



FREDERICK A. LASKEY  
COMMISSIONER

*The Commonwealth of Massachusetts*

*Department of Revenue*

*51 Sleeper Street*

*P.O. Box 9494*

*Boston, MA 02205-9494*

February 9, 2000

Ms. Sarah Cutchins  
Senate Committee on Ways and Means  
State House, Room 212  
Boston, MA 02133

Dear Ms. Cutchins:

Attached, per your request, is an analysis of the initiative petition and Governor's proposal that would reduce the income tax rate to 5.0% over three years.

I hope you find this analysis useful. Please do not hesitate to call me at 626-2201, or Howard Merkowitz, Director of the Office of Tax Policy Analysis, at 626-2100, if you have additional questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Fred A. Laskey".

Frederick A. Laskey  
Commissioner

Cc: Representative John H. Rogers  
Senator Marian Walsh  
Joe Doherty, Senate Committee on Ways and Means  
Paul Romary, House Committee on Ways and Means

# Massachusetts Department of Revenue Revenue Impact Analysis

## Reduce the Rate on Part B and Part A Income to 5.0% over Three Calendar Years

**Bill Number & Title:** Reduce the Massachusetts Personal Income Tax Rate to 5.0%

**Category:** Personal Income Tax

**Origin/Sponsor:** Initiative Petition/Governor's Proposal

**Effective Date** Phased in starting January 1, 2001

**Current Law/Proposed Change:** In calendar year 1999, the tax rate on Part A and Part B income was 5.95%. Under current law, the rate was reduced to 5.85% for the calendar year 2000, and will be declining to 5.80% in calendar year 2001 and 5.75% in calendar year 2002. This proposal would replace these tax rates with a reduction to 5.00% over three years, starting in 2001. These changes to the current schedule are summarized in Table 1.

Part B income includes all taxable income that is not dividends, capital gains, or interest from non-Massachusetts banks. Primary sources of Part B income include wages, salaries, sole proprietorships, partnerships, S-corporations, trusts, and interest from Massachusetts banks. Part A income includes interest and dividend income, but excludes capital gains. Since January 1, 1999, Part A income has been taxed at the same rate as Part B income. In tax year 1996, approximately 2.35 million taxpayers reported taxable Part B income, and 800,000 taxpayers reported taxable Part A income (almost all of these taxpayers also had Part B taxable income). Given recent growth in the taxpayer population, by the year 2000, more than 2.5 million taxpayers would experience a tax reduction under this proposal.

**Table 1  
Current and Proposed Part B and Part A Income Tax Rates**

<u>Tax Year</u>	<u>Current Part B Tax Rate</u>	<u>Proposed Part B Tax Rate</u>	<u>Change</u>
1999	5.95%	5.95%	-
2000	5.85%	5.85%	-
2001	5.80%	5.60%	0.20%
2002	5.75%	5.30%	0.45%
2003 and after	5.75%	5.00%	0.75%

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**Methodology/Data Source/History:** To estimate the revenue impact of these proposals, we first estimated taxable Part B income for 1997 to 1999 based on preliminary tax return data for tax year 1996 and actual revenue collections for 1997 - 1999. We then forecast taxable Part B income for fiscal years 1999 through 2004. A 5% growth rate over this period was used, based on the most recent economic forecasts of the WEFA Group, the New England Economic Project (NEEP), Data Resources Incorporated (DRI), and Regional Financial Associates (RFA) for wage and salary income growth over the fiscal 1999 - 2005 period. A range of +/- two percentage points was constructed to account for the uncertainty present in this or any other forecast of economic activity. As a result, the estimates assume 3% - 7% annual taxable Part B income growth.

We then adjusted these forecasts of taxable Part B income for the doubling of personal exemptions that was enacted in July 1998, and fully phased in as of January 1, 1999. From this forecast, we were able to calculate tax revenues under the current three year roll-back to the 5.75% rate that began on January 1, 2000. The revenue impact of this proposal is the difference between the forecast of Part B tax collections under the current rate and the forecast under the proposed rates.

We also forecast interest and dividend income for fiscal years 1999 - 2004, based on preliminary 1996 tax return data, actual collections for 1997, 1998 and 1999, and forecasts of WEFA, NEEP, DRI, and RFA. The growth rates for interest and dividend income ranged from 1.5% to 4.3% over the fiscal 1999 to 2004 forecast period.

**Tax and Fiscal Year Static Revenue Impact:** Tables 2,3 and 4 summarize the tax cut from the proposed roll back for Part B, Part A and the total for both Parts B and A, respectively. Note that the proposal would take effect half-way through FY01. The tax loss that year is for the second half of the year.

**Table 2**

#### Revenue Impact of Reducing Personal Income Tax Rate to 5% Over Three Years Beginning January 1, 2001 (in \$ millions)

##### PART B Income

	<u>Tax Year Impact</u>			<u>Fiscal Year Impact</u>		
	Lower Bound	Midpoint	Upper Bound	Lower Bound	Midpoint	Upper Bound
2001	247	<b>263</b>	279	124	<b>132</b>	140
2002	574	<b>623</b>	674	411	<b>443</b>	477
2003	986	<b>1,092</b>	1,206	780	<b>858</b>	940
2004*	1,016	<b>1,149</b>	1,294	1,001	<b>1,120</b>	1,250

\*First Fiscal year fully implemented

**Massachusetts Department of Revenue  
Revenue Impact Analysis**

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Reduce the Rate on Part B and Part A Income to 5.0% over Three Calendar Years

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**Table 3**

**Revenue Impact of Reducing Personal Income Tax Rate to 5%  
Over Three Years Beginning January 1, 2001 (in \$ millions)**

**Part A Income**

	<u>Tax Year Impact</u>			<u>Fiscal Year Impact</u>		
	<u>Lower Bound</u>	<u>Midpoint</u>	<u>Upper Bound</u>	<u>Lower Bound</u>	<u>Midpoint</u>	<u>Upper Bound</u>
2001	6	<b>8</b>	10	3	<b>4</b>	5
2002	17	<b>19</b>	21	12	<b>14</b>	15
2003	30	<b>33</b>	36	24	<b>26</b>	29
2004*	31	<b>34</b>	37	30	<b>33</b>	37

\*First fiscal year fully implemented

**Table 4**

**Revenue Impact of Reducing Personal Income Tax Rate to 5%  
Over Three Years Beginning January 1, 2001 (\$ millions)**

**Part B and Part A Income Combined**

	<u>Tax Year Impact</u>			<u>Fiscal Year Impact</u>		
	<u>Lower Bound</u>	<u>Midpoint</u>	<u>Upper Bound</u>	<u>Lower Bound</u>	<u>Midpoint</u>	<u>Upper Bound</u>
2001	255	<b>271</b>	288	127	<b>135</b>	144
2002	591	<b>642</b>	696	423	<b>457</b>	492
2003	1,016	<b>1,125</b>	1,243	803	<b>883</b>	969
2004*	1,047	<b>1,183</b>	1,332	1,031	<b>1,154</b>	1,287

\*First fiscal year fully implemented

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**Confidence Level:** These estimates are based on actual tax return data for tax year 1996 and actual collections amounts for fiscal years 1997 through 1999. As a result, the calculations of the near-term impact of the rate reduction should be accurate. However, because these proposals would be phased-in over five years and would not be fully effective until fiscal year 2004, our estimates are based on forecasts of taxable income growth of between 3% and 7% per year for Part B income and +/-10% from the midpoint forecast for interest and dividend income. To the extent that income growth falls short of or exceeds these ranges, the estimates would need to be revised.