

July 14, 2005

FACTS AND CLAIMS ON TAX LOOPHOLES

On July 13, the Associated Industries of Massachusetts (AIM) issued a release on tax loophole legislation currently pending in the Senate. Below are some of the claims AIM makes in its release, along with a few facts to consider in weighing them.

CLAIM

“... the Legislature has increased state business taxes by more than \$500 million since 2001...”

FACT

AIM arrives at its “more than \$500 million” figure only by including Massachusetts’ decoupling from federal “bonus depreciation” changes enacted in 2002, the effect of which AIM estimates to be \$200 million. Simply put, refusing to allow the federal government to mandate a tax cut here in Massachusetts is not a tax increase; businesses did not experience higher taxes than they had in prior years because Massachusetts exercised control over its own tax system. Indeed, the Commonwealth’s decision was a wise one, for recent research suggests that the federal “bonus depreciation” changes were ineffective in stimulating investment.¹

Just as importantly, data compiled by the Council on State Taxation, a national trade association that represents over 500 multi-state and multi-national businesses, show that for FY 2004 (i.e. after many of the changes about which AIM complains in its release had taken effect), state and local business taxes as a share of private sector gross state product in Massachusetts was lower than in all but nine states. (For the Commonwealth, state and local business taxes were 3.9 percent of state private sector GSP and for the nation as a whole, they were 4.7 percent. In dollar terms, this difference may exceed \$2 billion.) Thus, even once all of the changes adopted in the last few years have been fully implemented, it is likely that Massachusetts will still have a business tax burden considerably lower than most states.

Finally, reforms to the corporate excise and other taxes over the past several years can not be accurately described as tax increases. Such reforms were adopted to prevent multi-state businesses and other sophisticated taxpayers from devising schemes that followed the letter of the law, but clearly violated its spirit. Businesses that, year after year, comply with both the letter and the spirit of the law have seen no change in their tax liabilities due to reforms such as closing the passive investment company loophole.

¹Gleckman, Howard and Miller, Rich, “A Misbegotten Tax Break”, *BusinessWeek*, March 21, 2005.

CLAIM

“Now that the Commonwealth has closed the most recent fiscal year with over \$1B in surplus revenue, a further increase in business taxes would only reinforce the perception that Massachusetts is not a business friendly state.”

FACT

The semblance of a surplus in FY 2005 should not stop the Commonwealth from addressing shortcomings in its tax code that allow profitable businesses and other sophisticated taxpayers to avoid millions of dollars each year in taxes. Importantly, substantial claims against the higher than expected FY05 revenue total already exist, both in the form of costs associated with supplemental appropriations and the need to compensate for the use of temporary sources of revenue to support FY05 spending. Once those factors are taken into account, the preliminary surplus is closer to \$200 million.

Moreover, if there is a surplus, it has occurred primarily because the Commonwealth has reduced spending for essential services by approximately \$3 billion over the past several years. To take just one example, state funding for higher education, adjusted for inflation, has fallen 22 percent since the start of the fiscal crisis. Restoring such funding would be a far better investment in the Commonwealth’s economic future than permitting tax avoidance to continue unabated.

As to the alleged perception that Massachusetts is not a business friendly state because of changes in tax law, the above data from the Council on State Taxation indicates that the business tax burden in Massachusetts is actually well below that of other states.

CLAIM

“H. 4169 contains a very undesirable element ... a deeds excise provision that will levy a new tax when a taxpayer acquires control of an entity of any size that counts realty among its assets.”

FACT

H. 4169 does not impose any new tax – it simply seeks to ensure that the current deeds excise is applied to all of the transactions to which it ought to be applied. If a family sells their home, they must pay the deeds excise on that transaction. Businesses should not receive any different treatment, yet a loophole in existing law permits them to avoid the deeds excise by transferring ownership of a piece of property to a sham subsidiary and selling that subsidiary instead.

H. 4169 would close this loophole and thus would save the Commonwealth \$20 million each year, revenue that could be devoted to purposes such as housing programs, which have been cut dramatically in the wake of Massachusetts’ fiscal crisis. Just as importantly, this loophole can be closed without having an adverse impact on affordable housing or future economic development.