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BUDGET AND POLICY CENTER

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BUDGET MONITOR

Governor Romney's FY 2006 Budget

Overview

The House 1 budget proposal filed by the Governor on January 26th is most notable for what it does not do: it neither makes significant progress in reversing the deep cuts to education, health care, and other essential services enacted over the past four years, nor does it create a structurally balanced budget moving forward.

The budget does have some bright spots – most notably it saves the Commonwealth $170 million in annual revenue currently being lost because of tax loopholes. By allowing corporations and other sophisticated taxpayers to take advantage of various tax avoidance schemes, these loopholes shift more of the responsibility for supporting important government services onto ordinary people and small businesses. Closing these loopholes, as House 1 proposes, will help to level the playing field and provide needed revenue for schools, health care, and other essential public services. The Governor's specific proposals are described in more detail on page 21 of this *Budget Monitor*.

Additional Information on Budget Issues Available on the MBPC Website, www.massbudget.org:

- **Bang for our buck?** ***This Boston Globe feature, based on data and analysis by MBPC, uses a calendar theme to explain the value we get for our tax dollars and to describe the share of our income paid in state and local taxes.***
- **Real Cuts - Real People - Real Pain: The Effects of the Fiscal Crisis on Women & Girls in Massachusetts**
- **Four Key Questions on the Governor's Tax Cut Proposal**

The House 1 budget proposal creates structural balance problems for two reasons. It relies on money from a fiscal year 2005 surplus in Medicaid to pay Medicaid bills that would otherwise be paid using fiscal year 2006 appropriations. Therefore the fiscal year 2006 Medicaid appropriation is artificially low and will likely increase dramatically in fiscal year 2007. As explained in the discussion of Medicaid, this could present as much as a $327 million problem in FY 2007 (although half of that cost would be borne by the federal government).

More significantly, the budget proposes a tax cut that will cost $225 million in the coming fiscal year, and will increase in cost to $550 million in 2007. This means that in addition to addressing the Medicaid issue in FY 2007, the state will also have to find a way to pay for the additional $325 million that this tax cut will cost.

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These factors, as well as others – including the under-funding of the Uncompensated Care Pool and the use of tobacco settlement money that existing law would deposit in a trust fund for future health care costs – make it likely that adoption of this budget would lead to continuing structural imbalance in the state budget.

The tax cut proposal is also a major reason why the budget makes so little progress in restoring funding for essential services like education and health care. Over the past four years, close to $3 billion in budget cuts have been imposed. While the Legislature has enacted budgets that have restored some funding for essential services, the House 1 proposal recommends funding levels for education, health care, and other core services, that, in real terms, are significantly below historic levels.

Adjusted for inflation, the House 1 proposed funding level for public health is $150 million below what it was in FY 2001. Higher education is $295 million below the FY 2001 level. Funding for environmental affairs is $79 million below FY 2001. Funding for Chapter 70 (unrestricted state aid to local schools) is $254 million below what it was in FY 2002. These dollar cuts have real effects: our state's anti-smoking program has been virtually eliminated; the cost of higher education has increased for thousands of students; and class sizes are larger in many of our schools.

The harm that is being done to our Commonwealth as a result of these cuts is not inevitable. It is the result of choices: $3 billion in tax cuts during the 1990s created a structural budget gap that led to these budget cuts. In his House 1 budget proposal, the Governor chooses to maintain these cuts and uses the money "saved" to finance a large additional tax cut that provides most of its benefits to the highest income taxpayers in the state.

This *Budget Monitor* will examine how the Governor's FY 2006 budget is balanced, compare funding levels to existing appropriations, and look at the details of services that have been cut, restored, or expanded. Unless otherwise noted, this analysis will compare FY 2006 funding levels to FY 2005 without accounting for inflation.[1] It is important to remember that even in areas where funding remains constant between FY 2005 and FY 2006, services are likely to be reduced as the cost of providing them increases with inflation.

The table at the top of the next page presents revenue and expenditure totals for FY 2006 as proposed in the Governor's House 1 budget. After adjusting for changes in tax policy recommended by the Governor and for statutory transfers of sales tax revenue to the MBTA, net tax revenue amounts to $16.565 billion. Other forms of revenue – federal reimbursements, departmental revenues, and undesignated reserve funds – bring overall net revenue for FY 2006 to $25.356 billion. Line-item appropriations in the Governor's budget sum to $23.217 billion, while "off-budget" expenditures, such as transfers to the Uncompensated Care Pool, to the Commonwealth's pension fund, or for School Building Debt Assistance, equal $1.951 billion. Taking into account the statutory carry-forward into FY 2007 and the mandatory deposit into the Stabilization Fund yields an expenditure total of $25.341 for FY 2006.

[1] Budget figures reflect direct appropriations (without netting out reversions), retained revenue, and off-budget spending for certain areas. These totals do not incorporate appropriations for intergovernmental chargebacks or trust spending included in the operating budget.

FY 2006 REVENUE, EXPENDITURES, AND BALANCE All figures in millions of dollars	
BASELINE TAX REVENUE	**17,336.0**
Reduction of personal income tax rate to 5.0%	(225.0)
Closure of various tax loophooles	170.0
MBTA transfer	(716.4)
NET TAX REVENUE	**16,564.6**
Federal Reimbursements	4,924.3
Departmental Revenues, Transfers, and Other	3,793.2
UNDESIGNATED RESERVES	**74.1**
NET REVENUE	**25,356.2**
LINE-ITEM APPROPRIATIONS	**23,217.6**
OFF-BUDGET SPENDING	
Uncompensated Care Pool	120.0
Pension Funding	1,274.7
School Building Debt Assistance	488.7
Tuition Retention for Out-of-State Students	30.6
MassHealth Essential	36.5
STABILIZATION FUND TRANSFER	**86.4**
STATUTORY CARRY-FORWARD	**86.4**
TOTAL EXPENDITURES	**25,340.9**
REVENUE MINUS EXPENDITURES	**15.3**

Local Aid

The House 1 budget includes $1.2 billion for local aid – lottery aid and additional assistance.

FY 2005	**$1,131,646,098**
FY 2006	**$1,158,746,098**
Increase (decrease)	**$ 27,100,000**
Percentage Change	**2.4%**

The amount proposed for lottery distributions to cities and towns is $100 million more than the original FY 2005 appropriation. However, including $75.0 million in supplemental funding appropriated for FY 2005, the FY 2006 House 1 budget results in a net increase of $25.0 million. The House 1 budget also proposes to accelerate the five-year schedule to uncap lottery diversions. Currently, the Commonwealth diverts $200 million of lottery proceeds away from cities and towns to support the state budget. The Governor recommends ending this practice in FY 2006 as opposed to FY 2007 as is currently planned.

The House 1 budget also includes an additional $2.1 million for another category of local aid – Payment in Lieu of Taxes (PILOT) – which compensates municipalities where state tax-exempt properties are located.

K-12 Education

Including Chapter 70 Aid to cities and towns and the Department of Education's grant and reimbursement programs, the Governor's FY 2006 budget would increase overall funding for K-12 education by $96.2 million, an amount roughly equal to the costs associated with inflation.

Total K-12 Education Spending

FY 2005	**$3,646,485,481**
FY 2006	**$3,741,655,397**
Increase (decrease)	**$ 96,169,916**
Percentage Change	**2.6%**

Note: The numbers in this section do not include appropriations or debt service for the School Building Assistance program. Figures for grants and reimbursements include support for the Office of Educational Quality, and deduct the amounts which would be transferred to the Department of Early Education and Care under the proposed budget.

Chapter 70 Aid

FY 2004	**$ 3,183,282,601**
FY 2005	**$ 3,260,234,211**
Increase (decrease)	**$ 76,951,610**
Percentage Change	**2.4%**

Chapter 70 Aid is provided to cities and towns for public education funding. The FY 2006 House 1 budget would increase funding for these purposes by roughly $77.0 million or 2 percent. In real terms, this amount is still $254.3 million below the FY 2002 level after adjusting for inflation.

Grants and Reimbursements

FY 2005	**$463,202,880**
FY 2006	**$481,421,186**
Increase (decrease)	**$ 18,218,306**
Percentage Change	**3.9%**

After accounting for the Governor's proposal to move existing programs from the Department of Education to the Department of Early Education and Care, funding for grants and reimbursements programs rises by $18.2 million or about four percent. Highlights from the Governor's FY 2006 budget are as follows:

- Funding for student and school assessment would total $23.0 million, a $1.0 million or five percent increase over FY 2005.
- Appropriations for Adult Basic Education – level-funded at $27.8 million in FY 2005, down from $30.2 million in FY 2001 – would increase to $35.8 million.
- Support for MCAS remediation would also increase in this budget. The House 1 budget includes $20.0 million for FY 2006, up nearly $6.0 million, but well below the $50.0 million appropriated in FY 2002.
- Funding for the Special Education Circuit Breaker program is level-funded at $201.6 million, seven percent less than the Board of Education's budget request of $215.0 million.

Although the proposed amount for the Department of Education's grants and reimbursements program is higher than that for FY 2005, it is well below the FY 2001 appropriation. In real terms, the House 1 budget is $79.7 million or 14 percent lower than the FY 2001 level.

Higher Education

Funding for public higher education totals $921.7 million, $5.6 million or 0.6 percent more than FY 2005. However, after removing items designated as one-time funding in FY 2005 and FY 2006, the House 1 budget is actually 0.4 percent lower than FY 2005.

FY 2005	**$916,114,719**
FY 2006	**$921,682,719**
Increase (decrease)	**$ 5,568,000**
Percentage Change	**0.6%**

As proposed in the FY 2006 House 1 budget, funding for state and community colleges would rise by roughly two percent each. Funding for UMass campuses actually falls by $11.3 million ($20.5 million adjusted for inflation), primarily because the House 1 budget requires the university to spend $21.0 million on a one-time capital expense for the nanotechnology manufacturing center at UMass Lowell. The following table compares the proposed allocations to campuses with the Board of Higher Education's budget request as well as funding appropriated in fiscal years 2001 and 2005.

Higher Education Funding by Sector*
in Millions of FY 2006 $

Fiscal Year	UMass	State Colleges	Community Colleges
2001	552.0	219.5	266.0
2005	436.6	183.3	202.8
2006 - BHE Request	431.9	193.3	211.9
2006 - H. 1	416.0	183.2	203.2

** Totals include tuition revenue retained for out-of-state students at Umass Amherst and the Massachusetss College of Art, and deduct one-time funding included in the FY 2005 and FY 2006 House 1 budgets.*

Other elements of the FY 2006 House 1 budget include the following:

- Level-funding for the main account for financial aid at $82.4 million. Funding has fallen considerably – 26 percent after adjusting for inflation – compared to FY 2001 when $100.1 million was appropriated for this purpose.
- Funding for library reference materials remains unfunded, and was last funded at $1.2 million in FY 2003, down from $14.0 million in FY 2001.

Despite the small increase over FY 2005, proposed funding for public higher education is 24 percent below its FY 2001 level, after adjusting for inflation. Students have shouldered the burden of previous budget cuts: between 2002 and 2004, average tuition and fees rose about 40 percent in real terms. The University of Massachusetts recently proposed to increase tuition and fees by 3.2 percent over its current level.

Early Education and Care

The newly established Department of Early Education and Care would receive a total of $433.3 million under the Governor's FY 2006 budget proposal. Including other programs that fall under the realm of early education and care, the overall proposed level of funding is roughly the same as in FY 2005.

FY 2005	**$449,845,031**
FY 2006	**$450,205,129**
Increase (decrease)	**$ 360,098**
Percentage Change	**0.1%**

The Governor's budget proposal recommends moving nearly all of the programs and services currently administered by the Office of Child Care Services and a few offered by the Department of Education (Early Learning and School Readiness, the Parent-Child Home programs, and Head Start program grants) to the new department. The consolidation of programs and services would result in a net increase of $6.5 million or 1.5 percent, which is below the rate of inflation. After accounting for inflation, the budgeted amount would fall by $2.9 million or 0.6 percent. Ultimately, the amount proposed would not be sufficient to meet the increased demand for services created by the Governor's proposal to implement work requirements for thousands of parents receiving Transitional Aid to Families with Dependent Children (explained in more detail in the section on "Income Support Programs"), nor would it extend services to the 14,000 children currently on the waitlist for child care.

The House 1 budget also proposes to cut funding for the Healthy Families Newborn Visiting Program. This program, which provides services to pregnant and parenting teens, would experience a 50 percent reduction in funding. The Governor's FY 2006 budget proposes to cut funding from $12.2 million to $6.1 million.

Income Support Programs

The House 1 budget proposes to decrease funding for cash assistance programs by $20.2 million or three percent. This decrease in funding is primarily due to the Governor's attempt to restrict benefits and eligibility for two programs: Transitional Aid to Families with Dependent Children (TAFDC) and Emergency Aid to the Elderly, Disabled, and Children (EAEDC). The Governor also proposes to move a portion of funding for the State Supplement to Supplemental Security Income (SSI) to the Department of Elder Affairs, which is explained further in the corresponding section of this *Budget Monitor*. The table below includes this amount for FY 2006, and accordingly deducts it from the total for the Department of Elder Affairs.

FY 2005	**$601,481,017**
FY 2006	**$581,312,117**
Increase (decrease)	**($20,168,900)**
Percentage Change	**-3.4%**

The Commonwealth's welfare reform plan, enacted in 1995, provided for exemptions from the work requirement and the time limit, which allow Massachusetts to provide crucial supports to families in which the parent is not able to work for credible reasons. Massachusetts has been able to operate its own program, including its exemption policies, without risk of federal penalties in part due to waivers from the federal Transitional Assistance to Needy Families (TANF) program. On September 30, 2005, the state's waivers will expire and the federal TANF block grant rules will likely change before then. The state needs to adjust its program to ensure that Massachusetts can meet federal work requirements and not risk loss of federal funding. One option, which is in a bill pending in the Legislature, would allow the state to retain exemptions and meet federal work requirements by creating a separate state program for those who are exempt. This could be done at no additional cost by shifting existing resources. The Governor's alternative proposal would remove safeguards for vulnerable populations and impose work requirements and time limits on families in which the parent has documented barriers to employment, which may ultimately lead to sanctions and to the end of benefits for the families in which the parent cannot meet work requirements. Elements of the Governor's proposal are included below:

- The Governor proposes to impose work requirements and time limits for approximately 14,000 individuals who are currently exempt because they are disabled, caring for a disabled family member, caring for a young child, are in the last stage of pregnancy, or are teen parents attending school full-time.
- The proposed legislation would also remove "good cause" provisions, enacted in FY 2005, which prevent the Department of Transitional Assistance from sanctioning TAFDC recipients who face certain documented hardships and cannot meet their work requirement.
- In addition to the current 24 month out of 60 month time limit, a limit of five years within one's lifetime would be added, under which current recipients would have up to 24 months toward that lifetime limit retroactively imposed.
- Under current law, child care is provided for working parents receiving TAFDC for up to one year after their benefits end. The Governor proposes to remove this guarantee.

The Governor proposes to alter another program which provides support to low-income individuals. Emergency Aid to the Elderly, Disabled, and Children provides cash assistance to low-income elderly and disabled individuals or those charged with caring for disabled family members. The Governor proposes to change the name of this program to "Emergency Transitional Assistance" and to impose new work requirements that would apply to the majority of the disabled adult caseload. The Governor mentions that the $12.9 million or 18 percent reduction in the appropriation is "consistent with reforms," which indicates that many individuals will lose benefits under this proposal, including those who cannot meet the work requirement and will be sanctioned from the program. The Department of Transitional Assistance would also have the authority to change eligibility or cut benefits during the year in the event of a budget shortfall, which could occur at the proposed lower appropriation.

As proposed in the FY 2006 House 1 budget, funding for the Employment Services Program would increase from $22.0 million to $30.0 million.[2] The Department of Transitional Assistance administers this program, which provides education and training, as well as job search and placement assistance, to individuals receiving cash assistance. This additional funding is likely to fall short of the amount needed to provide adequate supports to individuals facing new or increased work requirements, many of whom are disabled and face additional challenges to securing employment.

Medicaid and Other Health Care Programs

There are several programmatic categories that make up the state's health care line items: there are the Medicaid programs (MassHealth), the pharmacy programs, as well as several other state-funded health care programs. In addition, the state's Uncompensated Care Pool is funded "off-budget" through language in the outside sections of the budget.

Funding for Medicaid and other health care program is $349 million less in FY 2006 than was appropriated in FY 2005, a reduction of 4.8 percent. Because of the way Medicaid and the Uncompensated Care Pool are budgeted, however, interpreting these numbers requires particular care (see detailed discussion below).

FY 2005	**$ 7,235,179,344**
FY 2006	**$ 6,886,279,185**
Increase (decrease)	**$ (348,900,159)**
Percentage change	**-4.8%**

Most notable in the Governor's health care proposals is what is missing: the Governor's budget does not reflect programmatic or budgetary changes that would implement his stated commitment to providing health care coverage for the close to one-half million uninsured residents of the Commonwealth. There are no significant funding increases in any of the publicly-funded health care programs, nor are there new programs or expansions built into his budget proposal. Moreover, previous years' cuts in benefits and eligibility are not restored in this budget.

[2] These totals include $3.0 million from a federal reimbursement for state expenditures on education and training for individuals receiving food stamps.

MassHealth

Because of the nature of MassHealth budgeting, the administration has flexibility to move up to 10 percent of an allocation among the various program accounts, so that to some extent the specific amounts allocated within the budget to the particular MassHealth line items (CommonHealth, Managed Care, Senior Care, Senior Care Options, Standard, Basic, the Breast and Cervical Cancer Treatment Program, the Family Assistance Plan, the Premium Assistance and Insurance Partnership Plans, the HIV Plan, Healthy Start, the Children's Medical Security Plan, and MassHealth Essential starting in FY 2006,) is less significant than is the total amount available.

As shown in the accompanying chart, the Governor projects that "on-budget" FY 2005 spending on the state's Medicaid program will be approximately $6.334 billion. The FY 2005 budget had appropriated $6.533 billion, but the Governor anticipates that $200 million of a projected $527 million Medicaid surplus will likely remain unspent and will revert to the General Fund. The Governor's budget includes $6.639 million for on-budget Medicaid items in FY 2006.

Total Medicaid Budget
In Millions of $

	FY 2005 Spending	FY 2006 House 1
"On-Budget" Medicaid	6,334.0	6,639.0
"Off-Budget" Medicaid	372.4	36.5
MassHealth Essential	*155.9*	*36.5*
Medicare Buy-In	*216.5*	*On-budget*
Prior Year's Surplus	251.8	327.0
Current Year's Surplus	-327.0	
Total Medicaid Budget	**6,631.2**	**7,002.5**

Also included in the total Medicaid budget are "off-budget" Medicaid costs. These include the full year's off-budget funding of the MassHealth Essential program in FY 2005 (estimated at $155.9 million). In FY 2006, the Governor budgets $36.5 million in off-budget funding for the MassHealth Essential program to pay for three months until the program comes "on-budget" with a line item (4000-1405) appropriation of $119.4 million that will begin on October 1, 2005.

In addition, included in off-budget funding in FY 2005 was approximately $216.5 million for the cost of the MassHealth Medicare Buy-In program. Up through FY 2005, these Medicare payments were made by reductions in the federal revenues coming into the Commonwealth. Starting in FY 2006, these payments are coming "on-budget," and are incorporated into the costs of the MassHealth Indemnity and Third Party Liability line item (4000-0700). Accordingly, the costs of this program will now be reflected in the increased federal revenues (with the elimination of the reductions) and in the line item appropriation. The Governor estimates that bringing these costs "on-budget" could save an estimated $800,000 in interest charges annually.

In FY 2005, $251.8 million of FY 2004 surplus Medicaid dollars paid some of the bills that came due early in FY 2005.
The Governor's FY 2006 budget similarly assumes that $327 million of the $527 million FY 2005 Medicaid surplus will be used to pay a portion of the FY 2006 bills that come due between July 1, 2005 and September 15, 2005. Using money across fiscal years in this way can obscure the true costs of a year's Medicaid programming.

Whether the administration intends to continue to use these "one-time" Medicaid surpluses as revenues to balance the budget is not clear. Because the FY 2006 proposal does not budget for a built-in surplus to carry over into FY 2007 to pay the FY 2006 bills that will come due by September 15, 2006, it is likely that there would need to be a significant funding increase in FY 2007 (approximately $327 million more) to pay those costs. This amount would be in addition to any increases necessary to accommodate increased enrollment or health care inflation rates.

Incorporating all of these calculations, the Governor's projected FY 2006 total budget for Medicaid is approximately $7.003 billion. This represents a 5.6 percent increase over the total projected FY 2005 funding level of $6.631 billion. Given the Governor's stated commitment to increase program enrollment (see below), and the national health care inflation rate (estimated at between 7 and 8 percent), holding program spending to this growth rate is very optimistic. There is no specific language in the budget about strategies to reduce the cost per Medicaid enrollee (through benefit reductions), and the only explicit proposed provider rate freeze is on nursing home rates (see below).

Program Enrollment

The Massachusetts Division of Health Care Finance and Policy estimates that there are approximately 105,000 people in the Commonwealth who are currently uninsured but potentially eligible for MassHealth coverage. This number includes approximately 25,000 low-income parents potentially eligible for MassHealth Standard coverage, 5,000 disabled adults potentially eligible for MassHealth CommonHealth, 41,000 uninsured children eligible for either MassHealth Family Assistance or the Children's Medical Security Plan, and approximately 33,000 low-income unemployed adults who could be eligible for the MassHealth Essential program if the enrollment caps were lifted.

Even though recent federal policy changes have allowed enrollment in the MassHealth Essential program to increase from 36,000 to 44,000, there is no indication that funding for the program within the Governor's budget could support enrollment at that higher level. Although there are no people currently on a waiting list, there are estimates that the program will reach its funded capacity of approximately 41,000 enrollees within a month or two. At that point, the Commonwealth would need to reinstate a waiting list or budget additional funds.

One of the most significant enrollment changes in the budget directly contradicts the administration's intent to increase MassHealth program enrollment: the Governor's budget proposes more stringent work requirements in the Emergency Assistance to Elders, Disabled and Children (EAEDC) Program within the Department of Transitional Assistance. EAEDC beneficiaries receive health care coverage through the MassHealth Basic program. Health care coverage for adults who cannot meet the new EAEDC requirements would be at risk. Section 165 of the budget does propose that persons already receiving MassHealth due to their receipt of EAEDC benefits under the current rules could continue to receive MassHealth even after the eligibility guidelines change in FY 2006, but any new EAEDC participants unable to meet the new work requirements and not "grandfathered in" to MassHealth eligibility would no longer be eligible for MassHealth Basic. Although some of the long-term unemployed might be eligible for coverage under MassHealth Essential, access to the program is likely to be limited by funding limitations or enrollment caps.

The administration expects that MassHealth program enrollment will reach close to one million members during FY 2006. Current enrollment (as of December 2004) is approximately 970,000. One aspect of the Governor's health care budget that reflects a commitment to increasing program enrollment is a new line item (4000-0352) funded at $250,000 which would provide grants to non-profit and private organizations to help enroll some portion of the uninsured in the state's health insurance programs. In previous years, however, there had been over $1 million allocated to outreach grants.

Programmatic Changes Proposed for Medicaid

In addition to money allocated for outreach, there is a new line item (4000-0301), budgeted at $1.5 million, for MassHealth compliance auditing and review. This item is consistent with the Governor's intent to "enhance program integrity" by tightening up eligibility reviews and disability verifications, as well as conducting financial and clinical audits of Medicaid providers. Earmarked within this line item is $150,000 each for the Medicaid Fraud Control Unit within the Attorney General's Office, and for MassHealth audits by the state auditor's office.

Also notable is that language in House 1 confirms that eligibility for the MassHealth HIV program (line item 4000-1400) has been restored to persons with incomes up to 200 percent of the federal poverty level. Income eligibility had been lowered from 200 percent to 133 percent in FY 2004, but was restored to 200 percent pending federal approval.

Section 155 of the budget would allow dental providers to limit the number of Medicaid patients they allow into their practice. The intent of this section is to increase the number of dental providers willing to take any MassHealth patients at all. There are estimates that fewer than 700 of the Commonwealth's 5000 dentists participate in the MassHealth program, largely because of unwillingness to accept the paperwork requirements and the reimbursement rates associated with the program. Currently, if any provider chooses to accept Medicaid, that provider is not allowed to place a limit on the number of Medicaid patients. Access to dental care for people receiving MassHealth has been an issue of significant concern. Notable, however, is that the Governor's budget does not propose restoring coverage for adult dental services. Coverage for these services (other than emergency extractions) had been eliminated in FY 2003.

In Section 83, the Governor proposes freezing MassHealth reimbursement rates for nursing facilities for two years at a time.

Pharmacy Programs

The most significant shift in the Governor's budget in the pharmacy programs is the accounting for the implementation of the federal Medicare Part D pharmacy benefit and the impact of this new federal program on the state's Prescription Advantage Program. There had been concerns about potential gaps in coverage as the new program is phased in over the next few years.

The Prescription Advantage Program, funded in line item 9110-1455 in the state budget, and enhanced by co-payment subsidies in line item 9110-1460, serves approximately 80,000 elders and low-income persons with disabilities. The program places a limit on out-of-pocket premiums and co-payments enrollees pay on their prescriptions.

The Governor's budget reduces funding for Prescription Advantage from $110.0 million budgeted in FY 2005, to $90.2 million in FY 2006, and eliminates $5.0 million in a separate line item that had been designated for co-payment subsidies for low-income elders. The Governor projected that actual spending on this program would be $100.0 million in FY 2005. The FY 2006 proposal is likely to be sufficient to cover the current level of enrollment of the program in its current form through the beginning of the fiscal year, and then will cover its current members as a "wrap-around" benefit when the new federal Medicare benefit is implemented in January 2006. It is not clear, however, exactly what portion of out-of-pocket costs the Prescription Advantage program will cover for people who are enrolled in a Medicare prescription program. The Governor's budget also does not allow for new "open enrollment" of persons age 66 and above who are not currently enrolled.

Within the funding for the Executive Office of Health and Human Services is a new line item for $120 million to pay the federally-mandated assessment for the Medicare Part D Prescription Program (known as the "Clawback" provision.) Unfortunately, this amount will likely offset most of the savings the Commonwealth could have recognized from the implementation of the federal program. Furthermore, this amount is only an estimate at this point, and may need to be changed as more information about the program's implementation becomes available.

It is also important to note that it is still unknown what the impact of the Medicare Part D benefit will have on other health care programs. There are some suggestions that enrollments could climb as people come to enroll for the Medicare Prescription program, and find themselves both eligible for and interested in other state health care programs.

Other Health Care Programs

There are two health care programs that are administered under the umbrella of the Office of Medicaid, and that are included within the Governor's totals for Medicaid spending. However, these two programs – Healthy Start and the Children's Medical Security Plan – are technically programs for people who do not qualify for MassHealth coverage.

The Governor proposes funding the Healthy Start program, a state-funded program that ensures prenatal care to low-income uninsured pregnant women, at a level $1.2 million more than the previous year. This represents a growth of approximately eight percent, or not much more than the expected rate of inflation in medical care costs. However, the Governor projects final spending in that program in FY 2005 to reach just over $12.8 million, so the proposed budget represents a 21 percent increase over projected spending, and the Governor expects that this amount will be sufficient to cover the anticipated caseload.

Similarly, the Governor's budget proposes funding for the Children's Medical Security Plan, a primary and preventive health insurance program for otherwise uninsured children, at a level expected to support the anticipated caseload. In FY 2006, the Governor proposes $20.2 million for the program. Funding in FY 2005 was $21.4 million, so the Governor's proposal appears to represent a 5 percent decrease. However, the Governor anticipates that spending in FY 2005 will only reach $16.3 million, and that his budget proposal represents a 24 percent increase over FY 2005 spending.

Uncompensated Care Pool

Funding for the Uncompensated Care Pool, which pays for a portion of the costs of uncompensated care provided by health care providers such as acute care hospitals and community health centers, declines dramatically in Governor Romney's budget. This analysis only includes funding that represents payments by the state into the Pool. Accordingly, the following totals will not include funds generated by assessments on hospitals and private payer surcharges ($160 million each), nor will it include the amounts incorporated into the intergovernmental transfers that generate significant amounts of federal revenue to help fund the Pool.

"Uncompensated care" (sometimes referred to as "free care") is most typically emergency room or urgent care provided for people who do not have health insurance at all, or whose health insurance does not cover needed medical services. Between October 2003 and September 2004, the state's Division of Health Care Finance and Policy estimates that more than 480,000 individuals received medical care paid for by the Uncompensated Care Pool.

In FY 2005, the state implemented procedures to screen people applying for uncompensated care to determine whether those individuals might indeed be eligible for MassHealth or other publicly-funded health insurance programs. The intent of this effort was to minimize demands on the Uncompensated Care Pool for health care coverage by people whose health care could otherwise be covered. Starting in October 2004, an applicant for uncompensated care was required to complete an application for the MassHealth insurance programs prior to being approved for uncompensated care eligibility. In fact, fairly recent increases in MassHealth enrollment – from approximately 940,000 members in August 2004 to close to 970,000 members in December 2004 – may be partially due to these expanded enrollment efforts.

The Pool receives funding through a complicated mechanism that combines state funding, federal reimbursements, funding paid into the pool by local government fund transfers, and by contributions (assessments) paid by hospitals and insurance companies. The Uncompensated Care Pool is not funded directly through identified line items in Section 2 of the Governor's budget, but rather via language in several of the "Outside Sections." In this way, funding for the Uncompensated Care Pool is considered to be "off-budget."

Certain payments for uncompensated care are eligible for federal reimbursement ("federal match"), so payments into the Pool are a generator of federal revenue for the Commonwealth. Typically, federal revenues go directly into the state's General Fund, but in the case of the Uncompensated Care Pool, a portion of these revenues are diverted back into the Pool. These federal funds fully cover the costs of the state's contribution to the Pool. Budgetary language describing Uncompensated Care Pool funding often refers to "federal financial participation" that is "transferred" to the Pool. Accordingly, the Governor's budget does not reflect funding for the Pool as a budgetary expenditure, but rather as reductions in the revenues generated by the Pool that are returned to the General Fund. This is simply an accounting mechanism, and in no way affects the actual amounts available for care.

When comparing Uncompensated Care Pool funding across years, it is necessary to account for the funding of the MassHealth Essential insurance program which has been funded by the Pool. In FY 2005, the state budgeted $360 million in state funds for the Pool, with $12 million added in at the beginning of the fiscal year through a supplemental appropriation. This $372 million included $160 million for "off-budget" funding of the Essential program. Therefore, in FY 2005 only $212 million remained from state funding for the Pool.

In FY 2006, funding for the MassHealth Essential program has been moved "on-budget" as a distinct line item within the Executive Office of Health and Human Services. To complicate matters slightly, however, the MassHealth Essential program comes on-budget starting only in October 2005. Between July 1 and September 30, funding for the program will still come from "off-budget" sources.

To compare funding for the Pool across years, this analysis nets out (removes) the budget for the MassHealth Essential program. The Governor's budget proposes transfers from the General Fund in FY 2006 of $85.9 million. This is $126.1 million less than was budgeted in FY 2005. However, the budget also allows for the transfer of surplus dollars in the old "off-budget" MassHealth Essential line item (4000-0896) from FY 2005 to be included in funding for the Pool. The Division of Health Care Finance and Policy estimates that the amount transferred in FY 2006 from this FY 2005 surplus will be approximately $34.1 million. Combining this amount with the $85.9 million designated transfer from the General Fund brings the state contribution to Uncompensated Care Pool funding up to $120.0 million. This amount is still $92.0 million less than was budgeted in FY 2005, a 43 percent decrease. It is also possible that the $36.5 million needed to fund MassHealth Essential from July 1 through September 30, 2005 will come from the FY 2006 Uncompensated Care Pool funding. This would reduce the FY 2006 net state contribution to $83.5 million, which is $128.5 million less than FY 2005, and a 59 percent reduction.

Public Health

The Governor's budget of $412.2 million for public health represents only a slight increase over funding in FY 2005 – $278.5 million in non-hospital public health spending, and $133.6 million in hospital spending. Although this is a 3.9 percent increase in nominal terms, it is only a 1.7 percent increase for non-hospital public health spending when adjusted for inflation, a 1.8 percent increase in hospital spending,

FY 2005	**$396,570,612**
FY 2006	**$412,164,672**
Increase (decrease)	**$ 15,594,060**
Percentage change	**3.9%**

It is important to realize, however, that funding for public health is still 27 percent below FY 2001 levels, when total funding was $562.4 million in inflation-adjusted dollars.

There are two public health programs that have received notable funding increases in the Governor's budget proposal. Family health programs, including preventive and primary care for low-income vulnerable women and children, received a $1.3 million increase over FY 2005 levels, bringing funding for these services up to $8.33 million. This is a real increase of 16 percent. Included in this item is $800,000 earmarked to fund services for non-English speaking victims of domestic violence.

The program that grows the most within the Department of Public Health is the Sexual Assault Nurse Examiner program. Funding in FY 2005 was $733,000, and the Governor's budget proposes approximately $1.0 million more, bringing the total to $1.74 million. In addition to funding for this line item, the Governor delineates a new program for a pediatric sexual assault nurse examiner program. The Governor proposes $1.0 million for this program.

Funding for substance abuse services includes an additional $9.3 million over what had been budgeted at the beginning of FY 2005. However, the Governor recently filed a FY 2005 supplemental budget appropriation that includes an additional $9.1 million for substance abuse services. This 2005 supplemental funding is essential to preserve federal funding coming into the program. The Governor proposes funding substance abuse services in FY 2006 at $45.9 million. Assuming that the FY 2005 supplemental appropriation is approved by the Legislature, the FY 2006 budget is slightly less than total FY 2005 funding would be, even without adjusting for inflation.

After several years of flat funding levels, the Governor recommends an increase of $1.2 million for the administrative costs of the Department of Public Health. This funding level of $19.5 million represents a real increase of 4.5 percent over last fiscal year.

The most significant public health program reduction is in the prostate cancer screening program. This program, funded in FY 2001 at $3.2 million, and in FY 2005 at $1.0 million, is funded at only $250,000 in the Governor's budget. The prostate cancer program, which targets African-American men who are disproportionately at risk of dying from prostate cancer, provides screening, prevention, education and treatment. The Governor's budget represents a real decrease of 75 percent in just one year, and a 93 percent decrease in funding for these services since FY 2001.

Funding for HIV/AIDS prevention and treatment increases by 1.9 percent in real terms to $34.7 million in House 1. When adjusted for inflation, funding for these prevention, education, outreach and screening services has been cut by 39 percent since FY 2001.

Other crucial public health programs fare similarly in the Governor's proposed budget. Level-funded programs (that is, those not even receiving funding to accommodate the costs of inflation) include: the CenterCare primary and preventive health care program, compulsive behavior treatment (primarily for gambling), dental health services, newborn hearing screening, suicide prevention, Hepatitis C screening and treatment, multiple sclerosis screening and treatment, tuberculosis testing, the universal immunization program, and smoking cessation efforts. Notably, the CenterCare program has been cut by 37 percent in real terms since FY 2001, the Hepatitis C program has been cut by 82 percent, and smoking prevention programs have been cut by 93 percent in real terms since FY 2001.

Other programs where recommended funding levels do not even account for inflation include environmental health services, the Office of Health Care Quality, early intervention services, teenage pregnancy prevention, breast cancer detection, and school health services. Since FY 2001, teenage pregnancy prevention services have been cut 84 percent in real terms, and breast cancer detection programs have been cut 73 percent.

Department of Mental Health

The Governor's budget proposes to increase funding for the Department of Mental Health by $24.3 million or four percent.

FY 2005	**$595,543,229**
FY 2006	**$619,851,712**
Increase (decrease)	**$ 24,308,483**
Percentage Change	**4.1%**

This budget would increase funding in several areas to meet growing costs. Appropriations for adult mental health and support services and for child and adolescent mental health services rise respectively by $12.5 million and $2.8 million. The Governor also continues the effort to move away from the state's reliance on institutional settings and toward community-based supports.

Although this budget provides higher appropriations than FY 2005, the Department of Mental Health has been under-funded in recent years. As the Commissioner for Mental Health, Elizabeth Childs recently stated, "This budget is just a maintenance budget."[3] The Governor's FY 2006 proposal maintains the current level of service, but it does not expand services nor does it address the high demand for services reflected in long waitlists. In real terms, the amount proposed in this budget is $36.4 million or 6 percent lower than the FY 2001 level.

Department of Mental Retardation

Under the House 1 budget proposal, funding for the Department of Mental Retardation increases by $58.2 million or 5.5 percent. This amount includes an $85.6 million appropriation for services that the state is required to provide pursuant to the Boulet Settlement, which mandates that the state provide interim services to individuals on the waitlist for residential placements.

FY 2005	**$1,063,894,604**
FY 2006	**$1,122,137,256**
Increase (decrease)	**$ 58,242,652**
Percentage Change	**5.5%**

In addition to meeting the legal funding requirement for the Boulet Settlement, the Governor also proposes higher appropriations than FY 2005 to address the rising cost of providing various programs and services.

- Funding for community-based residential supports would rise from $476.6 million to $499.5 million, a five percent increase.
- Support for community-based day and work programs would go from $109.2 million to $113.1 million, a four percent change.
- The appropriation for respite family support services would grow from $48.8 million to $50.8 million, a four percent difference.

Elder Affairs

In examining the funding for the Department of Elder Affairs, and in comparing funding levels across years, it is necessary to make sure that the numbers are comparable. Consequently, this analysis removes the

[3] *State House News Service*, January, 13, 2005.

MassHealth programs administered by the Department, the senior pharmacy program, and the cash assistance payments newly allocated to Elder Affairs. The Governor's budget proposes a $2.8 million, or 1.5 percent, increase in funding for the programs of the Department of Elder Affairs, after taking these adjustments into account.

FY 2005	**$196,676,585**
FY 2006	**$199,535,373**
Increase (decrease)	**$ 2,858,788**
Percentage change	**1.5%**

Included in the Department of Elder Affairs is a new line item with close to $22 million for state supplements to Supplemental Security Income (SSI) payments for rest home residents. In fact, this amount is simply a transfer of cash assistance dollars that were previously administered by the Department of Transitional Assistance. By moving the responsibility for these payments to the elder service system, rest home care management and coordination should be able to be better integrated with other elder service supports and funding. In this *Budget Monitor*, these costs are included as "Income Supports," rather than within the budget of the Department of Elder Affairs.

Funding for other line items within the Department of Elder Affairs remains relatively stable in FY 2006, with a 2.9 percent increase in funding for departmental administration when adjusted for inflation. Funding for the elder protective services program, however, increases by 5.2 percent in real terms, to $12.32 million, in order to accommodate an increasing caseload.

The Governor's budget includes $133.9 for home care services (combining purchased services and case management); this is a real decline of close to $953,000, or just under one percent. Funding for the elder home care program has declined almost five percent since FY 2001, when adjusted for inflation.

Other than protective services, there are no real increases in funding for elder service programs within the department. Funding for local councils on aging remains flat at $6.5 million, and the elder lunch program stays stable at $4.0 million. Even the Enhanced Community Options program, designed to provide more extensive community-based services for frail elders, did not receive a funding increase in the Governor's proposal. This program was funded at $37.5 million, an amount that does not even account for inflation from the previous year.

For a discussion that includes the two MassHealth programs administered by the Department of Elder Affairs (the MassHealth Senior Plan and MassHealth Senior Options) and the pharmacy program, refer to the "Medicaid and Other Health Care Programs" section elsewhere in this *Budget Monitor*.

Other Human Services

The Governor's budget includes $1.3 billion for other human services, including $5.0 million to fund salary increases for privately-contracted human service providers.

FY 2005	**$1,261,076,478**
FY 2006	**$1,292,415,082**
Increase (decrease)	**$ 31,338,604**
Percentage Change	**2.5%**

Although the Governor includes a salary reserve for private human service providers, this amount is substantially below the $20.0 million currently appropriated for FY 2005. Moreover, while this budget proposes higher levels of funding for several agencies, the amounts are generally lower than in FY 2001. For example, the proposed level of funding for the Massachusetts Rehabilitation Commission is higher than FY 2005 (two percent more), but 18 percent lower than FY 2001, in inflation-adjusted terms. The budget for the Massachusetts Commission for the Blind is three percent higher in this budget, but 11 percent lower, in real terms, than it was in 2001.

Environmental Affairs

The Governor proposes $190.2 million for environmental affairs. This amount is $62.1 million or 25 percent below current appropriations. After accounting for $66.5 million in funding for what appear to be one-time expenditures for FY 2005, the House 1 budget stands $4.4 million or two percent higher than the FY 2005 operating budget.

Including one-time funding in FY 2005:

FY 2005	**$252,302,391**
FY 2006	**$190,171,212**
Increase (decrease)	**($62,131,179)**
Percentage Change	**-24.6%**

Less one-time funding in FY 2005:

FY 2005	**$185,756,791**
FY 2006	**$190,171,212**
Increase (decrease)	**$4,414,421**
Percentage Change	**2.4%**

In the House 1 budget, the Governor proposes to move funding for employees currently paid for by the capital budget onto the operating budget, which would add $3.2 million to the budget of the Executive Office of Environmental Affairs. In addition to this increase, the Governor proposes to increase funding for the Department of Conservation and Recreation by $1.5 million or two percent. On the other hand, funding for the Departments of Environmental Protection and Fish and Game would respectively decline by roughly $74,000 and $328,000.

The level of funding in this budget does not reverse the damage resulting from cuts in recent years. For example, funding for the Department of Environmental Protection (DEP), has limited this agency's ability to perform its duties. The *Boston Globe* cites an internal memo from the DEP which shows that programs that help to detect health threats in drinking water are not sufficiently funded, and "as a result, problems are being identified only after the public has been exposed."[4] In real terms, the FY 2006 House 1 budget would leave funding for DEP $21.4 million (30 percent) below its FY 2002 level.

Housing

The House 1 budget proposes $77.1 million for the Department of Housing and Community Development (DHCD), $6.4 million, or roughly 8 percent, less than the current FY 2005 total.

FY 2005	**$83,522,284**
FY 2006	**$77,123,672**
Increase (decrease)	**($ 6,398,612)**
Percentage Change	**-7.7%**

[4] "DEP Memo Details Costs of Cuts," Boston *Globe*, February 9, 2005, p. B4.

The level of funding for operating subsidies to public housing authorities appears to increase from $30.3 million to $31.3 million. However, budget documents released by the Governor's office show that projected spending for FY 2005 will total $33.2 million. Consequently, the amount proposed by the Governor for FY 2006 is $1.9 million or 6 percent lower than the current projection.

While the House 1 budget includes level-funding ($24.3 million) for the Massachusetts Rental Voucher Program (MRVP), the Governor proposes substantial changes to the program:

- The Governor's budget contains language that prevents the Department of Housing and Community Development to re-issue mobile vouchers upon turnover, thereby reducing the number of housing vouchers available to families in need of affordable housing.
- The FY 2006 House 1 budget includes language which calls for DHCD to re-determine each household's income and voucher value at six month intervals, rather than the current annual re-determination.
- The Governor goes further to impose time limits and work requirements for individuals receiving MRVP; individuals would be restricted to 36 consecutive months and a five year lifetime limit. Proposed work requirements for TAFDC and EAEDC recipients would be extended to individuals receiving MRVP.

The House 1 budget includes $2.0 million for Residential Assistance for Families in Transition (RAFT), the same amount as FY 2005. The RAFT program provides up to $3,000 to help families who are at-risk of homelessness to pay for utilities, security deposits, rent or moving expenses. Currently, demand is very high and funding for FY 2005 is likely to run out before the end of the fiscal year.

Public Safety

The Governor's budget includes $1.3 billion for public safety, nearly two percent more than FY 2005 but below the rate of inflation.

FY 2005	**$1,281,977,760**
FY 2006	**$1,305,234,042**
Increase (decrease)	**$ 23,256,282**
Percentage Change	**1.8%**

The proposed budget for public safety provides increases for specific areas, including:

- $12.6 million for the State Police Crime Lab, a $2.8 million or 28 percent rise over FY 2005;
- $100,000 for sexual assault evidence kits, roughly $44,000 or 79 percent more than FY 2005; and
- $4.4 million for one new state police class.

While the budget proposes to increase overall funding for public safety, this amount does not keep pace with inflation.

Judiciary

The Governor proposes $617.6 million for the Judiciary, about the same amount appropriated in FY 2005 and well below the amount necessary to compensate for inflation.

FY 2005	**$615,206,661**
FY 2006	**$617,595,130**
Increase (decrease)	**$ 2,388,469**
Percentage Change	**0.4%**

The House 1 budget proposes various consolidations within the judiciary including merging operations for the Superior, District, Family, Probate and Juvenile Courts. This budget also proposes to consolidate funding for various legal services, including the Massachusetts Legal Advisors Corporation, Massachusetts Correctional Legal Services, and Mental Health Legal Advisors.

Revenue

One of the centerpieces of Governor Romney's FY 2006 budget proposal is a reduction in the personal income tax rate to 5.0 percent. To accomplish this goal while simultaneously bringing revenue and expenditures into line in the coming fiscal year, the Romney Administration relies on four strategies: tax revenue estimates that are more optimistic than the Legislature's, additional revenue from statutory changes designed to combat a variety of tax avoidance techniques, the use of tobacco settlement funds that were originally intended for other purposes, and appropriations below those necessary to restore funding lost to several years of budget cuts. In the end, as is discussed elsewhere in this *Budget Monitor*, this combination of assumptions and policy changes yields a budget that is balanced in FY 2006, but could undermine the Commonwealth's fiscal health in the years ahead.

I. Tax Revenue

A. *Anticipated tax revenue* – The Governor's budget proposal assumes that tax revenue, prior to the tax law changes included in his budget and associated legislation, will total $17.336 billion in FY 2006. That sum is below the $17.341 to $17.464 billion range that the Department of Revenue projected for FY 2006 tax collections during the Consensus Revenue hearing on December 6 of last year. However, for tax collections to reach that level in FY 2006, they would have to continue to come in at their current pace in FY 2005 – namely, 1.7 percent ahead of benchmark – and then grow another 5.0 percent in FY 2006. In addition, the tax revenue figure on which the Governor bases his budget is $236 million higher than the $17.1 billion figure the House and Senate Ways and Means Committee intend to use in formulating the Legislature's versions of the budget.

B. *Changes in tax policy* – The Governor's House 1 budget proposal contains two notable changes in tax policy – a reduction in the personal income tax rate to 5.0 percent and the repeal of the currently-suspended personal income tax deduction for charitable contributions. Legislation filed by the Governor on January 26 in conjunction with House 1 (which has since been assigned H. 21 and referred to the Joint Committee on Revenue) contains a third set of changes, all of which are designed to reduce tax avoidance and which, collectively, are expected to generate $170 million in FY 2006.

1. Reduction in the personal income tax rate – The Governor renews his efforts – first embodied in legislation filed in June 2004 – to reduce the personal income tax rate from its present level of 5.3 percent to 5.0 percent, effective January 1, 2006. Reducing the personal income tax to 5.0 percent would result in a revenue loss of $225 million in FY 2006; that revenue loss would grow to roughly $550 million in FY 2007, when the change would be in effect for the entire fiscal year.

   As the MBPC pointed out in its July 2004 publication, *Four Key Questions on the Governor's Tax Cut Proposal*, reducing the personal income tax rate to 5.0 percent would overwhelmingly benefit the most affluent taxpayers in the Commonwealth. The wealthiest fifth of taxpayers in Massachusetts would enjoy nearly two-thirds of the total tax reduction arising from a rate of 5.0 percent. In fact, nearly one of out of every five dollars from the tax cut would flow into the pockets of the top one percent of taxpayers in the Commonwealth; in 2003, this group had an average family income of more than $1.27 million. On the other hand, the poorest 20 percent of taxpayers in the Commonwealth – those with incomes of less than $17,200 in 2003 – would receive less than one percent of the ultimate $550 million tax cut. Only about one out of every five taxpayers in this income range would receive any benefit at all from such a rate reduction.

   Further, Governor Romney has suggested that his proposal to reduce the personal income tax rate would help to stimulate employment growth in Massachusetts. At the time House 1 was released, the Governor claimed that "Lowering the personal income tax rate from 5.3 percent to 5.0 percent will make Massachusetts more attractive to both employers and employees." A recent report from the Washington, DC-based Center on Budget and Policy Priorities offers a distinctly different perspective. The report, *Tax Cuts and Consequences*, finds that the six states that cut taxes the most during the late 1990s – a group that includes Massachusetts – suffered larger job losses, in the aggregate, than the other 44 states during the latest economic downturn. It further notes that total personal income in five of the six states that adopted relatively large tax cuts has fallen, after adjusting for inflation, even as it has risen in most other states.

   In sum, the Governor's proposal to reduce the personal income tax rate would make it more difficult to balance the budget in future years, would further reduce the progressivity of the Commonwealth's tax system, and would be an ineffective means of fostering economic growth. The price of this policy choice would be, at minimum, a further delay in restoring funding for essential public services harmed by repeated budget cuts.

2. Repeal of the charitable deduction – In July 2000, the Legislature enacted a change in law permitting personal income taxpayers to claim a deduction for charitable contributions made over the course of the year. That deduction was suspended in 2002 and, under current law, is scheduled to be reinstated no earlier than 2015. Section 59 of House 1 repeals the deduction outright. Since the deduction is not currently in effect, this proposal would have no impact on tax revenue in FY 2006 (or in any of the next eight fiscal years), but

would ultimately preclude a future revenue loss of some $200 million annually.

3. Legislation to close tax loopholes – As he did in 2003 and 2004, the Governor has again proposed legislation (H. 21) to close a variety of tax loopholes. According to the Romney Administration's budget presentation, that legislation is expected to generate $170 million in FY 2006. The following is a list of the principal provisions of the legislation, along with estimates of the revenue each would produce in the coming fiscal year. H. 21 would:

- Enhance the Department of Revenue's authority to combat "distortionary" tax planning practices ($50 million) – The Governor's bill would improve the ability of the Department of Revenue (DOR) to address situations in which a corporation uses transactions with one of its subsidiaries to reduce the income it reports on its Massachusetts tax return. DOR would be permitted, in such situations, to adjust the corporation's return to reflect more accurately the income the corporation earns from doing business in the Commonwealth. For instance, in such situations, DOR could require the corporation to use combined reporting, an approach to corporate taxation that is discussed in more detail below.

- Apply the sales tax to "intangible" software sales ($50 million) – Under current law, sales of software that is delivered in tangible form (e.g. via a compact disc sold in a store) are subject to the sales tax. If that same software package were sold without tangible property changing hands (e.g. if it were installed by a consultant who retained possession of the disc on which the software were stored), it would not be subject to the sales tax. The Governor's bill would ensure that the sales tax is applied in both cases.

- Prevent companies from using intermediaries to avoid the deeds excise tax when selling real estate ($20 million) – At present, a seller of real estate can avoid the Massachusetts deeds excise tax by establishing a partnership, transferring that real estate to the partnership, and then selling the partnership to the buyer. Once the buyer assumes control of the partnership it can dissolve that entity and take ownership of the real estate, without ever having had to pay taxes on the transfer of the real estate. To prevent the use of such schemes, the Governor's bill would apply the deeds excise tax to sales of partnerships (or other, similar entities) that own real estate.

- Ensure that out-of-state owners of Massachusetts real estate pay personal income taxes when such property is sold ($15 million) – Individuals who own property in Massachusetts but who reside out of state have used tactics similar to those described above in order to avoid paying Massachusetts income tax on gains realized from real estate sales. The Governor's bill would treat, for income tax purposes, the sale of a partnership or a similar entity that owns real estate as though it were the sale of the real estate itself.

- Impose new penalties on the promoters and users of abusive tax shelters ($5 million) – For example, the bill would create a new fine for legal or accounting firms that market abusive tax shelters.

The fine would be $5,000 for each taxpayer to whom the shelter was marketed or the amount of money the firm made from the shelter (whichever is lower).

H. 21 reflects significant and continued progress in combating tax avoidance. Nevertheless, the Commonwealth could still take additional steps to prevent profitable corporations from taking advantage of flaws in Massachusetts law to reduce their tax liabilities inappropriately. In particular, Massachusetts could institute what is known as combined reporting, the method of determining the amount of a corporation's profits that are subject to taxation that most accurately reflects its total profits. Under combined reporting, all entities subject to the corporate excise tax in the Commonwealth, when filing their tax returns, would be required to list all of the profits realized by all of their related subsidiaries, regardless of where those subsidiaries are located. The Massachusetts apportionment formula would then be applied to the full amount of profits listed in the combined report in order to determine how much of those profits are taxable in the Commonwealth. Such an approach would serve as the most effective means of preventing corporations from artificially shifting profits from one state to another to avoid their fair share of the Massachusetts tax burden; indeed, one noted tax expert calls the failure to use combined reporting "an open invitation to tax avoidance."[5]

[5] McLure, Charles E., Jr., "The Nuttiness of State and Local Taxes – and the Nuttiness of Responses Thereto," *State Tax Notes*, September 16, 2002, p. 851.

Sixteen states – including California, as well as New Hampshire and Maine – use combined reporting; Vermont will begin using it next year. Provisions of H. 21 appear to allow the Department of Revenue to require taxpayers to use combined reporting under certain circumstances, but those circumstances are limited to returns that are audited by the Department, rather than requiring taxpayers to use combined reporting when they file their initial returns.

In addition, Massachusetts could modify current law to ensure that Internet hotel resellers collect and pay the proper amount of room occupancy taxes, a change that could be worth as much as $20 million in FY 2006.[6] The Romney Administration, as part of its 2004 tax loophole legislation, recommended statutory changes to address this issue, but such provisions were removed during legislative debate over the bill.

II. Other Revenue

In addition to the above changes in tax policy, House 1 contains several other policy changes designed to make more revenue available in the coming fiscal year. Most notably, the Governor's budget proposal reprises a set of policies, temporarily adopted as part of the FY 2005 budget, that would increase the amount of funds related to the tobacco settlement that could be used to support current spending. Specifically, House 1 would, for FY 2006, transfer to the General Fund the full amount of the annual payment that Massachusetts is scheduled to receive as part of the master tobacco settlement agreement. The Commonwealth used the full amount of this payment to support

[6] "Romney targets $280M in 'loopholes'," *Boston Business Journal*, January 3, 2005.

current spending in FY 2005 as well, but, under current law, in FY 2006 and each succeeding year, 70 percent of that payment is supposed to be deposited in the Health Care Security Trust for future “funding [of] health related services and programs, including, but not limited to, services and programs intended to control or reduce the use of tobacco in the commonwealth.” For FY 2006, the payment is projected to be $250 million; thus, in spending that full amount, House 1 uses $175 million that existing law would have set aside for future use. In addition, under current law, 30 percent of the annual investment earnings of the Health Care Security Trust are to be transferred to the General Fund to be used for current expenditures. For FY 2006, House 1 would increase that transfer to 50 percent of the annual investment earnings. As interest earnings are expected to total approximately $40 million in FY 2006, this change would make an additional $8 million available for use in the coming fiscal year, funds that otherwise would have been saved for the future. Here too, the Governor’s budget simply reprises a practice employed in FY 2005.

Finally, House 1 recommends extending Massachusetts’ “bottle bill” to cover containers for water, fruit juices, and sport drinks, among others. Expansion in this manner would generate an additional $4 million to $9 million for the Commonwealth in FY 2006.

Spending by Program Area

(in Millions of $)

Program	FY 2005*	FY 2006 H. 1	FY 2006 H. 1 vs. FY 2005	% Change FY 2006 H. 1 vs. FY 2005
Local Aid - Lottery	736.4	761.4	25.0	3.4%
Local Aid - Additional Assistance and PILOT	395.3	397.4	2.1	0.5%
Local Education Aid (Ch. 70)	3,183	3,260	77.0	2.4%
K-12 Educ (non Ch. 70) [1]	463.2	481.4	18.2	3.9%
School Building Debt Assistance [2]	395.7	488.7	93.0	23.5%
Higher Education [3]	916.1	921.7	5.6	0.6%
Early Education and Care	449.8	450.2	0.4	0.1%
Income Support Programs [4]	601.5	581.3	(20.2)	-3.4%
Medicaid and Other Health Care Programs [5]	7,235	6,886	(348.9)	-4.8%
Public Health (DPH)	396.6	412.2	15.6	3.9%
Mental Health (DMH)	595.5	619.9	24.3	4.1%
Mental Retardation (DMR)	1,064	1,122	58.2	5.5%
Elder Affairs	196.7	199.5	2.9	1.5%
Other Health & Human Services	1,261.1	1,292.4	31.3	2.5%
Environmental Affairs	252.3	190.2	(62.1)	-24.6%
Transportation	145.8	162.1	16.3	11.2%
Housing & Community Development [6]	83.5	77.1	(6.4)	-7.7%
Economic Development	131.7	127.1	(4.6)	-3.5%
Public Safety	1,282	1,305	23.3	1.8%
Judiciary	615.2	617.6	2.4	0.4%
District Attorneys	79.2	82.6	3.4	4.3%
Attorney General	36.2	36.6	0.4	1.1%
Libraries	27.1	27.2	0.1	0.3%
Debt Service	1,754	1,807	52.8	3.0%
Pensions [7]	1,217	1,275	57.7	4.7%
Group Insurance	830.9	900.7	69.8	8.4%
Other Administrative	661.4	685.3	23.8	3.6%
Total	**25,007**	**25,168**	**161.4**	**0.6%**

Notes:

(1) The FY 2006 House 1 budget proposes to consolidate functions that are currently funded separately by the Department of Education and Office of Child Care Services. To enable a year-to-year comparison, the FY 2005 total adjusts for these transfers by subtracting $81.8 million from the K-12 Education total and adding it to the total for Early Education and Care. The total for Early Education and Care also includes funding for the Office of Child Care Services that was kept intact in the FY 2006 House 1 budget.

(2) The FY 2005 budget reduces available revenue by $395.7 million to cover the costs of School Building Assistance; In FY 2006, revenue would be reduced by $488.7 million. The table includes these amounts as appropriations.

(3) The higher education totals include $30.6 million in tuition revenue retained by the campuses.

(4) The FY 2006 House 1 budget proposes to move a portion of funding for the State Supplement to Supplemental Security Income (SSI) to Elder Affairs for beneficiaries residing in rest homes. This appropriation is incorporated in the total for Income Support Programs and, therefore, is deducted from the Elder Affairs figure.

(5) Totals include Medicaid appropriations, “off-budget” Medicaid funding, senior pharmacy program funding, and the costs of other state-administered health care programs. These totals also include the “off-budget” state payments into the Uncompensated Care Pool. The FY 2005 Medicaid amount total does not include a $251.8 million FY 2004 Medicaid surplus used to pay a portion of FY 2005 expenses, nor is it reduced by $527 million appropriated in FY 2005 but expected to remain unspent at the end of the fiscal year. The FY 2006 total does not include $327 million of the FY 2005 surplus that the budget assumes will be used to pay bills that will come due in FY 2006. Totals do not include $288.5 million for the nursing home assessment.

(6) The FY 2005 budget transfers $2.0 million from the General Fund to the Affordable Housing Trust Fund. This amount is included in the total above.

(7) Off-budget pension funding in FY 2005 totals $1.216 billion; the FY 2006 House 1 budget includes $1.275 billion for this purpose. These amounts are treated as appropriations for these years.

* **NOTE:** The totals for FY 2005 reflect total amounts appropriated to date, including one-time supplemental funding and prior appropriations that are continued for this year. The totals also incorporate off-budget spending for certain areas as noted above.