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MTF Bulletin

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The Income Tax Reduction Ballot Question

A Primer for Understanding the Question and Potential Impacts

On March 30th, the Special Joint Committee on Initiative Petitions heard testimony on H.5007 *An Act to Reduce the State Personal Income Tax Rate from 5% to 4%*. MTF was asked to provide expert testimony on the proposal, which would reduce state tax collections by the largest amount in recent Massachusetts history. This Bulletin expands upon MTF’s testimony by explaining what the ballot question proposes and provide an overview of how the proposed change relates to four topics that could be top of mind for voters:

- The impact of the question on residents;
- The impact of the question on the state’s economy and competitiveness;
- The impact of the question on state tax collections; and
- The impact of the question on the state’s public finances and operations.

This Bulletin is intended to provide information and context essential for policymakers and the public.

Understanding the Ballot Question

The ballot question is straightforward, it would reduce the income tax rate in Massachusetts from 5 percent to 4 percent over a three-year period. The question would reduce rates for regular wage income, interest and dividend income, and short and long-term capital gains. The proposal would not affect the state’s income surtax, which adds an additional 4 percent tax to income over \$1.08 million.¹

Proposed Income Tax Rate Changes By Year

	2026 Rate	2027 Rate	2028 Rate	2029 Rate
Wage Income	5.00%	4.67%	4.33%	4.00%
Interest & Dividends	5.00%	4.67%	4.33%	4.00%
Short-term Capital Gains ²	8.50%	4.67%	4.33%	4.00%
Long-term Capital Gains	5.00%	4.67%	4.33%	4.00%
Income Surtax	4.00%	4.00%	4.00%	4.00%

¹ The income surtax threshold was set at \$1 million for tax year 2023 and is updated annually for inflation. The threshold for tax year 2025 is \$1.08 million.

² The initiative petition eliminates statutory language applying an 8.5 percent rate to short-term capital gains. This brief assumes that the intent is to apply the 4 percent rate to short-term capital gains. If the short-term capital gains rate were to remain at 8.5 percent it would reduce the revenue loss of the tax reduction by approximately \$87 million. If the short-term capital gains tax were eliminated, it would increase the revenue loss by \$80 million.

The proposed changes would be effective for the start of each tax year (January 1st), meaning that each rate reduction would go into effect halfway through the state’s fiscal year, which runs from July to June.

Thinking Through the Impact on Residents

Reducing taxes has a number of economic goals, but central to them is to reduce costs for residents or businesses. Cutting the state’s income tax rate would bring material cost savings to residents by reducing income tax liability by up to 20 percent. How that reduction translates to individual filers depends on their circumstances.

Examples of Rate Reduction Impact³

Income Level	Basic Taxable Income	Tax Liability at 5%	Tax Liability at 4%	Savings
Full-time, married at \$25 per hour (\$46,875)	\$38,075	\$1,904	\$1,523	-\$381
Full-time, married at median income in Brockton (\$80,115)	\$71,315	\$3,566	\$2,853	-\$713
Full-time, married at median income in Lexington (\$238,444)	\$229,644	\$11,482	\$9,186	-\$2,296
Full-time, married at surtax threshold (\$1,083,150)	\$1,074,350	\$53,718	\$42,974	-\$10,744

Using the state’s median household income (approximately \$104,000) the savings per filer are around \$1,000 annually or just under \$40 per biweekly pay period. The largest rate reduction is to short-term capital gains income (currently taxed at 8.5 percent) so filers with disproportionate levels of that income would experience the most significant tax cut.

As noted below, we estimate that by FY 2030 this reduction will reduce state revenues by \$5.3 billion compared to baseline, which means that this is the total state tax payment savings for filers. That savings is equivalent to a little less than 1 percent of income earned in Massachusetts.

Thinking Through the Impact on the Economy and Competitiveness

The impact of the proposed tax cut on individual taxpayers is clear, but its impact on the state’s economy and competitiveness is less easily measured, primarily because larger economic factors could outweigh or distort the impact of the tax reduction on its own. This section looks at potential economic impacts first and then examines the impact on competitiveness with other states.

³ All examples assume income is adjusted by the Massachusetts standard deduction, without other deductions. Municipal median income data taken from US Census QuickFacts and is provided in 2024 dollars.

Impact on the Economy

Providing taxpayers in Massachusetts with additional take home income will provide some level of increased economic activity that would not otherwise occur, as people will likely spend all or some of their tax savings. That economic activity will come in the form of increased commerce that provides economic benefits. To the extent that new spending occurs in Massachusetts, it has an added positive impact on businesses in the state and could affect investment or hiring decisions.

There are two caveats to apply when assessing the economic benefits of an income tax reduction. First, as will be discussed later, a sizable reduction in state revenues will likely lead to a reduction in state spending, which has its own economic impact. State resources are marbled into our economy in many ways, but simply put: the state employs thousands of residents and spends tax resources in ways that interact with our economy and communities – for example, MassHealth payments to hospitals and state aid to municipal schools. There will be some offsetting negative impact from reduced state spending that will depend on where those reductions occur.

Second, national and international economic trends often overwhelm the impact of state policy, especially in the near-term. The aftermath of the successful voter referendum from 2000 to lower the income tax rate from 5.95 percent to 5 percent demonstrates that in spite of lower tax rates, the state’s economy still reeled as a result of a national recession.

Massachusetts Economic Snapshot, 2000 – 2005

	Massachusetts Income	Massachusetts Outmigration	Unemployment Rate
CY 2000	\$202.4	11,671	2.8%
CY 2001	\$185.5	14,677	4.7%
CY 2002	\$174.6	30,511	5.6%
CY 2003	\$178.2	44,633	5.5%
CY 2004	\$192.4	54,695	4.9%
CY 2005	\$207.0	55,077	4.9%

\$ in billions

As the table shows, between 2001 and 2003, in spite of a significant reduction in the state income tax rate, earnings in the state fell by 14 percent, outmigration increased and the unemployment rate spiked. Not only did the Massachusetts economy suffer during the dot com recession, but the impacts in Massachusetts were worse than in the nation at large. Between 2000 and 2002, while income in Massachusetts fell by 14 percent, national income declined by less than 5 percent, and the gap between the Massachusetts and US unemployment rates narrowed from 1.1 percent to 0.4 percent.

It is possible that the impacts of the recession in Massachusetts would have been more pronounced with a higher income tax rate. Nevertheless, it is apparent that even a major state level economic policy change – a 10 percent reduction in the income taxes paid by residents (from 5.95 to 5.3 percent) – did not forestall larger economic forces that brought a recession to Massachusetts.

Impact on Competitiveness

Competitiveness refers to how Massachusetts compares to other states with whom it competes for people, businesses and investments. While state level changes have limitations on the broader economy, tax rates are a real cost for residents and employers that are easily comparable between states and are a factor in location and expansion decisions. Therefore, it is important to assess how Massachusetts' current income tax base rate stacks up to other states and how the proposed reduction would impact the state's competitiveness.

Because most states, now including Massachusetts, have multiple tax rates, a direct comparison depends on a filer's income. Using the median US income in 2024 (\$83,730), Massachusetts' base rate of 5 percent is higher than the rate that filer would pay in 22 states that have an income tax, and lower than the rate in 17 states. If states without an income tax at that level are included, Massachusetts' rate is higher than that in 31 states. If the question were approved, the Massachusetts 4 percent rate would be higher than the rate in 19 other states (including states without an income tax).

Impact of Rate on State Comparisons

Income Tax Rate for Filer at US Median Income (\$84K)	States with IT Lower	All States Lower	All States Higher
5.00%	22	31	17
4.67%	16	25	25
4.33%	12	21	29
4.00%	10	19	30

The rate change would also reduce Massachusetts' top rate—which applies to individuals earning more than \$1.08 million—from 9 percent to 8 percent. This change would not alter Massachusetts relative position for its top rate very much. At 9 percent, Massachusetts' top rate is higher than that in 43 states. At 8 percent, the top rate would be higher than 42 other states, jumping ahead of only Vermont.

If other states remain static, a reduction of the base income tax rate from 5 to 4 percent would keep Massachusetts in the middle third of state rates, but we would have a lower base rate than most other states. The change of the competitiveness on the top rate would be more muted; Massachusetts would continue to have among the top highest marginal rates in the nation.

Thinking Through the Impact on State Revenues

In 2025, Massachusetts collected \$23.7 billion in non-surtax income taxes at the 5 percent rate.⁴ Simply adjusting for a 1 percentage point rate cut would imply a \$4.7 billion revenue loss. However, because the

⁴ Short-term capital gains, which are included in that figure are taxed at 8.5 percent, but the breakdown of short-term versus long-term capital gains for TY 2025 is not yet available. The level of short-term capital gains collections is relatively small, \$154 million in TY 2024, and so for the purpose of this rough estimate, no adjustment is made for the differentiated rates, but if an adjustment were made it would increase the cost by around \$60 million.

petition proposes phasing that reduction in over time, the analysis that follows models the revenue loss beginning in FY 2027, with full implementation in FY 2030.

Estimating the reduction in state tax collections requires applying the new rate to assumed collections and adjusting for the differences between tax years and fiscal years (which begins on July 1st). Assuming that income subject to taxation grows at 2.4 percent annually for the next three years, a reduction to the income tax from 5 percent to 4 percent will reduce state collections by \$5.4 billion by FY 2030 compared to the level of revenues that would otherwise be collected.⁵

MTF Estimated Revenue Impacts by Year

	FY 2027	FY 2028	FY 2029	FY 2030
Withheld	\$675	\$2,029	\$3,446	\$4,185
Non-Withheld	\$126	\$552	\$936	\$1,195
Total	\$801	\$2,581	\$4,382	\$5,381

\$ in millions

The estimated revenue loss builds over a four-year period, beginning halfway through FY 2027, as three rate reductions are implemented,. Making reasonable assumptions for how the mid-year implementation will affect different forms of income tax, MTF estimates that effects of the tax reduction would be felt immediately through withheld income taxes (taxes set aside from biweekly payments) and estimated payments due in the first half of 2027. Both of these changes would impact the upcoming fiscal year, though the revenue loss would triple in FY 2028, the first year tax returns which reflect a lower rate would be due and refunds offered.

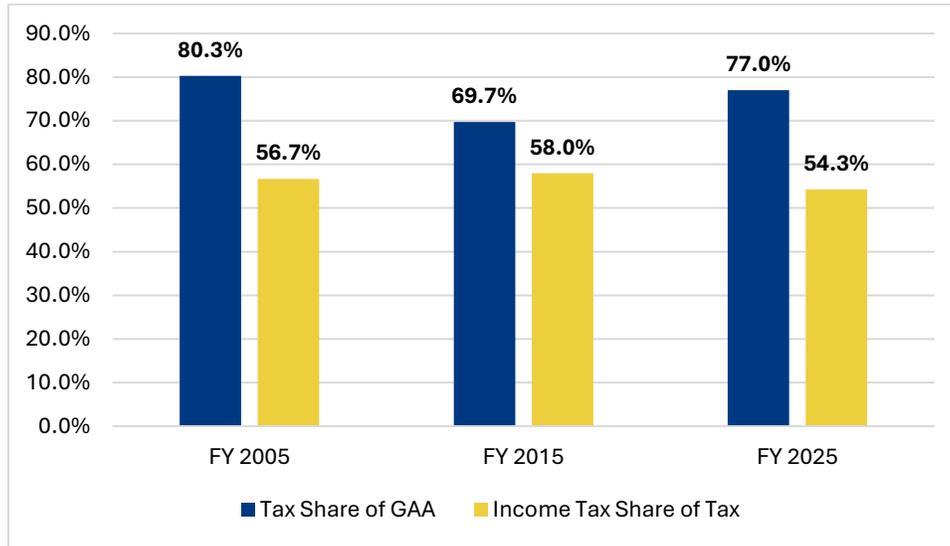
These estimates do not make assumptions for Massachusetts taxpayer behavior or larger economic trends. The goal of the estimate is to provide a clear and transparent baseline, to which more subjective adjustments can be applied in other areas. For example, if you assume that the tax will boost economic activity and earnings in Massachusetts by 5 percent, it would reduce the revenue loss by about \$1.1 billion (the assumed tax collections from 5 percent in additional earnings). Similarly, if the rate reduction were to coincide with an economic downturn, the foregone revenue would be less, as income in Massachusetts would fall – though the negative impact on the budget would likely be enhanced.

These estimates apply only to the state’s base rate (currently 5 percent); the 4 percent income surtax would remain unchanged, though the surtax share of tax collections would increase as base rate collections declined.

In assessing the estimated revenue impact, it is important to also understand the role of income taxes in state revenues. Taxes support between 70 and 80 percent of budgeted state services, and the income tax makes up the majority of tax revenues.

⁵ 2.4 percent growth is used because it is equal to assumed non-surtax tax revenue growth rate agreed upon in the FY 2027 Consensus Revenue Agreement

Taxes as Share of Signed Budget (GAA Spending), FY 2005 – FY 2025



Going back twenty years, the picture of tax revenues as a share of the budget is consistent, with the base income tax (not including surtax) making up just around 55 percent of tax revenues. Reducing the state’s base income tax rate by 20 percent will significantly reduce state tax collections, even after accounting for any related economic boost.

Thinking through the Impact on Public Finances

The revenue loss associated with the proposed income tax rate cut would bring with it immediate and ongoing challenges to the state’s public finances. Looking at the timeline of the revenue loss and examining state actions during previous economic shocks can provide a framework for thinking through the fiscal impacts of the proposal.

Immediate Public Finance Impact

The immediate fiscal challenge the rate reduction would present is to the state’s FY 2027 budget. The first reduction, to 4.67 percent, would go into effect halfway through the coming fiscal year and the timing of the initial revenue loss (estimated at \$801 million) would be disruptive.

Impact of Rate Reduction on Current FY 2027 Non-Surtax Revenue Assumptions

FY 2026 Collections (estimated)	\$41,214
FY 2027 Revenue Growth Assumption	2.4%
FY 2027 Consensus Revenue	\$42,200
Estimated Reduction Impact	-\$801
FY 2027 Revenues Post Reduction	\$41,399
Growth over FY 2026	0.4%

\$ in millions

The FY 2027 budget process is ongoing right now and foundational to it is the consensus tax revenue number agreed to by the administration, House and Senate. That non-surtax revenue figure of \$42.2 billion assumes 2.4 percent growth over the current year and reflects the current tax rates. That \$42.2 billion figure supports the majority of spending in the budget plan ultimately put before the Governor for signing in the summer.

Should the ballot question pass, the administration would need to act to keep the budget in balance after accounting for the change in revenue assumptions. Typically, if the state is faced with a midyear tax shortfall of more than \$500 million, the solutions include spending cuts and the use of other one-time resources to balance the budget. However, in this situation, because two additional tax rate reductions will also be forthcoming, the scale of cuts is likely to be greater than usual because the administration will need to solve for an even larger budget shortfall expected in FY 2028.

Longer Term Fiscal Impact

Looking past the FY 2027 impact, the state will need to plan around increasing revenue losses, compared to baseline, between 2028 and 2030. The estimated revenue losses, compared to baseline growth, will increase by more than \$1 billion per year over three years, culminating in the \$5.4 billion impact.

Marginal Revenue Losses, FY 2027 – FY 2030

	Baseline Income Tax Revenue	Income Tax with Rate Change	Loss From Baseline	Loss From Prior Year Estimate
FY 2026	\$24,237	\$24,237	\$0	\$0
FY 2027	\$24,819	\$24,018	-\$801	-\$219
FY 2028	\$25,414	\$22,892	-\$2,522	-\$1,126
FY 2029	\$26,024	\$21,643	-\$4,382	-\$1,250
FY 2030	\$26,649	\$21,268	-\$5,381	-\$374

\$ in millions

In order to manage through four years of expected revenue losses, policymakers will have three tools available to them – drawing down reserves, reducing ongoing spending, and raising new revenues.

Massachusetts has experienced two sustained revenue declines over the last 25 years and those provide helpful context for thinking through how these tools have been deployed.

In 2001, Massachusetts began implementing a voter approved income tax reduction (from 5.95 to 5 percent), and that process coincided with a national recession that impacted the state budget for several years. In 2008, the Great Recession resulted in sharp declines in tax collections that once again required several years of emergency budget balancing actions. While these two time periods differ in many ways, there are notable commonalities in terms of the approach taken to stabilize the state’s finances.

Fiscal Challenge and Response, FY 2001 – 2004 and FY 2008 – FY 2010

	FY 2001 - FY 2004	FY 2008 - FY 2011
Income Tax Loss	\$1.99 B initial drop (20%) between FY 2002 and FY 2003	\$1.9B initial drop (15%) between FY 2008 and FY 2009
Reserve Use	\$1.1 billion draw (63% of initial balance)	\$1.45 billion draw (68% of initial balance)
Notable Spending Cuts	<ul style="list-style-type: none"> \$1.1B in cuts between FY 2003 and 2004 GAA, including \$320M to local aid and C70 \$534.7M in 9C cuts in FY 2002 and FY 2003 	<ul style="list-style-type: none"> \$1.1B in cuts between FY 2009-2010 GAA including \$378M to local aid \$846.9M in 9C cuts in FY 2009 and FY 2010
Tax Increases	<ul style="list-style-type: none"> Capital gains tax increase Freeze of income tax reduction Fee increases 	<ul style="list-style-type: none"> Sales tax increase Combined reporting for corporate taxes

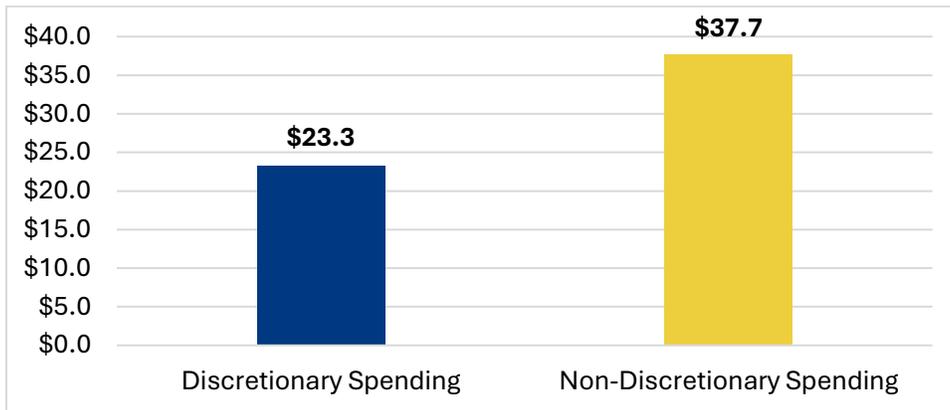
There are important differences between these historic revenue shocks and the fiscal situation the state would manage with a reduced income tax rate. Notably, both of these time periods largely reflect the impact that a national recession has on state finances. However, the tools available to address revenue loss remain relatively proscribed and if faced with a major drop in income tax collections again, it is likely that each of these three tools will be employed. Given that, it makes sense to assess each of those tools in the current fiscal climate:

Reserves – The state’s Stabilization Fund has a current balance of \$8.3 billion. This represents 13.1 percent of spending proposed in Governor Healey’s FY 2027 budget. This is a stronger reserve position than the state was in prior to the budget challenges of FY 2001 and FY 2008, when the Stabilization Fund was equivalent to about 8 percent of budgeted spending. The Stabilization Fund remains a strong tool to address short-term revenue shocks, and could be called upon to offset immediate drops in tax collections compared to baseline, but it is not a good tool to address ongoing changes in tax collections.

Spending – Rates of spending growth have been elevated in Massachusetts since the midst of the pandemic – with average GAA spending growth standing at 5.8 percent between FY 2001 and FY 2025. Curbing spending growth is critical to the state’s fiscal position with or without a drop in the income tax rate. Doing so will require reducing rates of health care spending especially, which has outpaced core budget spending in recent years.

The rate reduction would likely reduce income tax collections, year over year, for several years likely necessitating reductions on overall spending – as opposed to simply reducing rates of growth. Cutting spending year over year, while maintaining core services is especially challenging because much of the budget is comprised of non-discretionary spending – spending to support programs or obligations that are legally required.

Discretionary v. Non-Discretionary Spending, FY 2026 GAA



About 60 percent of the budget is broadly non-discretionary, including the state’s Medicaid program, K-12 education funding, and debt service. While reductions can be made in those areas, opportunities are more limited and often require statutory changes. When cuts do occur, they are typically concentrated in discretionary spending and this is reflected in the last two downturns where consistent areas of nominal cuts were unrestricted local aid, direct support for higher education campuses, discretionary human services programs, and K-12 support funds.

Ongoing Revenues – If this proposal is adopted, it is likely that policymakers will look to offset some of the impact through new or increased ongoing revenues. In the last periods of sustained revenue loss, lawmakers have suspended planned income tax cuts, increased capital gains taxes, and increased the sales tax, among other changes, to raise new revenues or prevent anticipated revenue losses. It is hard to predict what revenue changes could be on the table in the future, but a recent House supplemental budget offers a sense of policies that could be considered. The House included several sections which eliminates state conformity to several recent federal corporate tax changes if the ballot question is passed. The same bill includes a provision requiring the Administration to make recommendations on other areas in which the state could decouple from the federal corporate code to mitigate revenue loss.

Bottom Line

The ballot question to reduce the state’s income tax from 5 percent to 4 percent would be the largest tax cut in the state’s recent history. The reduced rate would have impacts on Massachusetts residents, the economy, state competitiveness, tax collections, and state public finances. Specifically, we find that:

- A tax filer at the median state income would see about \$1,000 in tax savings;
- A tax cut would lead to increased resident economic activity and reduced public sector economic activity. Reduced taxes would improve the state’s relative ranking for base income tax rate, but historically have not been able to forestall negative impacts of national economic trends;
- The proposed rate cut would reduce state tax collections by an estimated \$801 million in FY 2027 and \$5.4 billion, compared to baseline, when fully implemented in FY 2030. This estimate does not make dynamic behavior assumptions; and

- The revenue loss associated with the rate cut would likely require immediate action to balance the FY 2027 budget. Over time, policymakers will likely employ a combination of spending cuts, use of reserves, and new or increased ongoing revenues to adjust to reduced income tax collections.

One other public finance consideration to consider when assessing the ballot question is the national context. As evidenced in 2001 and 2008, national recessions bring public finance consequences that can override the impact of state policy choices. It is never possible to predict where the economy will be in a year or three years. A booming economy would do much to mute revenue losses related the proposed tax cut, as resident income would likely be on the rise. The flip side is also true. As experienced in 2001, a recession coming at the same time as a major tax reduction would exacerbate impacts.

In addition to the economy, the state/federal financial partnership is also a national factor of note. Massachusetts will see impacts of federal legislation on health care coverage over the coming years, and MTF estimates that around 250,000 residents may lose state and federally subsidized care. While additional federal cuts to the state are by no means certain, it is fair to say that the predictability of ongoing federal support as well as the availability of federal stimulus should a recession occur cannot be reliably planned upon.

This Explainer provides a framework to quantify and think through those impacts. In additional publications, MTF will provide more analysis and context on this and other ballot questions that directly relate to the Massachusetts economy and its fiscal condition.