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Massachusetts Tax Relief Package Is a Step in the Right Direction

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Massachusetts still has a long way to go to modernize its tax infrastructure, but the decision to enact the first comprehensive tax relief package in more than 20 years removes some of the most obvious tax downsides of living and investing there.

The package includes 17 relief provisions for businesses, estates, and individuals. The total estimated cost of the tax expenditures is $951 million, $571 million of which is attributable to fiscal year 2024.

Some provisions, such as the transition to single sales factor apportionment, are a significant departure from Massachusetts' current tax system. Other components, such as the reduced short-term capital gains rate, are more modest changes that represent the concessions required for major tax reform.

Single Sales Factor Apportionment

The package mandates single sales factor apportionment for corporate income tax purposes starting Jan. 1, 2025. Although this is a tax expenditure, supporters maintain that it will help Massachusetts to attract and retain employers.

Not every out-of-state company will applaud the transition—companies with minimal Massachusetts payroll and property likely will see their liabilities increase. The switch to single sales factor makes relocating to Massachusetts a tax-neutral decision for these companies, but it doesn't necessarily create a tax incentive to relocate.

Consequently, single sales factor might not lead to major corporate relocations to Massachusetts even though it brings the commonwealth closer to the tax rules of other states.

Estate Tax Cap

Massachusetts' $1 million estate tax exemption was tied for the lowest in the country. The package increases the estate tax exemption to $2 million and introduces a uniform estate tax credit starting Jan. 1, 2023.

This change not only eliminates Massachusetts estate tax liability for taxable estates between $1 million and $2 million, but also eliminates the "cliff effect" of the prior law through a $99,600 uniform estate tax credit. Gov. Maura Healey (D) said the increase intends to "reduce the tax burden on smaller estates, which historically have filed over 70% of estate tax returns."

The increase is a major change in estate tax policy, but crystallizing the exemption at a set dollar figure creates the same vulnerabilities as the prior system. While $2 million might seem like a generous exemption today, inflation will erode the significance of the increased cap for middle-class families.

Short-Term Capital Gains Rate

Massachusetts' short-term capital gains rate of 12% was among the highest state income tax rates in the country. The tax package reduces the short-term capital gains rate to 8.5% starting Jan. 1, 2023. Although the House proposed to reduce the rate to 5% over two years, the final bill split the difference—business-oriented proponents and progressive opponents of cutting the rate are both dissatisfied with this compromise.

An 8.5% rate is still punitive on a category of income that's arguably "derived from the same class of property" as long-term capital gains. Whereas the federal tax code rewards long-term capital gains through a lower tax rate, Massachusetts punishes short-term gains at a higher rate and imposes the standard 5% rate on long-term gains.

This discrepancy with federal tax policy—rather than the difference between long-term and short-term rates—presents the most significant obstacle to high-net-worth individuals who are considering investing in the commonwealth.

Family Assistance

The package includes several tax breaks directed toward lower-income residents. These provisions—including a child and dependent tax credit, an increased earned income tax credit match, an increased senior circuit breaker credit, and an increased renters' deduction—received bipartisan support in the House and Senate.

Joint Filing Requirement

The package requires individual taxpayers to file a joint Massachusetts return when filing a joint federal return starting Jan. 1, 2024. This provision closes a loophole that married couples might have used to avoid or mitigate the newly approved 4% millionaires' surtax.

Because the relevant Massachusetts constitutional amendment refers to an "additional tax of 4% on that portion of annual taxable income in excess of $1,000,000 (one million dollars) reported on any return related to those taxes," wealthy couples have considered jointly filing at the federal level, but separately in Massachusetts, starting in 2023.

The new law likely will be challenged, but there's nothing in the constitutional amendment that constrains the commonwealth's ability to require state conformity with an individual's federal filing status.

Pass-Through Entity Tax Analysis

The current pass-through entity excise tax rate is 5%, which is equal to the standard individual income tax rate. The package requires the Department of Revenue to analyze the feasibility and potential impact of a new pass-through entity excise tax rate of 4%, which is designed to allow individuals subject to the 4% millionaires' surtax to benefit from a supplemental PTE excise election.

Pending the results of the Department of Revenue's analysis, the legislature likely will consider additional legislation to enable pass-through entities to make supplemental allocations of 4% PTE excise credits to high-income members.

Although it's aimed at high-income taxpayers, a supplemental PTE excise credit shouldn't be very controversial because it's likely to be as revenue neutral as the standard credit.

Outlook

The extent to which the $951 million in estimated tax expenditures will stimulate new investment in the commonwealth remains to be seen, but business groups, policy leaders, and practitioners are generally optimistic about the changes.

The compromise bill illustrates the ability of the governor and the legislature to build consensus around a central theme of competitiveness and tax relief, even if some of the provisions are less generous than those originally proposed.

The governor, legislature, and Department of Revenue must devote more time to paring down the idiosyncrasies and anachronisms of Massachusetts' tax system, but the package is a significant step forward.

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