Massachusetts Taxpayers Foundation

Written Testimony in Opposition of S.16/H.86
of
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Thank you for this opportunity to testify today on S.16/H.86, the proposal to amend the Massachusetts Constitution to impose an additional surtax on annual income over $1 million. I am Eileen McAnneny, President of the Massachusetts Taxpayers Foundation. MTF's mission is to provide accurate, unbiased research with balanced, thoughtful recommendations that strengthen the state's finances and economy in order to foster the long-term well-being of the Commonwealth. Over the course of nearly ninety years, MTF has played an instrumental role in achieving major reforms and promoting sound public policy in state government.

I appear before the Committee today to voice my concern regarding the proposal to amend the state's constitution to allow for a four percent marginal tax on income over a million dollars, more commonly referred to as the millionaire's tax. While the prospect of taxing a small number of taxpayers to generate significant new revenue is appealing on its face, there are inherent problems with this approach. Consistent with my previously shared views on this issue, let me outline four principles of sound tax policy and describe how those principles are violated by the proposed income surtax.

Like a good investment portfolio, the Commonwealth's revenue system should be well diversified in order to protect against downside risk. Massachusetts is already overly reliant on income tax as a source of tax revenue and this proposal will further exacerbate that problem. Like a sound investing strategy, Massachusetts should aim to diversify its revenue streams. In fact, according to the US Census Bureau's 2017 Annual Survey of State Government Finances data, MA ranked 5th in the country, behind only Oregon, Virginia, New York, and California for its reliance on the individual income tax, which equals almost 54% of our annual tax revenue. To further increase our reliance on the income tax, or any one source of tax revenue, is not sound tax policy. To further increase our reliance on income tax from a small subset of taxpayers may be foolhardy.

Transparency is vital. How the income surtax revenue will be spent should be clearly outlined for voters. While the stated goal of the surtax is to generate additional revenue to support public education and transportation in the Commonwealth, the petition lacks enough specificity for voters to know how the money will be allocated between education and transportation and for what exactly within each spending category.

Given that money is fungible, it is much more likely that any additional revenue deposited into the General Fund will go to support expensive existing obligations, rather than supporting new commitments, particularly during a recession.
For example, MassHealth represents nearly 40% of total state spending and the annual state contribution to the pension system is $2.6 billion in fiscal 2019 and is currently scheduled to rise nine percent annually until state fiscal year 2036. Further, the Commonwealth has barely started to address the unfunded liabilities associated with other post-employment benefits (OPEBs), currently projected at nearly $15.3 billion in the 2018 Comprehensive Annual Financial Report (CAFR).

For MTF, having dedicated revenue streams more directly related to transportation – such as an increase in the gas tax, tolling or vehicle miles driven that could be better leveraged – would be preferable and have the added benefit of reducing congestion, encouraging shared rides and meeting environmental goals. Dedicated revenue streams can also be leveraged and borrowed against, creating more capital investment opportunities for the state's aging transportation infrastructure.

The Commonwealth's revenue system should not rely on volatile revenue sources. Much of the tax revenue generated by this proposal will come in the form of capital gains tax revenue, which is already one of the most volatile sources of tax revenue in the Commonwealth's revenue system. The differences between fiscal year 2008 and 2009 are an object lesson in this regard. In 2008, capital gains revenue totaled $2.175 billion and represented 10.4 percent of total tax revenues collected that year. In 2009, capital gains tax revenue generated just $520 million, comprising 2.8 percent of total tax revenue. The surtax would make swings like this much more common than is already the case, and thwart efforts to affect real change in Massachusetts.

As the legislature has recognized, it is unwise to build a budget on capital gains. That is why current law requires that any capital gains revenue above the statutory threshold (approximately $1.2 billion in fiscal 2019) be deposited into the Stabilization Fund. It is unclear how the ballot initiative would interact with the current statutory requirement. Would the new marginal tax revenues derived from capital gains be deposited into the Stabilization Fund as the current law requires or t used for education and transportation as the petitioners indicate? Conversely, would the Commonwealth lose an important source of revenue for replenishing the Stabilization Fund if the new taxes must be spent on education and transportation? The lack of clear answers to these questions adds another source of uncertainty about the projected revenue.

We should have reasonable and current estimates of the impacts of the surtax *before* we decide whether to enact the policy. The Department of Revenue (DOR) estimates on the impact of this policy have not been updated since 2015 and much has changed since that time. Most notably, federal tax reform as enacted in the Tax Cuts and Jobs Act of 2017 have substantially altered the tax landscape in Massachusetts and across the country. In many ways, taxpayers are still unpacking the new tax regime at the federal level. The federal cap on the state and local tax deduction has sensitized taxpayers to their state and municipal tax burden. Federal tax reform has also made Massachusetts more of an outlier with respect to its estate tax. These changes, coupled with the proposed income surtax, will make Massachusetts considerably more expensive for impacted retirees, business owners and investors. DOR must re-evaluate their initial estimates of the income surtax in this new context. Further, as the only organization in the Commonwealth with the authority to analyze individual-level taxpayer data, DOR is uniquely suited to assess how taxpayers would be affected. Without updated estimates, the discussion of this policy seems premature.

Like everyone, MTF recognizes the pressing need for change when it comes to education and transportation.

As a founding member of the Massachusetts Business Alliance for Education (MBAE), MTF has long recognized that the long-term well-being of the Commonwealth relies on a high performing education system. The employers of the modern economy need well-trained, well-prepared employees in order to compete and thrive. We know the

Commonwealth has much to be proud of when it comes to education, but we cannot rest. We support making targeted investments to close the achievement gap so long as it is accompanied by accountability for how the money is spent, metrics to measure success and an annual progress report so that we can change course if necessary to ensure that we achieve the stated goals within a reasonable period of time.

Further, as the co-chair of the Commission on the Future of Transportation, MTF is taking a leading role in estimating the costs associated with improving the transportation system in Massachusetts and identifying revenues available to support those costs.

We are eager to affect change, but after nearly ninety years as the state's premier public policy organization analyzing the state's finances, we know that change requires a sustainable, thoughtful approach. The income surtax does not achieve that standard.

Thank you very much for your time and consideration.