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FACTS AT A GLANCE **October 25, 2018**

Who Pays? Low and Middle Earners in Massachusetts Pay Larger Share of their Incomes in Taxes

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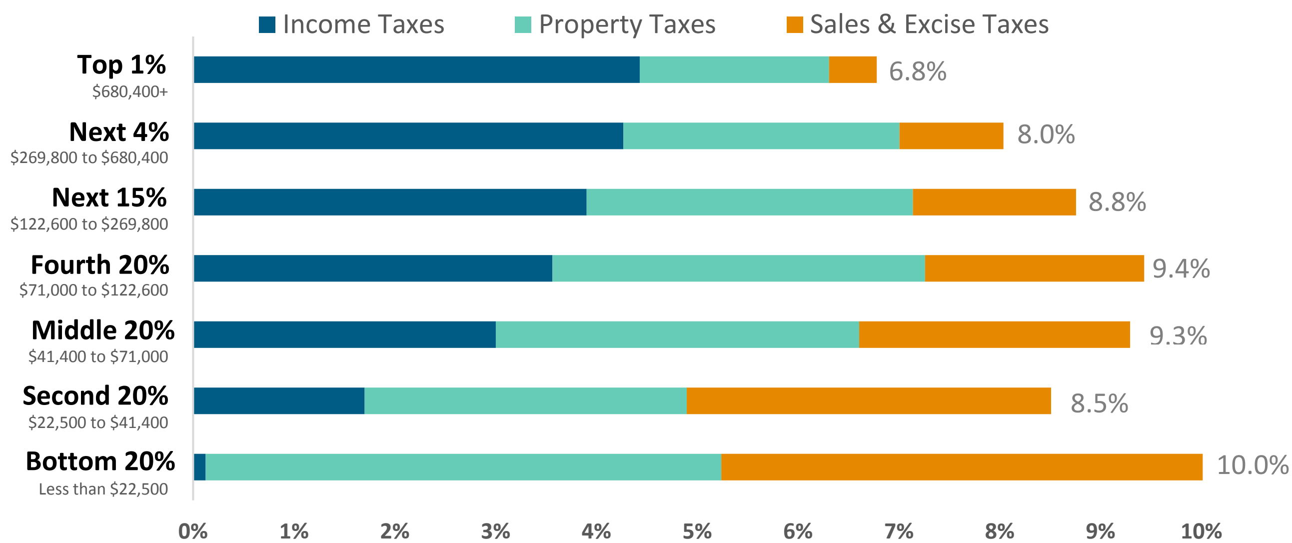
Taxes are the main way communities pay for the things we do together. Taxes pay for essential programs and infrastructure we take for granted, like fire protection, public education, and health inspectors; roads, bridges, and public transit; and the support for people facing hard times. Examining how much people at different income levels pay in taxes is important when considering the fairness of tax policy.

Massachusetts state and local taxes are "upside down" when it comes to the different portions of income that higher- and lower-income people pay. While most taxes in Massachusetts have a single, uniform *rate*—for example, regardless of income, people all pay the same 5.05 percent income tax rate and 6.25 percent sales tax—different income groups nonetheless pay very different portions of their incomes in state and local taxes. On average, Massachusetts households with the lowest incomes contribute a larger percentage of their incomes in state and local taxes than do households in the top 20 percent of incomes. In fact, those with the highest incomes contribute the lowest percentage of their incomes.

According to the most recent data, taxpayers in the lowest-income 20 percent in Massachusetts pay the largest share: 10.0 percent of their incomes in state and local taxes. The highest-income 1 percent of taxpayers pay 6.8 percent of their incomes, the smallest share of any group. Those in the middle pay amounts in between.[1]

Highest Income Taxpayers Pay Smaller Share of Income in State and Local Taxes

% of personal income paid in state and local taxes, 2018 projection



Source: Institute for Taxation and Economic Policy.

TAX FAIRNESS IN MASSACHUSETTS

Massachusetts state and local taxes are composed of different types of taxes that impact higher- and lower-income taxpayers differently. When people with higher incomes pay a larger share of their incomes for a type of tax than do lower-income taxpayers, economists describe that as a "*progressive tax*." When higher-income people pay a smaller share of their incomes toward a particular tax than lower-income people do, it's called a "*regressive tax*." Regressive consumption taxes can sometimes have other merits, especially in enhancing stability of revenues, and thus may be a valuable part of the overall system. When considering progressivity and regressivity, it is important to examine not just individual tax types (e.g., income taxes or sales taxes), but rather the overall tax system in a state.

As the first chart shows, overall the Massachusetts tax system is regressive, collecting a larger share of household income from lower-income households than it does from upper-income households. This is primarily due to the sales tax and property tax, each of which has the effect of taxing lower-income people more heavily as a share of their household incomes than it does higher-income people.[2]

Sales taxes are the most regressive of the Commonwealth's major taxes. Middle- and low-income taxpayers typically make less expensive purchases than do taxpayers with higher incomes. Thus middle- and low-income households typically pay out fewer dollars in sales taxes. But these dollars paid in sales taxes by middle- and low-income people represent a larger portion of their (smaller) incomes. For high-income taxpayers, the impact of sales taxes is further diminished because they typically do not spend every dollar of their income, leaving a significant portion of their incomes not subject to the sales tax. While the middle 20 percent of households and those in the bottom 20 percent pay 2.7 percent and 4.8 percent of their incomes in sales taxes respectively, the highest 1 percent pay 0.5 percent of their incomes.

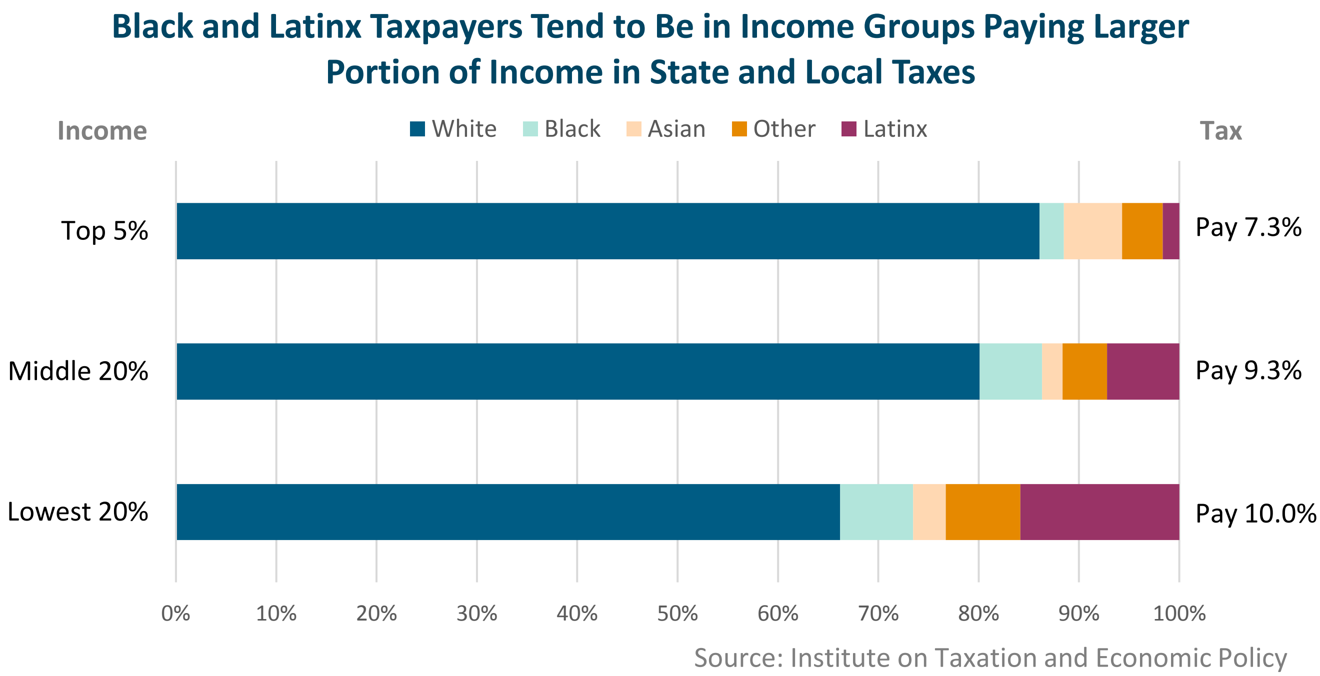
The one major tax in the Massachusetts tax system that reduces somewhat the regressivity of the overall system is the personal income tax. The Massachusetts personal income tax is progressive in its effect even though there is a single, flat rate applied to income at all levels. This is because of progressive features of the personal income tax, including a provision that exempts very low-income tax filers from paying the income tax; a sizeable personal exemption for which all filers are automatically eligible; and a state-level Earned Income Tax Credit.[3]

Altogether, the percent of income paid in state and local taxes is significantly different for different income groups. The middle 60 percent of taxpayers in the income distribution pay an average of 9.2 percent of their incomes in combined state and local taxes, compared to 6.8 percent for the highest-income 1 percent of taxpayers and 10.0 percent for the bottom 20 percent of taxpayers.

BLACK AND LATINX TAXPAYERS TEND TO BE IN INCOME GROUPS PAYING LARGER PORTIONS OF EARNINGS IN TAXES

A long history of systemic barriers to opportunity has prevented Black and Latinx people in Massachusetts from equitable access to high-paying jobs, education, and other avenues leading to higher household income.[4] As a result, Black and Latinx workers are over-represented among low-income taxpayers and underrepresented among higher-income taxpayers. Given the "upside-down" structure of the Massachusetts tax system, this means Black and Latinx taxpayers tend to pay a larger share of their incomes in state and local taxes than White taxpayers do. In other words, the structure of Massachusetts' current tax system makes it relatively harder for people of color to get ahead.

While whites comprise about three quarters of all Massachusetts tax filers, they represent 86 percent of the highest-income 5 percent of income earners, a group that pays a smaller portion of its income in taxes than do other filers.[5]



RAISING TAX SHARE OF THE TOP 1% TO OTHERS' LEVEL WOULD RAISE BILLIONS CUT BY FEDERAL TAX CHANGES

More revenue would be available to the Commonwealth for education, infrastructure, and other public programs if people with the highest incomes paid the same average portion of their income as other Massachusetts households. For instance, if changes to state tax law caused those with the highest 1 percent of incomes to contribute the same portion of their incomes in taxes as do the middle 60 percent of households, they would pay an additional $2.12 billion to the Commonwealth in 2018.

Despite those state tax increases, when federal tax changes are included in the picture, the net result would be a substantial tax cut for the highest-income 1 percent. Recent changes to the federal tax law deliver very large tax cuts to America's highest income households (low- and middle-income households receive far smaller cuts as part of these federal tax changes).[6] In 2018, Massachusetts households with the highest 1 percent of incomes will receive an estimated $2.51 billion in federal tax reductions. Thus, even if *state* tax law was amended as described in the previous paragraph, the highest income Massachusetts households *still* would receive a net (i.e., combined state and federal) tax reduction of some $400 million in 2018.[7]

SEVERAL STATES HAVE TURNED THEIR TAX SYSTEMS "RIGHT-SIDE UP"

There are several states that have turned their tax systems "right-side up," meaning people with the highest incomes contribute a greater percentage of their incomes in state and local taxes than do people with middle or low incomes. In the following six states, the highest-income 1 percent pay a larger share of their incomes in state and local taxes than do the middle 60 percent or the bottom 20 percent of households: California, New Jersey, Minnesota, Vermont, the District of Columbia, and Delaware. Despite having very different economies and tax structures, five of these six states that have turned their tax systems "right-side up" have done so in part by adding to their state tax codes a "millionaire's tax"—a relatively high top tax rate on personal income, applied to annual income above a high threshold (typically $250,000 to $500,000 or higher).[8] These taxes ensure that those who have the greatest ability to contribute taxes and have benefited most from a state's economic success pay a greater share of their incomes in state and local taxes.

See MassBudget's additional research on the income tax, the property tax, and the sales tax.

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[1] The Massachusetts tax system is still more regressive than presented in this chart because the chart does not take the effects of the "federal offset" into account. When calculating income subject to federal tax, tax filers can deduct up to $10,000 of state and local taxes paid plus any state or local taxes they pay through business pass-through entities like S-corporations. These tax deductions disproportionately benefit upper-income taxpayers because: (1) they are more likely to receive the full $10,000 deduction for state and local taxes paid; (2) they are more likely to be able to deduct significant business earnings, and (3) they are avoiding a higher rate of federal tax on the deducted income because the federal income tax rates, unlike Massachusetts', are higher at upper levels of incomes. See "Sweeter than SALT: Higher-Income Households Get Federal Tax Cuts More Than Twice SALT Losses," (Mass. Budget and Policy Center, Jan. 2018).

[2] For a methodological description, please see, "Methodology," in *Who Pays? A Distributional Analysis of the Tax System in All 50 States* (Institute on Taxation and Economic Policy, Oct. 2018). The data show the effect of current state and local tax laws, including the estimated amount of income, consumption, and property taxes paid by residents in that year. The data present the impact of tax changes in effect through September 10, 2018. Income taxes include personal and corporate income taxes. Property taxes include local levies on homes and motor vehicles as well as estate taxes, with property taxes on rental property distributed partly to property owners and partly passed on to tenants. Sales taxes include general sales and use taxes, as well as excise taxes on alcohol, tobacco, and motor vehicle fuels. Findings are not comparable to earlier years' analyses because some taxes were not included previously. Unless otherwise stated, the Massachusetts data in this paper takes taxpayers of all ages into account including those over age 65. For reasons explained in its Methodology section, ITEP typically excludes taxpayers over age 65 from their state-by-state analyses. In order to facilitate accurate comparisons, the analysis in the last section of this paper examining multiple states, follows ITEP in not including taxpayers over 65.

[3] See "The Massachusetts Earned Income Tax Credit," (Mass. Budget and Policy Center, March 2018).

[4] "Obstacles on the Road to Opportunity: Finding a Way Forward," (Mass. Budget and Policy Center, October 2018).

[5] The highest-income 1 percent of households are not broken out for special analysis here because too few Black and Latinx taxpayers in the sample fall within this top income group. Without a sufficient sample size, it is not possible to generate reliable estimates.

[6] The lowest-income 20 percent of income earners are projected to receive a tax cut equal to 0.6 percent of their incomes; whereas the middle 20 percent are projected to receive a tax cut equal to 1.8 percent of their incomes, and the top 1 percent of income earners will receive a tax cut equal to 2.5 percent of their incomes. The skewed effect of the tax change is more dramatic when viewed in pure dollar terms: The average federal tax cut for the highest-income 1 percent of Massachusetts taxpayers is projected to be $72,730, whereas the average tax cut for the middle 20 percent of taxpayers is $1,080 and the average tax cut for the bottom 20 percent is $90. See Institute on Taxation and Economic Policy, "Extension of the New Tax Law's Temporary Provisions Would Mainly Benefit the Wealthy" (state tables download), April 2018.

[7] Institute on Taxation and Economic Policy, "Extension of the New Tax Law's Temporary Provisions Would Mainly Benefit the Wealthy" (state tables download), April 2018.

[8] These five progressive state tax systems have top tax rates of 13.3 percent, 8.97 percent, 8.97 percent, 8.95 percent, and 8.95 percent, respectively. Delaware combines a graduated income tax that has a top rate of 6.6 percent with the absence of a sales tax, increasing the progressivity of the overall system. Among the other states with the 10 most progressive state and local tax systems for individuals are Oregon, New York, and Maryland (which has a similarly high top tax rate when also including county taxes). All three of these states include some form of "millionaire's tax" as part of their overall tax systems.