

Tax Expenditure Review Commission Public Meeting Minutes
November 15, 2023
Via Zoom
1:30PM

Commission Members in Attendance:

Chairperson Rebecca Forter, MA Department of Revenue
Sue Perez, Designee, MA Treasurer
Stephen Maher, Designee, Joint Revenue Committee, Senate Co-Chair
Hailey Jenkins, Designee, Senate Ways and Means Committee
Representative Michael Soter, Designee, House Minority Leader
Stephen Lisauskas, Designee, MA Auditor
Professor Michelle Hanlon, Governor's Appointee
Professor Matthew Weinzierl, Governor's Appointee

Commission Members Absent:

Tim Sheridan, Designee, House Ways and Means Committee
Ryan Sterling, Designee, Joint Revenue Committee, House Co-Chair
Senator Bruce Tarr, Senate Minority Leader

List of Documents:

- I. Meeting Agenda
- II. Draft Minutes – October 12, 2023 Meeting
- III. Revisit June and October Draft Reports of Tax Expenditures
 - i. Exemption for Steam
 - ii. Dairy Farmer Tax Credit
- IV. November Draft Reports of Tax Expenditures
 - i. Expensing of Certain Capital Outlays of Farmers
 - ii. Exemption of Employer Contributions to Accident and Health Plans and Certain Benefits Received
 - iii. Self-Employed Health Insurance Deduction
 - iv. Exemption for Medical and Dental Supplies and Devices Including Breast Pumps
 - v. Exemption of Public Assistance Benefits
 - vi. Exemption of Workers' Compensation Benefits

Chairperson Forter welcomed Commission members. Members were asked to announce themselves and a quorum was recognized by Chairperson Forter. The meeting via Zoom was called to order at 1:34PM. Chairperson Forter put the Commission and public on notice that the meeting is recorded for the purpose of meeting minutes. The recording of the meeting will be kept for public record.

Chairperson Forter stated that the Exemption for Steam was briefly discussed during the June meeting, but the Commission had not voted to approve the evaluation template; Professor Hanlon continued the discussion on this tax expenditure. The exemption was adopted in 1971 & 1990 and has an annual revenue impact of \$0.6M-\$0.7M during FY20-FY24 with no sunset date. The tax expenditure provides a sales and use tax exemption for sales of (i) steam used for residential purposes, (ii) steam

purchased for use by certain small businesses and (iii) steam purchased for use in an industrial plant subject.

Most states that impose a sales and use tax exempt sales of steam used in residences or industrial plants, at least in part. Connecticut, Maine, New York and Rhode Island provide exemptions for residential and industrial users. California and Vermont exempt only residential use. The Commission is not aware of any other state that provides an exemption for purchases of steam by small businesses. The Commission assumes that the goal of the expenditure is to shield households, small businesses, and manufacturers from sales and use tax on steam, which is often used for residential, heating, or manufacturing purposes. The Commission further assumes that steam used in manufacturing is exempt in order to avoid pyramiding of the sales and use tax.

Members noted that steam is typically generated by a third party (either the seller or a vendor of the seller) at a generation facility using oil or natural gas and delivered via a piping system to the customer. By encouraging the usage of steam, this expenditure could have a negative environmental impact and may discourage the use of other “greener” energy sources. Members had also discussed the narrow market for steam in Massachusetts and questioned whether the purchase of steam should be incentivized. It is not known how many MA taxpayers benefit from this tax expenditure. Steam is often purchased by customers in the health, government, and hospitality industries for myriad purposes, e.g., power generation, process needs, heating and cooling, sterilization, etc. Members voted to approve the Exemption for Steam evaluation template with a change to “Yes” on the question whether to flag this tax expenditure for legislative review.

Hailey Jenkins and Professor Weinzierl led a discussion on the Dairy Farmer Tax Credit. This tax expenditure was adopted in 2008 and has an annual revenue impact of \$4.8-\$5.0 million for personal income and \$1.0-\$1.1 million for corporate and business tax during FY21-FY25 with no sunset date. Massachusetts provides dairy farmers registered with the Massachusetts Department of Agricultural Resources (MDAR) a refundable personal income tax or corporate excise credit to offset cyclical downturns in milk prices. The credit is determined under regulations issued by the MDAR. The credit is triggered for any taxable year in which aggregate milk production costs (as determined by MDAR) exceed aggregate milk prices (also as determined by MDAR) in at least one month. The credit is based on the difference between production costs incurred by farmers (referred to as the farm price of the milk) and the price of milk established by the MDAR. The credit is determined on a statewide basis and is allocated to taxpayers based on the amount of milk they produced and sold. The MDAR determines the credit and notifies the Department of Revenue (DOR) of the amount of credit awarded to each taxpayer. At the time the summary report for this tax expenditure was drafted the total credits that could be awarded across the state could not exceed \$6 million in any year. Members noted that that tax credit annual cap recently increased from \$6 million to \$8 million. The credit is fully refundable but cannot be sold or transferred. In the absence of the credit dairy farmers would be exposed to fluctuations in milk prices that might provide a disincentive for them to start new dairy farms or continue existing dairy businesses.

States offer a variety of tax incentives for taxpayers engaged in agriculture, including dairy farming. However, it appears that Louisiana is the only other state that offers dairy farmers a credit to offset downturns in milk prices. The Commission assumes that the tax expenditure is intended to offset the effect of cyclical downturns in milk prices on Massachusetts dairy farmers, thereby helping to ensure a stable supply of local dairy products.

Members voted to approve the Dairy Farmer Tax Credit evaluation template with (i) a change to “Somewhat Agree” on the question whether we can measure the overall benefit toward achieving the goal, (ii) a change to “Somewhat Disagree” on the question whether the tax expenditure’s benefit justifies its fiscal cost, (iii) a change to “Somewhat Agree” on the question whether the tax expenditure is relevant today, and (iv) additional comments noting that Massachusetts is not a leading state in dairy farming and that it may be worthwhile to observe other states’ programs more closely as there may be more efficient or effective ways to support dairy farmers.

Chairperson Forter led a discussion on the Expensing of Certain Capital Outlays of Farmers. This tax expenditure was adopted in 1954 and has an annual revenue impact of \$0.2-\$0.3 million during FY21-FY25 with no sunset date. The expenditure results from Massachusetts’ conformity to the Internal Revenue Code (Code) with regard to the immediate deduction allowed to farmers for soil and water conservation expenses, prevention of erosion, endangered species recovery, and fertilizer costs. Such items might otherwise have to be capitalized and depreciated or amortized over a number of years. Code §§ 175 and 180 provide exceptions to the capitalization requirement for expenses incurred by farmers for (i) soil and water conservation expenses and (ii) fertilizer costs, respectively.

Code § 175 allows a deduction for soil and water conservation expenses in the year they are incurred even if the conservation measures provide a benefit over a number of years. The deduction cannot exceed 25% of a taxpayer’s gross income derived from farming. To qualify for an immediate deduction, expenses must be consistent with a plan approved by the federal Department of Agriculture or a similar state agency. Eligible expenses include amounts paid for (i) the treatment or movement of earth, including leveling, grading and terracing, (ii) contour furrowing, (iii) the construction, control, and protection of diversion channels, drainage ditches, earthen dams, watercourses, outlets, and ponds, (iv) the eradication of brush, (v) the planting of windbreaks, and (vi) expenses incurred in preserving endangered animal species under a recovery plan approved pursuant to the federal Endangered Species Act of 1973.

Code § 180 allows the immediate deduction of fertilizer costs even if the fertilizer’s effect lasts for multiple years. There is no limit on the amount of the deduction and no requirement that the expenses be approved by any federal or state agency. Massachusetts generally adopts the business expense deductions allowed under the Code, including the federal deduction allowed to farmers for soil and water conservation expenses and fertilizer costs.

States that base their personal and corporate income taxes on the Code allow the immediate deduction of soil and water conservation expenses and fertilizer costs unless they decouple from the Code with respect to the deduction. The Commission is not aware of any state that has decoupled. States that adopt the deduction include California, Connecticut, Maine, New Hampshire, New York, Rhode Island, and Vermont. The Commission assumes the goal of the tax expenditure is to support farmers by allowing an immediate deduction for conservation and fertilizer expenses, thereby encouraging participation in the agricultural industry, decreasing farmers’ production costs, and encouraging farmers to undertake certain conservation efforts.

Members noted that the benefit of this tax expenditure is difficult to quantify because DOR does not have data on the number of individuals claiming it, or the amount per claim. Members agreed that the federal deduction is a meaningful incentive, but it is less clear that the addition of the state deduction moves the needle at all. Furthermore, it’s not entirely clear why investments in conservation and expenditure on fertilizer are both included in this tax expenditure, but perhaps this is best thought of as a

rule that is offsetting the general distortion on investment in farming due to the excise tax. Members agreed to approve the Expensing of Certain Capital Outlays of Farmers evaluation template as presented.

Professor Weinzierl led a discussion on the Exemption of Employer Contributions to Accident and Health Plans and Certain Benefits Received. This tax expenditure was adopted in 1973 and has an annual revenue impact of \$1,235-\$1,489 million during FY21-FY25 with no sunset date. Massachusetts conforms to the federal individual income tax exclusions (i) for employer contributions to employees' accident and health plans and (ii) benefits received by employees from such plans.

The federal exclusion for employer contributions to accident and health plans results from Code § 106. The term "accident or health plans" includes not only health insurance but also accidental death and dismemberment insurance, short-term and long-term disability coverage, and coverage through reimbursement arrangements such as health care flexible spending accounts (FSAs) and health reimbursement accounts (HRAs). The exclusion is generally available up to a statutory limit specified for each type of plan. Note that Massachusetts law may require employer-provided accident or health plans to offer coverage beyond what is excludable under Code § 106.

Code § 105 provides exclusions for the value of benefits received by employees under an accident and health plan. The exclusion generally applies to health care services received under such a plan, so long as the services would be eligible for the federal medical expense deduction under Code § 213. Amounts received due to accidents are generally excludable if the accident results in the permanent loss or loss of use of a part of the body, or permanent disfigurement. Compensation for absence from work is generally not eligible for the exclusion. Note that Code §§ 105 and 106 contain technical rules preventing discrimination in favor of highly compensated employees and requiring minimum participation thresholds among employees.

All states that impose a personal income tax adopt the expenditure unless they decouple from Code §§ 105 and 106. California has decoupled from the federal exclusion for the limited purpose of including in employee income certain employer contributions to medical savings accounts. Rhode Island allows a slightly expanded exclusion, covering employer contributions to certain medical savings accounts beyond the exclusion allowed under the Code. Connecticut, Maine, New York, and Vermont conform to the federal exclusion. The Commission assumes the goal of the expenditure is to promote employees' participation in employer-sponsored accident and health plans by reducing employees' after-tax cost of participation.

Members agreed that given the enormous revenue impact of this tax expenditure, it is important for policymakers to understand its effects and whether it continues to be an efficient way to subsidize access to coverage. Members agreed to flag this tax expenditure for legislative review. Missing from the current DOR report is a discussion of this tax expenditure's distortion of the market for health insurance. The exemption lowers the cost of health insurance relative to wages, so employers and employees are incentivized to purchase more generous health insurance plans than they would in an undistorted market. Members voted to approve the Exemption of Employer Contributions to Accident and Health Plans and Certain Benefits Received evaluation template with a change to "Yes" on the question whether to flag this tax expenditure for legislative review.

Professor Hanlon led a discussion on the Self-Employed Health Insurance Deduction. This tax expenditure was adopted in 1986 and has an annual revenue impact of \$44-\$49 million during FY21-FY25

with no sunset date. Massachusetts adopts the trade or business expense deductions allowed under the Code for personal income tax purposes.

Code § 162(l) allows self-employed individuals to deduct the amount they pay for health insurance for themselves, their spouses, their dependents that are family members, and their children under the age of 27. The deduction cannot exceed the taxpayer's earned income derived from self-employment and must be reduced by any applicable federal credit that the taxpayer claims for health insurance. Because of the Commonwealth's reliance on the Code for purposes of determining deductible trade or business expenses, Massachusetts allows self-employed taxpayers a deduction for health insurance costs equal to the federal deduction. The revenue that is lost as a result of the deduction constitutes a tax expenditure.

All states that impose an income tax adopt the expenditure, unless they decouple from Code § 162(l). The Commission is not aware of any state that has decoupled. States that adopt the expenditure include California, Connecticut, Maine, New York, Rhode Island, and Vermont. The Commission assumes the goal of the expenditure is to encourage taxpayers to start or continue businesses by allowing self-employed taxpayers a deduction for health insurance similar to the exclusion for health insurance benefits that is available to employees.

Members voted to approve the Self-Employed Health Insurance Deduction evaluation template with an additional comment. The Commission agreed not to flag this tax expenditure for legislative review but agreed that it is important for policymakers to understand its effects and whether it continues to be an efficient way to subsidize access to coverage.

Hailey Jenkins led a discussion on the Exemption for Medical and Dental Supplies and Devices Including Breast Pumps. This tax expenditure was adopted in 1967 and has an annual revenue impact of \$638.0-\$818.5 million during FY21-FY25. Massachusetts provides a sales and use tax exemption for sales of certain medicines, medical supplies and devices, and dental supplies and devices, as set forth in M.G.L. c. 64H, §§ 6(l) and 6(z).

Section 6(l) exempts a specified list of products related to health care. Some listed items are described narrowly (e.g., blood plasma and ultrasonic nebulizers), while others more broadly cover a category of products (e.g., "equipment worn as a correction or substitute for any functioning portion of the body"). Some of the items listed require a prescription from a registered physician to qualify for the exemption (e.g., medicine and medically necessary breast pumps), while others do not (e.g., oxygen and baby oil). In addition to the exemptions set out in § 6(l), § 6(z) exempts sales of medical supplies that are needed as the result of a colostomy or ileostomy operation.

In general, medical supplies and devices that are not expressly listed in §§ 6(l) or 6(z) are not exempt from the sales and use tax. However, in administering the exemption, the DOR has ruled that certain items not specifically designated as exempt under § 6(l) may nonetheless be exempt if their purpose and function is sufficiently connected to items that are specifically enumerated in the statute. See Letter Ruling 14-3. For example, in Letter Ruling 02-6, the DOR ruled that sales of water filtration system equipment and various supplies necessary for the process of kidney dialysis were exempt, even though they are not expressly listed in the statute, because the dialysis machines themselves were exempt. Revenue that is lost as a result of the sales tax exemption constitutes a tax expenditure. Absent the exemption afforded by this tax expenditure, all sales of medicines, medical supplies and devices, and dental supplies and devices would be subject to sales and use tax.

Most states provide a sales and use tax exemption for various health care products. All of the New England states that impose a sales tax, and California and New York, have sales tax exemptions for certain health care products. The scope of these exemptions varies from state-to-state. Certain products are generally exempt, such as prescription medications, blood products, oxygen products, and devices for persons with physical disabilities. Other products, such as breast pumps and glucose monitoring supplies and devices, are only exempt in some states. For example, sales of breast pumps are exempt in Connecticut, New York, and Rhode Island, but are taxable in California, Maine, and Vermont. Sales of glucose monitoring supplies and devices are exempt in Connecticut, Maine, New York, Rhode Island, and Vermont, but only partly exempt in California. The Commission assumes the expenditure is intended to remove the sales and use tax burden on certain medicines, medical supplies and devices, and dental supplies and devices, which are considered necessary for the health and well-being of the public.

Members noted that DOR receives a high volume of inquiries about whether certain items are exempt. Members further discussed the broad scope of this tax expenditure and its high revenue impact and agreed to flag it for legislative review. Members agreed to approve the Exemption for Medical and Dental Supplies and Devices Including Breast Pumps evaluation template with additional comments noting that it may be worthwhile to periodically revisit and update the exemption.

Sue Perez led a discussion on the Exemption of Public Assistance Benefits. This tax expenditure was adopted in 1971 and has an annual revenue impact of \$877.5-\$1,293.1 million during FY21-FY25 with no sunset date. Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, public assistance benefits are excluded from gross income.

The exclusion applies to payments (i) made by a governmental welfare fund; (ii) for the promotion of the general welfare (i.e., based on individual or family need, including financial or employment status); and (iii) not made for services furnished by the recipient. Because of the Commonwealth's reliance on the Code for purposes of determining income, public assistance benefits are not included in gross income for Massachusetts tax purposes. The revenue lost by not taxing public assistance benefits constitutes a tax expenditure.

All states that impose an income tax adopt the expenditure, unless they decouple from Code § 61. The Commission is not aware of any state that has decoupled. States that adopt the expenditure include California, Connecticut, Maine, New York, Rhode Island, and Vermont. The Commission assumes the goal of the expenditure is to prevent the benefits of public assistance from being diminished by subjecting them to income tax.

Members voted to approve the Exemption of Public Assistance Benefits evaluation template with a change to "Strongly Agree" on the question whether the tax expenditure is primarily beneficial to lower income taxpayers.

Chairperson Forter led a discussion on the Exemption of Workers' Compensation Benefits. This tax expenditure was adopted in 1954 and has an annual revenue impact of \$45.8-\$53.0 million during FY21-FY25 with no sunset date. Due to Massachusetts' reliance on the Code for purposes of determining income, amounts received under workers' compensation acts as compensation for personal injuries or sickness are excluded from gross income.

Code § 104 provides that gross income does not include “amounts received under workmen’s compensation acts as compensation for personal injuries or sickness.” Because of the Commonwealth’s reliance on the Code for purposes of determining income, amounts received as workers’ compensation for personal injuries or sickness are not included in gross income for Massachusetts tax purposes. The revenue lost by not taxing workers’ compensation payments constitutes a tax expenditure.

All states that impose an income tax adopt the expenditure, unless they decouple from Code § 104. The Commission is not aware of any state that has decoupled. States that adopt the expenditure include California, Connecticut, Maine, New York, Rhode Island, and Vermont. The Commission assumes the goal of the expenditure is to prevent amounts received as workers’ compensation for personal injury or sickness from being diminished by subjecting them to income tax.

Members voted to approve the Exemption of Workers' Compensation Benefits evaluation template as presented.

Members discussed the next batch of tax expenditures to be reviewed at the next Commission meeting. Members agreed to schedule the next meeting for mid-January. Chairperson Forter mentioned the Commission is required by statute to submit a report to the legislature by March 1, 2024 and that DOR will distribute a draft report for review following the January meeting. Members agreed to schedule the following meeting in February to review the draft report. Cole Doherty-Crestin will distribute polls to members to determine the next meeting dates. Chairperson Forter concluded the meeting at 2:54PM.