business tax cuts. They have left us with \$400 million less to spend.
- The governor has filed a corporate loophole bill to stop business from jumping through various loopholes to avoid paying taxes. This could yield another \$500 million.
- People are spending less in a downturned economy.

Adequacy: What Do We Want to Achieve?



Facilitator's Note:

Current tax regime provides less revenue (as a share of resources) than Massachusetts has provided historically.

We pay less in taxes now than we did in 1977, leading to funding cuts for important services.

“There’s no doubt in my mind if we are as ambitious in the next 10 years as I want us to be, we are going to have to raise revenues.”

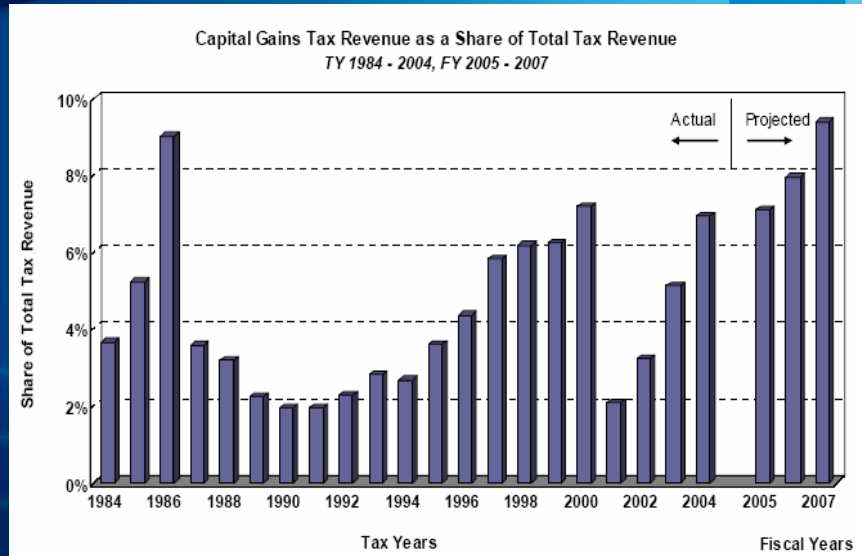
Governor Patrick



Facilitator’s Note:

The Governor appears to believe current system is not adequate to meet his goals for improved education.

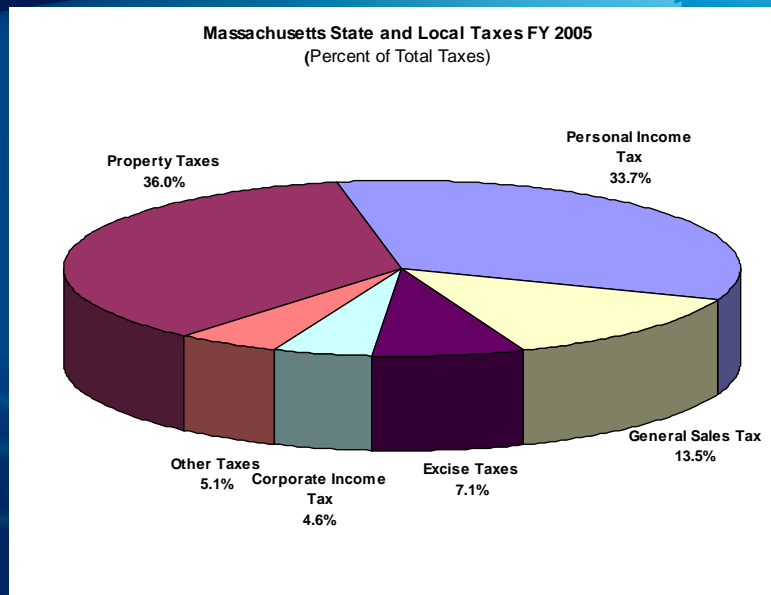
Stable: How Do We Treat Unstable Sources?



Facilitator's Note:

We should recognize that some taxes are not stable – but that doesn't mean they are bad. They may be very good on other measures (for example the capital gains tax is unstable but it is also just about the most progressive tax). One solution is to use unstable revenue sources for things other than operating expenses. For example, such revenue could be deposited into stabilization funds.

State and Local Taxes in MA in 2005



Read the chart. We'll go into detail later on.

Our Major Taxes: The Sales Tax

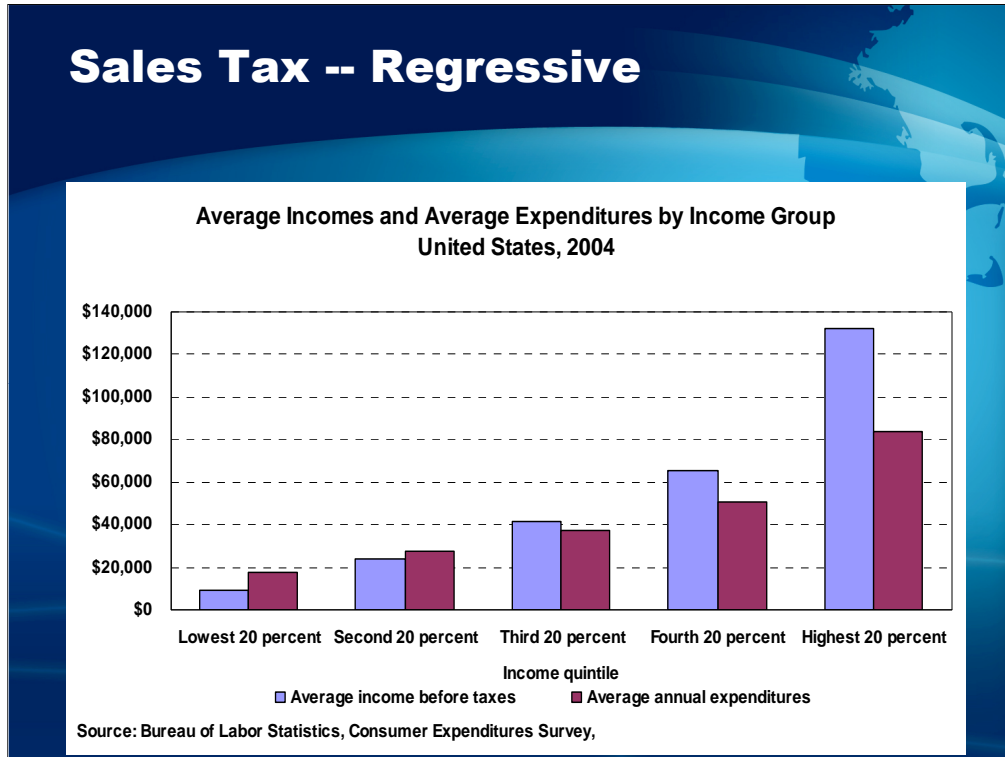
- Problems with Horizontal & Vertical Equity
- Problems with Adequacy Over Time
- Reasonably Stable

Facilitator's Note:

ASK FOR WHAT WE KNOW ABOUT HOW THIS TAX WORKS—DESCRIBE.

- Horizontal equity issue—buying lawnmower (sales tax applies) versus hiring landscaping company (no tax applies b/c services are exempt).
- Vertical equity issue—low income people spend higher portion of income on consumption.
- Adequacy—shift from goods based to service based economy has diminished sales tax base. Services are not taxed, while many goods are (exemptions include food and clothing below \$75 per purchase).
- Reasonably stable—people consume on basic items even during economic downturns, either by drawing down savings or borrowing/credit card.

Sales Tax -- Regressive



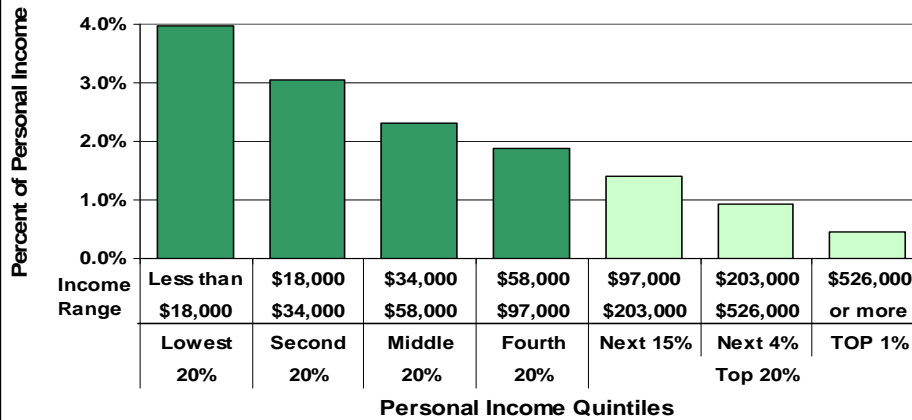
Facilitator's Note:

Low income people spend a larger portion of their income on consumption than people with higher incomes.

In fact, the lowest income people spend more than their income due to borrowing/credit card debt and drawing down savings. Also, life cycle issues contribute to spending being greater than income at a given moment in time. For example, when students spend loan proceeds, which are borrowed money, not earned or senior citizens spend their savings, while reporting low income from social security, interest or other pension income.

Who Pays the Sales Tax in Massachusetts

Distribution of Personal Income Dedicated to Sales Tax in Massachusetts, 2006



Source: Institute for Taxation and Economic Policy.

Facilitator's Note:

Even though MA exempts many “necessities”, sales tax is still very regressive. As a share of personal income, the low and middle income taxpayers pay much more in sales taxes than higher income taxpayers.

Our Major Taxes:

Personal Income Tax

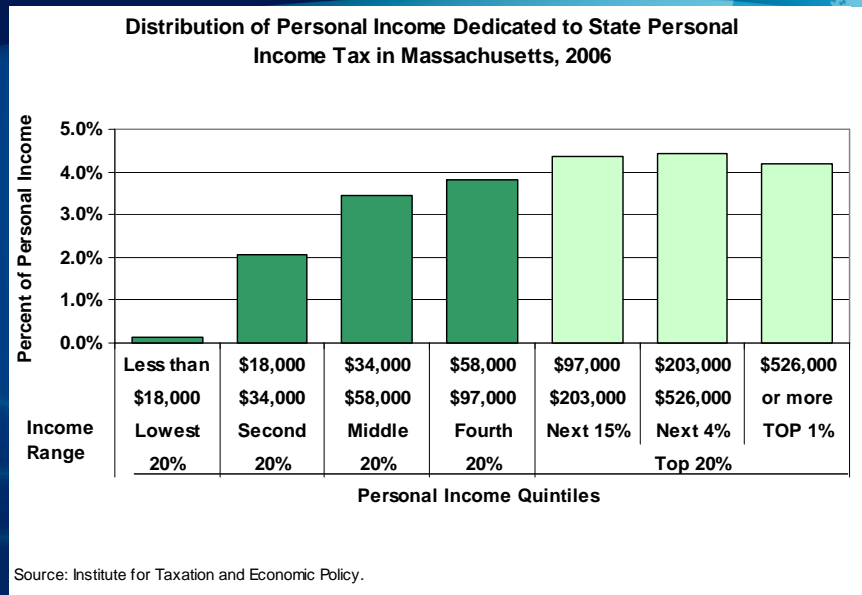
- Good on Vertical and Horizontal Equity
- Grows With the Economy – Unless Cut
- Not that Stable

Facilitator's Note:

Fairly progressive because of Earned Income Tax Credit (tax refunds), high no-tax status and personal deductions.

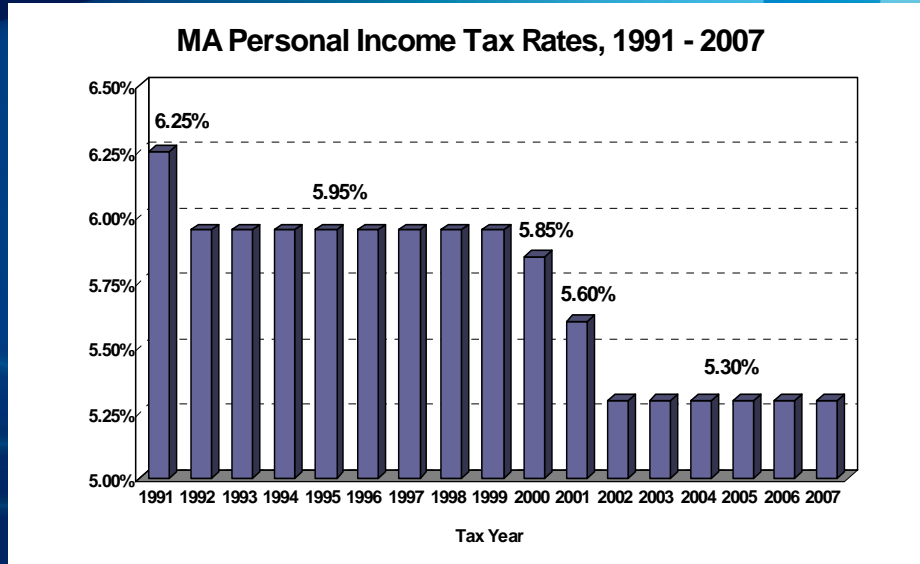
Not as stable as sales tax or property tax.

Income Tax: Progressive



Our income tax, due to high personal exemptions and the Earned Income Tax Credit, is actually fairly progressive.

MA Personal Income Tax – \$2 B per 1%



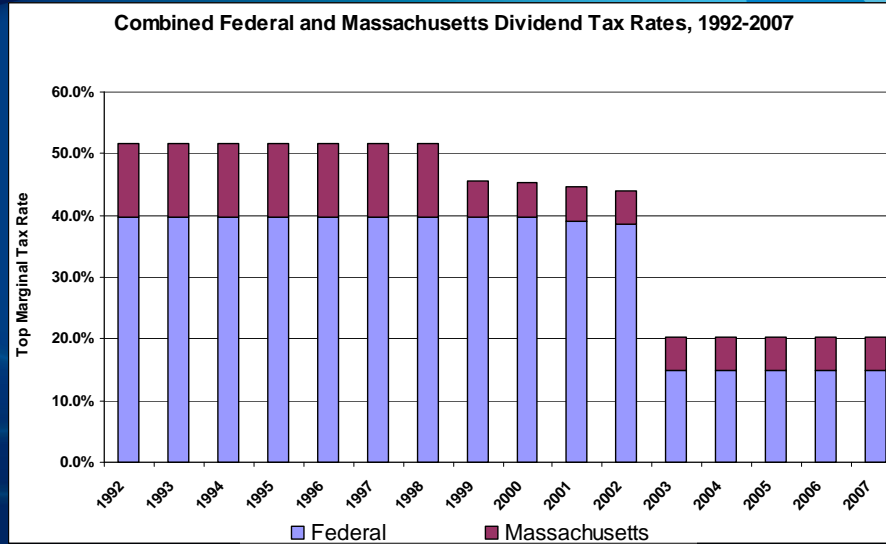
Facilitator's Note:

If MA returned to 2001 level, we would have an additional \$600 million in revenue.

If MA returned to 2000 level, we would have an additional \$1.1 billion in revenue.

If MA returned to 1999 level, we would have an additional \$1.3 billion in revenue.

How Could MA Balance Federal Cuts?



Facilitator's Note:

MA reduced income tax rate on dividend income from 12% to 5.6% in tax year 2001, 5.3% in 2002. In 2001, the federal government started lowering its tax rate on dividend income. The federal rates shown here are for taxpayers in the highest tax bracket, who have the most dividend income (until 2002 the federal government taxed dividend income using the same graduated rate structure it uses for other income.)

We could restore the federal cuts by increasing our state tax rates.

Our Major Taxes: the Property Tax

- Not a Progressive Tax
- Can Grow With the Economy
- A Stable Revenue Source

Facilitator's Note:

Why not progressive—Property value is not the same as income level. Some moderate income people own homes with equity that has appreciated at rates higher than their income growth. Therefore ability to pay is not factored into property tax bills. Note: Property taxes are mildly regressive. The revenue from property taxes can grow with the economy as house prices go up. It is a stable revenue source because property values don't go down as quickly as they go up.

Property Taxes: Stable



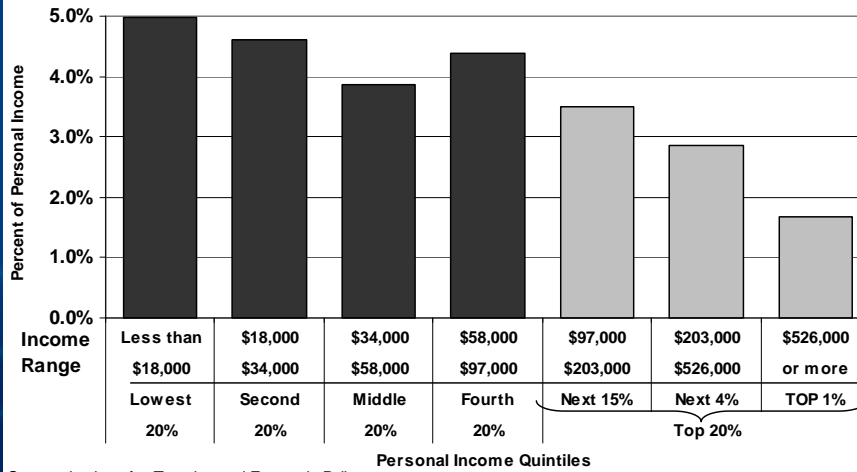
Facilitator's Note:

Recent increases in property taxes have been driven by cuts in state aid, which are the result of state tax cuts (e.g. personal income, capital gains, dividends).

1983 showed the first impact of Proposition 2 ½, and since then they have remained fairly stable.

Property Tax: Can We Improve Fairness?

Distribution of Personal Income Dedicated to Property Taxes in Massachusetts, 2006



In Massachusetts we have something called a “circuit-breaker” for lower income persons. A circuit breaker says that if a property tax is more than 10% of their income, that person can apply to their city or town for a rebate.

Our Major Taxes: Corporate Income Tax

- Good on Vertical Equity, Not Horizontal
- Usually Grows With the Economy
- Not Very Stable

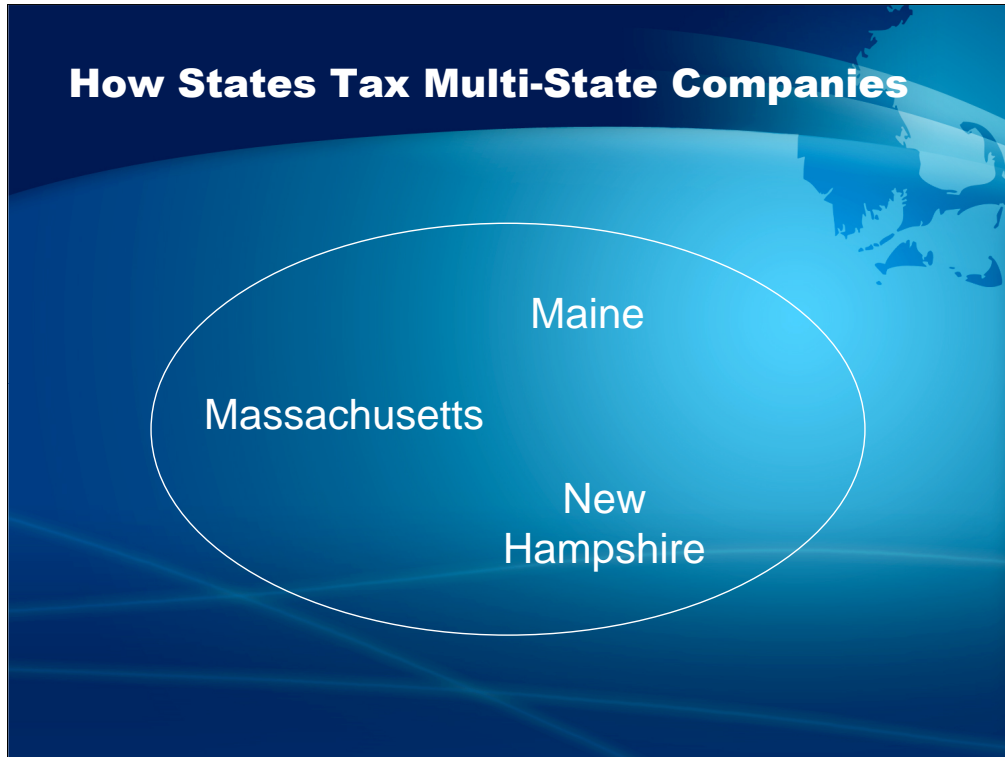
Facilitator's Note:

Horizontal Equity issue—there are lots of narrow tax breaks in the corporate code.

Not stable—economic downturns reduce corporate income.

Very progressive.

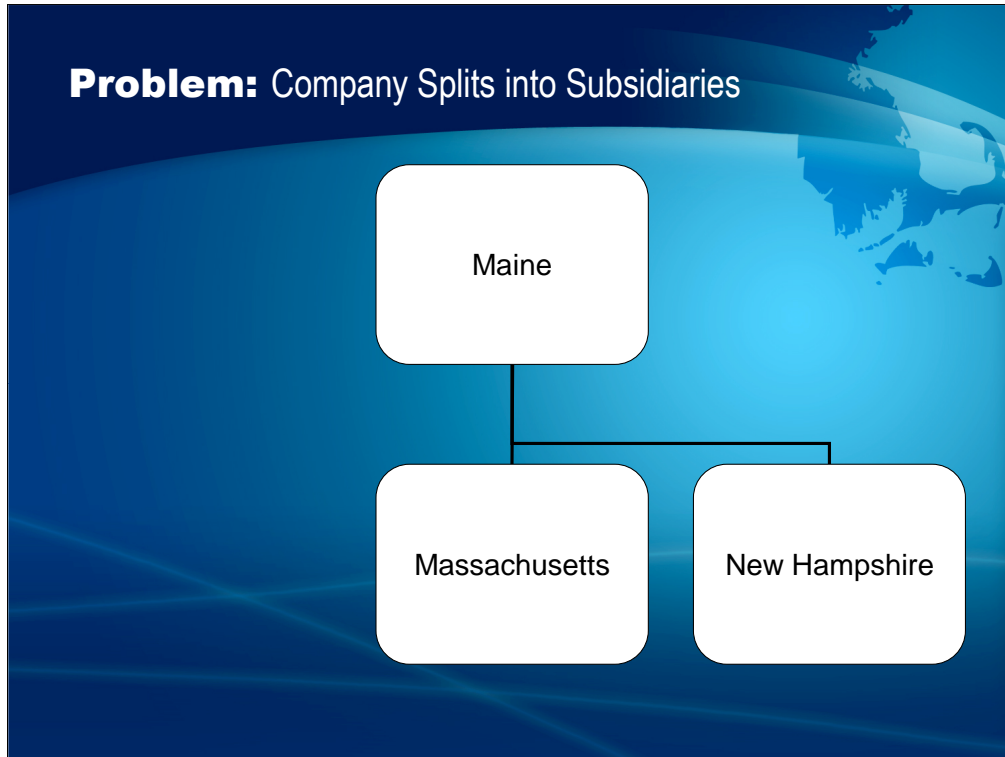
How States Tax Multi-State Companies



Facilitator's Note:

States tax multi-state companies by looking at total profits and then apportioning them based on objective criteria: the share of the companies property, sales, and employees in the state. States use slightly different formulas for combining these factors, but all use an apportionment system that uses some or all of those factors. They don't try to define in some abstract sense where profits are earned. They look at total profits and then apportion based on where economic activity occurred.

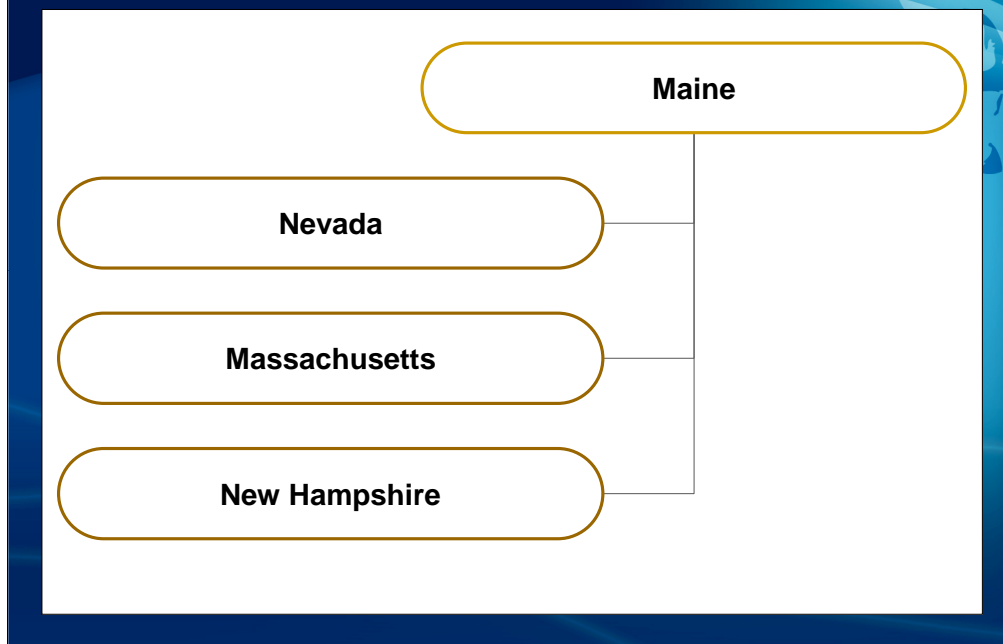
Problem: Company Splits into Subsidiaries



Facilitator's Note:

The problem arises when a company divides itself up into different subsidiaries. Some states, including Massachusetts, then tax only the subsidiaries operating in the state. This allows the company to use accounting techniques to make sure that profits show up in subsidiaries that are in low-tax or no-tax states. Say that there's a software manufacturer in Maine that sells licenses for software in Massachusetts and New Hampshire. In Massachusetts, the seller writes a check to the Massachusetts salesman, so the Commonwealth of Massachusetts can tax that sale. Say New Hampshire taxes the sales that occur in their state.

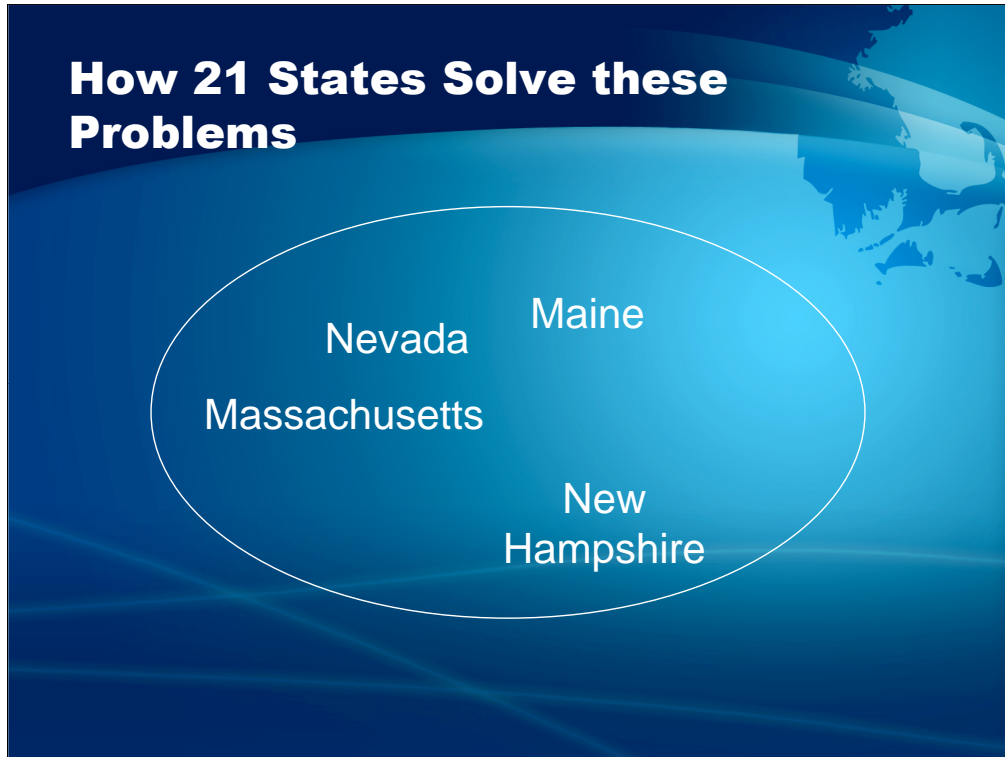
Creates Subsidiary in No Tax State



Facilitator's Note:

Say the software manufacturer in Maine sets up a subsidiary in Nevada, where there is no corporate income tax and then makes sure that this subsidiary realizes most of the profits of the whole company. So when the salesmen in Massachusetts and New Hampshire sell their software, the buyers are instructed to send their check to Nevada, thus avoiding any corporate taxes.

How 21 States Solve these Problems



Facilitator's Note:

here is a solution. It is called combined reporting. The state simply treats the entire company as one company and disregards the separate subsidiaries for tax purposes. In this system you look at the entire unified company profits and apportion them based on the system that you generally use to apportion corporate profits. This is what 22 states do (some of those just adopted combined reporting and are phasing it in).

Programs that serve communities and business needs require a broad base of revenue sources to work effectively. If we lose funding from one source, the cost to other groups goes up and/or...we are forced to cut necessary services

Institute for Wisconsin's Future
www.wisconsinsfuture.org



Facilitator's Notes

We've just seen the various taxes that support the various public structures that do everything from educate our children to repair our roads to keep our water and air clean. This slide comes from a similar group to ONE Massachusetts in Wisconsin, just showing that every state in the Union needs balanced revenue sources to support their public structures.

Effect of Tax Changes in Massachusetts

- A 1% increase in the sales tax rate would be worth about \$692 million.
- The meals tax is a 5% tax on meals served in restaurants, a 1% point increase in the meals tax would be worth about \$123 million

Effect of Personal Income Tax Changes in Massachusetts

- A 1% change in the personal income tax rate (which was 5.3% in FY07) would increase or decrease collections by about \$2.15 billion