FACTS AT A GLANCE

JANUARY 2006

Impact of Reducing the Personal Income Tax Rate

Over the past several years, a variety of proposals have been put forward to reduce the Massachusetts personal income tax rate from its present level of 5.3 percent to 5.0 percent. The following summarizes the impact that reducing the personal income tax would have along a number of different dimensions, including on the budget, on individual taxpayers, and on the Massachusetts economy.

- **Gradual implementation of a reduction in the personal income tax rate may make such a policy appear affordable, but its full effect on the budget is substantial.** For instance, in his House 1 budget proposal for FY 2006, Governor Romney recommended reducing the personal income tax rate to 5.0 percent, but accounted for only about half the cost of doing so in his budget calculations. Importantly though, in testimony at the Consensus Revenue hearing on December 12, 2005, officials from the Department of Revenue indicated that a personal income tax rate of 5.0 percent, if in effect for all of FY 2007, would reduce tax revenue by $610 million. This sum is well in excess of any budget surplus the Commonwealth is likely to experience in the coming fiscal year, meaning that a reduction in the personal income tax rate, once fully implemented, could lead to the return of budget deficits.

- **Reducing the personal income tax rate to 5.0 percent would prevent the Commonwealth from addressing important public priorities.** Every dollar that the Commonwealth would fail to collect because of a reduction in the personal income tax rate is a dollar that policymakers would be unable to use to restore the millions of dollars in spending cuts adopted during the fiscal crisis that are still in place today. For instance, between 2002 and 2004, Massachusetts reduced real per pupil spending on K-12 education more than any other state in the nation. Other areas, such as higher education, public health, and environmental affairs, have been reduced by more than 20 percent in real terms since 2001. Moreover, an annual loss of $600 million would almost certainly imperil the Commonwealth's efforts to expand access to health care.

CUTS IN SELECTED PROGRAM AREAS, FY 2001 - FY 2006

	Funding Level (in $M)		Nominal Change		Real Change	
	FY 2001	*FY 2006*	*$M*	*%*	*$M*	*%*
Higher Education	1,092.3	965.3	(127.0)	-11.6%	(264.1)	-21.5%
Early Education and Care	524.1	481.1	(42.9)	-8.2%	(108.7)	-18.4%
Public Health	521.3	430.8	(90.5)	-17.4%	(155.9)	-26.6%
Environmental Affairs	240.0	203.3	(36.8)	-15.3%	(66.9)	-24.8%
Housing & Community Development	155.8	111.6	(44.2)	-28.3%	(63.7)	-36.3%
Libraries	34.6	29.6	(5.1)	-14.6%	(9.4)	-24.1%

- **A reduction in the personal income tax rate would disproportionately benefit the most affluent.** Data from the Institute on Taxation and Economic Policy suggest that 59 percent of the benefits of a reduction in the personal income tax rate would go to the wealthiest 20 percent of taxpayers in the Commonwealth. In contrast, the poorest 20 percent of taxpayers in Massachusetts (that is, those with incomes below $18,600 in 2005) would receive just 0.9 percent of a rate reduction. Of note, the gains accruing to Massachusetts residents from the federal tax cuts enacted since 2001 are also heavily skewed towards the wealthy. In 2006, the top 20 percent of taxpayers in Massachusetts will receive 72 percent of the more than $5 billion in federal tax cuts that will flow into the Commonwealth. In other words, reducing the personal income tax rate in Massachusetts now would simply exacerbate the very unequal distribution of federal tax cuts put in place over the past few years.

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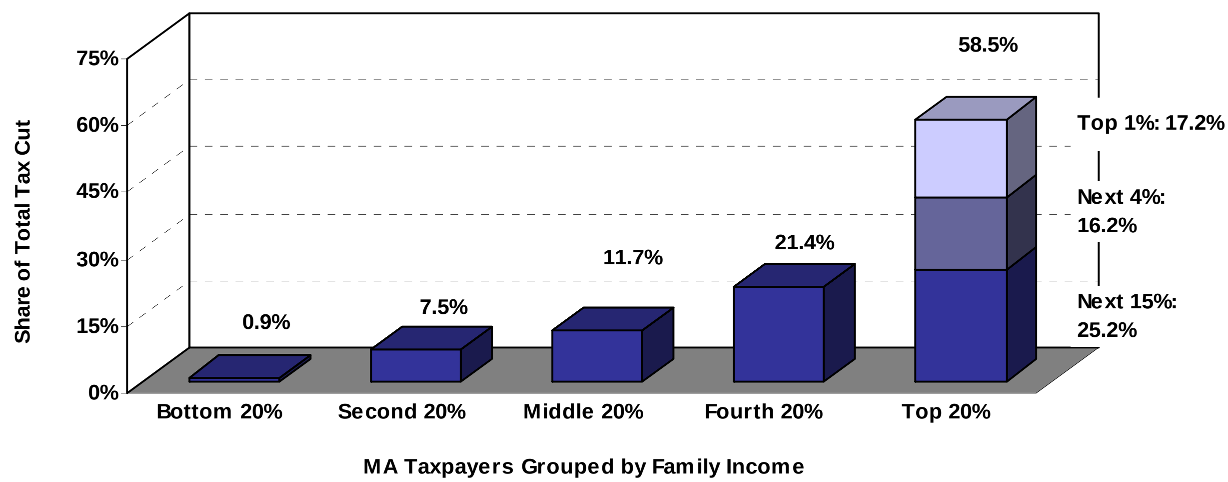
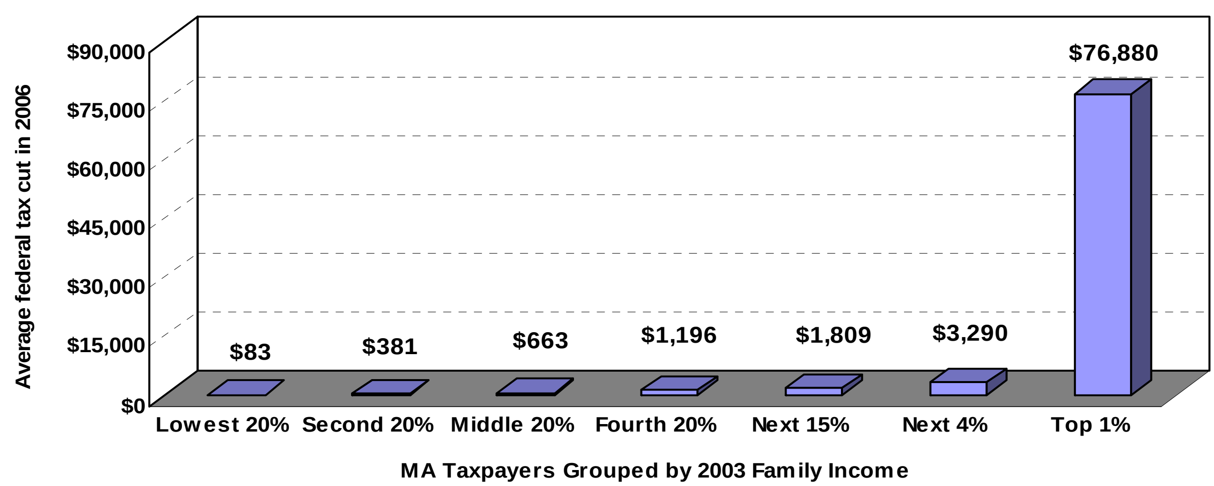
Who Gains from Cutting the Personal Income Tax Rate?
Distribution of tax cut by 2005 family income



Rate Cut in MA Would Reinforce Skewed Federal Tax Cuts
Distribution of 2001-2003 federal tax cuts



- **The recent performance of the U.S. and Massachusetts economies runs counter to claims that reducing taxes contributes to long-term growth.** According to a December 2005 Economic Policy Institute briefing paper, despite a total of $860 billion worth of federal tax cuts since 2001, "[by] virtually every measure, the [U.S.] economy has performed worse in this business cycle than was typical of past ones, including that of the early 1990s, which saw major tax *increases* [emphasis in original] … In fact, over the last four-and-a-half years, nearly every indicator – from job gains to economic output to spending – have fallen far short when stacked against comparable periods in past cycles."[1] Similarly, a January 2005 report by the Center on Budget and Policy Priorities found that 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 2001-2003 period. It also noted that, over the same time frame, total personal income in five of the six states adopting relatively large tax cuts had fallen, after adjusting for inflation, even as it had risen in most other states.[2]

[1] Price, Lee, *The Boom That Wasn't: The economy has little to show for $860 billion in tax cuts*, Economic Policy Institute (Washington, DC), December 19, 2005, p. 2.
[2] Zahradnik, Robert, *Tax Cuts and Consequences: The States That Cut Taxes the Most During the 1990s Have Suffered Lately*, Center on Budget and Policy Priorities (Washington, DC), January 12, 2005.