

TAX EXPENDITURE BUDGET

FISCAL YEAR 2000

January 1999

Executive Office for Administration and Finance

Commonwealth of Massachusetts

Fiscal Year 2000 Tax Expenditure Budget: Table of Contents

I. Introduction to the Tax Expenditure Budget

What Are Tax Expenditures?..... 1

Defining the Basic Tax Structure 2

Description of the Data..... 4

Data Limitations..... 4

Reading the Budget..... 5

II. The Personal Income Tax

Personal Income Tax: Basic Structure..... 6

Computation of the Personal Income Tax..... 8

Types of Tax Expenditures under the Personal Income Tax..... 9

List of Personal Income Tax Expenditures..... 10

III. The Corporate Excise And Other Business Excises

Corporate Excise: Basic Structure..... 26

Computation of Massachusetts Business Corporation Excise..... 28

Types of Tax Expenditures under the Corporate Excise..... 29

List of Corporate Excise Tax Expenditures..... 30

IV. Sales And Use Tax

Sales and Use Tax: Basic Structure..... 40

Computation of Massachusetts Sales and Use Tax by Vendor..... 41

Types of Tax Expenditures under the Sales Tax..... 42

List of Sales and Use Tax Expenditures..... 42

Fiscal Year 2000 Tax Expenditure Budget: Table of Contents

V. Appendices

APPENDIX A: Recent Law Changes Affecting Tax Expenditures..... 55

APPENDIX B: Tax Expenditures Fiscal Year 1997-Fiscal Year 1999..... 58

APPENDIX C: Glossary..... 70

Fiscal Year 2000 Tax Expenditure Budget -- Introduction

While taxes are an essential source of revenue for all state economies, the manner in which they are imposed varies widely from state to state. In its simplest form, a tax is an across-the-board levy on a base, such as income, to which a specific rate applies and for which no modifications exist. Taxes are rarely levied in this manner, however. Instead, most state tax codes incorporate a number of exemptions, deductions, credits, and deferrals designed to encourage certain taxpayer activities or to limit the tax burden on certain types of individuals or endeavors. Known as "tax expenditures," these provisions can have a significant impact on state tax revenues.

This document offers a summary of the tax expenditures affecting three taxes from which Massachusetts derives the bulk of its revenues: the personal income tax, the corporate excise, and the sales and use tax. It also provides revenue estimates for each tax expenditure, as mandated by Massachusetts state law. Organized into five separate sections, this study analyzes all aspects of Massachusetts tax expenditures. The first section contains a detailed explanation of how we identify and estimate the costs of tax expenditure provisions in the tax code. In the next sections we have provided detailed information about each of the three major tax types, including an explanation of how each tax is calculated and the ways in which that tax's basic structure is modified to produce the various types of tax expenditures. The tax expenditures for each tax are listed after the description of the tax.

Following the expenditure listings, there are three appendices: one lists recent law changes that affect this year's tax expenditure budget; a second gives three-year tax expenditure estimates which are consistent with our most recent estimation methodology; the third is a glossary that defines terms used throughout the text. In reviewing this document it is important to remember that although a tax expenditure represents a deviation from the generally agreed-upon, or basic, structure of a given tax, determining whether a provision is a tax expenditure is not the same as making a judgment about its desirability. An element of the basic structure of a tax can be inequitable or have undesirable economic effects, just as a tax expenditure can. If so, it can be changed by legislative action just as a tax expenditure can.

The estimates of the costs of tax expenditures included in this volume are revised annually. As improved methodologies and data become available over the course of the year, some estimates may be reexamined and occasionally revised.

What Are Tax Expenditures?

Tax expenditures are provisions in the tax code, such as exclusions, deductions, credits, and deferrals, that are designed to encourage certain kinds of activities or to aid taxpayers in special circumstances. When such provisions are enacted into the tax code, they reduce the amount of tax revenues that may be collected. In this sense, the fiscal effects of a tax expenditure are just like those of a direct government expenditure. Some tax expenditures involve a permanent loss of revenue, and thus are comparable to a payment by the government; others cause a deferral of revenue to the future, and thus are comparable to an interest-free loan to the taxpayer. Since tax expenditures are designed to accomplish certain public goals that otherwise might be met through direct expenditures, it seems reasonable to

Fiscal Year 2000 Tax Expenditure Budget -- Introduction

apply to tax expenditures the same kind of analysis and review that the appropriations budget receives.

It is essential to distinguish between those provisions of the tax code that represent tax expenditures and those that are part of the "basic structure" of a given tax. The basic structure is the set of rules that defines the tax; a tax expenditure is an exception to those rules. In general, most taxes have a series of features that define their basic structure. These features are:

1. A base, on which the tax is levied, such as net income, or a particular class of transactions;
2. A taxable unit, such as a person or a corporation;
3. A rate, to be applied to the base;
4. A definition of the geographic limits of the state's exercise of its tax jurisdiction; and
5. Provisions for the administration of the tax.

Defining the Basic Tax Structure

A tax expenditure is a deviation from the generally agreed-upon, or basic, structure of a given tax. For example, the base of the sales tax includes all retail sales to final consumers. The exemption for sales of energy conservation equipment is an exception, created to encourage purchases of such equipment. The sales tax that is not collected because of the existence of this exemption, then, is a tax expenditure.

While this general definition seems straightforward enough, the task of compiling a comprehensive list of tax expenditures presents many conceptual problems. For example, some of the deductions and exemptions allowed under the tax statutes are not tax expenditures. The broad category of income tax deductions allowed for business expenses is not listed as a tax expenditure. Since the income tax is generally considered to be a tax on income net of the costs of producing that income, deductions for business expenses are taken against gross income and therefore occur prior to calculation of the tax base. In addition, tax provisions reflecting constitutional prohibitions, such as the prohibition on taxation of sales to the federal government, are considered parts of the basic tax structure and therefore are not properly considered tax expenditures. These distinctions are fairly simple, but more complex analytical questions quickly arise.

For example, deductions for the depreciation of property and equipment used in a trade or business are considered part of the basic tax structure because the use of productive assets is a legitimate cost of doing business. However, federal depreciation rules allow larger depreciation deductions in the early years of a property's useful life. These accelerated depreciation rules could be viewed as properly reflecting changing notions of obsolescence and thus as part of the basic tax structure; or the faster rates of depreciation could be considered a special adjustment in the tax base designed to provide an incentive for investment, and therefore a tax expenditure. Indeed, past federal tax expenditure budgets prepared by the Congressional Budget Office and versions prepared by the Treasury Department have disagreed on exactly this issue.

Fiscal Year 2000 Tax Expenditure Budget -- Introduction

We have adopted the point of view that accelerated depreciation is a tax expenditure. Although accelerated depreciation still allows the same total deduction for a piece of property, the rate of depreciation allowed in the early years is faster than would be permitted under traditional accounting principles. Generally, revenue cost estimates in this document for tax expenditures associated with accelerated depreciation rely on assumptions used in congressional federal tax expenditure analysis concerning ordinary depreciation rates.

We have chosen to view the rules for personal exemptions and for no tax status in the Commonwealth's personal income tax as provisions which help to define the income tax base, and thus as a part of the basic structure of the tax (much as the progressive rate structure of the federal income tax, which similarly reduces the tax burden on low-income people, is a part of its basic structure). The base of the tax is defined as net income above what is required for subsistence. Since personal exemptions help define the amount of income needed for subsistence, and therefore the base, they should not be classified as tax expenditures. According to this reasoning, exemptions allowed for dependents would also be considered part of the basic tax structure, since subsistence requirements increase with the size of the taxpayer's household. However, we note that this view of the tax structure did not always lead to easy conclusions. First, taxpayers are allowed exemptions for dependents even if those dependents have their own income and take personal exemptions for themselves. We have treated the use of the dependents' exemption as a tax expenditure. Second, the fact that the no tax status amount is greater than the personal exemption suggests that the intent behind the no tax status and personal exemptions goes beyond simple definition of an income base. Although personal exemptions and the no tax status are not listed in this document as tax expenditures, estimates for the revenue loss associated with these provisions are provided in an endnote.

The sales tax presents the most difficult case. The sales tax statute and its legislative history indicate that the established base of the tax is all "retail" sales. At a minimum, the sales tax exemptions for business purchases of component parts and of products to be resold appear to be provisions that help define which sales are considered non-retail sales, and therefore should not be classified as tax expenditures. However, it is difficult if not impossible to decide which other sales tax exemptions might also cover non-retail sales. For example, manufacturing companies are allowed an exemption from the sales tax for purchases of machinery used in the production process. Since this machinery is not a direct component part of any product being manufactured and is not purchased simply to be resold, it could be argued that the machinery purchase is a retail sale and that the machinery exemption is a tax expenditure. Others would argue that because these purchases are not purchases by the final consumers of an end product, and because they represent legitimate business expenses, these sales tax exemptions should not be considered tax expenditures.

The Massachusetts sales tax statute is filled with exemptions that do not follow a discernible pattern. For example, manufacturers are exempt from sales tax on machinery but not on motor vehicles, and construction firms are not fully exempt from sales tax on their equipment purchases. Because it is difficult to define the basic tax structure, the discussion of the sales

Fiscal Year 2000 Tax Expenditure Budget -- Introduction

tax in this document is not a conventional "tax expenditure analysis." Instead, virtually all of the exemptions from the sales tax are listed as tax expenditures.

As stated in the introduction, the most important thing to remember is that making a judgment about whether a provision is a tax expenditure is not the same as making a judgment about its desirability. With this in mind, we have attempted to provide more rather than fewer tax expenditure estimates, so that necessary information is available for those charged with making policy judgments.

Description of the Data

This budget should be considered part of an ongoing effort to list tax expenditures, describe their characteristics, and estimate their revenue costs. Each year, we attempt to improve upon the analysis presented in the prior year's tax expenditure budget. For purposes of comparison, we have provided an appendix containing updated tax expenditure estimates for the past two years as well as for Fiscal Year 2000.

Information collected by the Department of Revenue (DOR) from Massachusetts tax returns was an important source of data in this budget. Estimates made from these data tend to be the most reliable. Unfortunately, many tax expenditures cannot be estimated from DOR records. When a particular category of income is excluded from taxation, amounts often do not appear on tax records. This is especially likely to be the case for those tax expenditures brought about by "coupling" the state tax code to the federal code, since exclusions and some deductions are not reported explicitly, but are simply carried over to state tax calculations as part of the reporting of federal income. In such cases we have had to estimate a Massachusetts figure using national tax data, census information, sales statistics, and other information.

You will note that in several cases, this year's revenue estimate is very different from last year's. Revisions to the estimates occur for four reasons: we have new data sources, federal tax expenditure estimates on which we rely have changed, we have refined our estimation methodologies, or changes in Massachusetts tax law have modified existing estimates. In a few instances, more than one of these factors operate to explain the difference. All estimates are projections forward from a base year (which varies depending on the availability of data) to Fiscal Year 2000.

Data Limitations

There are some additional caveats that the reader should keep in mind when reading this budget. Most revenue loss estimates have been made without taking into account how repeal of a provision might change taxpayer behavior. For example, if the sales tax exemption for a particular item were repealed, the item would become more expensive to consumers, so one would expect sales of that item to decline. The revenue gain from repealing the provision would be, therefore, somewhat less than if the level of sales for the affected items remained the same. On the other hand, some of the income not spent on that item might be spent on other taxable items. To the extent that consumers and businesses pay more taxes and have less

Fiscal Year 2000 Tax Expenditure Budget -- Introduction

income available for other purposes, the repeal of a tax expenditure might have much broader economic and revenue effects. Clearly, the full calculation of these effects is very difficult.

Second, the interaction among different taxes and tax expenditures may be quite complex. Repealing some tax expenditures may increase or decrease the value of others. For example, increasing the no tax status amount would mean that fewer people would pay taxes, and thus fewer people would claim other exemptions. This would reduce the revenues lost through other exemptions.

Third, the revenue cost estimates do not generally reflect compliance factors which may significantly reduce revenues available from a tax expenditure repeal. In particular, where Massachusetts tax provisions are "coupled" with federal tax rules, audits of Massachusetts taxpayers generally compare state and federal returns. If Massachusetts tax provisions were "decoupled," taxpayers would have to make separate calculations for Massachusetts tax purposes, and these provisions would require special audit procedures. Compliance difficulties would certainly result.

And fourth, particular caution is appropriate with respect to the tax expenditure budget's totals for expenditures for particular taxes. Not only do these totals reflect the imprecision of the specific estimates, but they also omit those items for which no estimates were available. In consequence, particular totals may be substantially understated. At the same time, included in the totals, particularly with regard to the sales tax, are a number of substantial items that many analysts would regard, not as tax expenditures, but rather as features of the underlying tax itself. The general approach in preparing the tax expenditure budget has been to count questionable items as tax expenditures, so that information concerning them would be available for analysis. The result is that certain of the totals are higher than they would be under a more restrained analytic approach.

Reading the Budget

In this document, tax expenditures and cost estimates are listed according to the taxes to which they pertain: personal income, corporate excise, and sales and use. Each of the three major taxes includes an introductory section with a description of the tax, followed by a listing of the tax expenditures for that tax. Each tax expenditure item includes a brief description, the cost estimate, a statutory citation, and an indication of the tax expenditure's type. Taxes on financial institutions, utilities and insurance companies are not treated separately, and the various special excises on motor fuels, cigarettes, and alcoholic beverages are not covered in this budget.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Although income from professions, trades or employment was taxed throughout the nineteenth century under the local property tax, it was not until 1916, under the authority of Article 44 of the Amendments to the Massachusetts Constitution, that the Massachusetts personal income tax was enacted as a separate tax. Unlike most states with income taxes, Massachusetts applies flat rather than graduated rates, because Article 44 requires that all income of the same class be taxed at the same rate.

Generally, the Massachusetts personal income tax ties into the federal Internal Revenue Code as it was on January 1, 1998. To the extent that the Massachusetts tax takes federal law as its starting point, it adopts many federal tax expenditures.

The personal income tax is the state's largest revenue source, accounting for 57.3% of taxes collected in Fiscal Year.

Personal Income Tax: Basic Structure

Tax Base: The personal income tax base is gross income minus the costs of producing the gross income (trade or business expenses). Massachusetts gross income is defined as federal gross income with certain modifications. Effective January 1, 1996 it was divided into three classes: interest, dividends, and short-term capital gains ("Part A" income); long-term term capital gains ("Part C" income); and all other income ("Part B" income). Massachusetts taxpayers are entitled to a basic personal exemption which varies according to taxpayer status. The exempted amounts are considered to be outside the generally accepted tax base. They reflect the notion that income needed for bare subsistence should be free from tax. Thus, for the purposes of this document, these exemptions are not listed as tax expenditures. In addition, taxpayers whose income is below a specified level are entitled to "no tax status." For the same reason, this status is not listed as a tax expenditure. On the other hand, because policy makers are often interested in the effects of adjusting the dollar amounts for the personal exemptions and the no tax status, estimates are provided for them in endnote 3 to item 1.405 in the list of personal income tax expenditures.

Taxable Unit: Individuals are taxed separately, with the exception of married couples, who may file a joint return. The income of children is not aggregated with that of their parents. The income of trusts, estates and corporate trusts, including partnerships and associations with transferable shares, is also subject to the personal income tax.

Rate Structure: The rate of tax on Part B "earned" taxable income is 5.95%. Effective Jan. 1, 1999 the rate on Part A "unearned" income is also 5.95%. The differential between "earned" and "unearned" income has its roots in the historical origin of the personal income tax. When the personal income tax was adopted, the property and economic activities whose income was subjected to the new statewide tax were simultaneously exempted from the local property tax in order to avoid double taxation. The rates originally established for these classes of income were apparently intended to approximate the previous statewide average burdens of local property taxes on the related properties and activities. Therefore, in this document, this differential rate feature will be treated as part of the basic structure of the tax.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Effective January 1, 1996, Part C income, long-term capital gains, is subject to the following tax rates based on how long the assets are held:

<u>Holding Period</u>	<u>Tax Rate</u>
up to one year	12%
more than one, but less than two years	5%
more than two, but less than three years	4%
more than three, but less than four years	3%
more than four, but less than five years	2%
more than five, but less than six years	1%
more than six years	0%

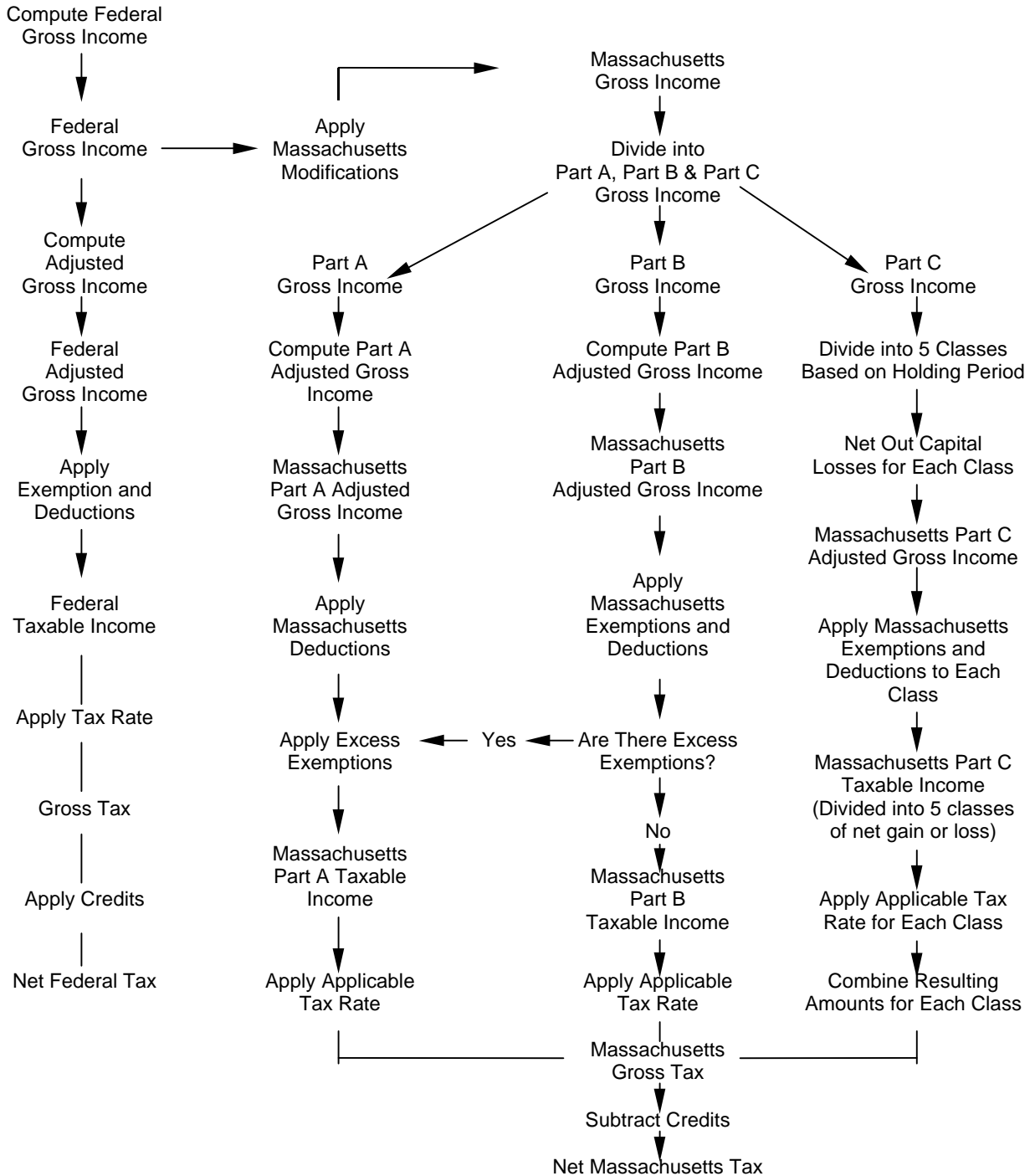
Assets acquired prior to January 1, 1996 are deemed to have been acquired on the later of January 1, 1995 or the actual date of acquisition.

Taxable Period: The taxable period is one year (or less), usually the calendar year. Income may be reported according to the cash or accrual method. Where property is sold on a deferred payment basis, gains may be reported in the years the payments are received. There is no Massachusetts provision for income averaging. Net capital losses may be carried forward to future years.

Interstate and International Aspects: Residents are taxed upon their entire income, whether derived from Massachusetts sources or elsewhere, without allocation or apportionment. Nonresidents are taxed only on income from sources within Massachusetts. A resident may take a limited credit against the Massachusetts income tax for income taxes due to other states, the District of Columbia, any territory or possession of the United States, or Canada or its provinces on any item of Massachusetts gross income.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Computation of the Personal Income Tax



Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Types of Tax Expenditures under the Personal Income Tax

The basic structure of the personal income tax can be modified in a number of different ways to produce tax expenditures. Brief explanations of the various types of tax expenditures follow:

Exclusions from Gross Income: Gross income is the starting point in the calculation of income tax liability and, in the absence of tax expenditures, would include all income received from all sources. Items of income that are excluded from gross income typically are not reported by the taxpayer on his or her tax return, and they escape taxation permanently.

Deferrals of Gross Income: Where an item of income is not included in gross income in the year when it is actually received, but is instead included in a later year, the result is a tax expenditure in the form of an interest-free loan from the state to the taxpayer in the amount of the tax payment that is postponed.

Deductions from Gross Income: Certain amounts are subtracted from gross income to arrive at adjusted gross income (AGI). Many of these deducted amounts reflect the costs of producing income (business expenses), and are not properly part of the income tax base. Such deductions are not tax expenditures. Other deductions which do not reflect business expenses constitute tax expenditures, which permit corresponding amounts of income to escape taxation permanently.

Accelerated Deductions from Gross Income: In a number of cases, taxpayers are allowed to deduct business expenses from gross income at a time earlier than such expenses would ordinarily be recognized under Generally Accepted Accounting Principles. The total amount of the permissible deduction is not increased, but it can be utilized more quickly to reduce taxable income. The result is to defer taxes, thus in effect occasioning an interest-free loan from the state to the taxpayer.

Deductions from Adjusted Gross Income (AGI): Taxable income results from the subtraction of certain deductions and exemptions from AGI. Certain of these subtracted items represent amounts of income necessary for subsistence; their exclusion is part of the basic structure of the income tax. Other subtracted items represent tax expenditures, which permit corresponding amounts of income to escape taxation permanently.

Preferential Rates of Taxation: Generally, all income from the same source is taxed at the same rate. When an item of income is taxed at a rate below the rate ordinarily applied to that class of income, a tax expenditure results. The result is equivalent to excluding a portion of the income from taxation.

Credits Against Tax: After a taxpayer's basic tax liability has been calculated by applying the tax rates to taxable income, the taxpayer may subtract certain credit amounts from this initial liability in determining the actual amount of taxes that must be paid. It is important to note that, whereas a one dollar exclusion or deduction results in a tax savings of only a few cents (one dollar times the applicable tax rate), a one dollar credit results in a one dollar tax savings.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

List of Personal Income Tax Expenditures

1.000 EXCLUSIONS FROM GROSS INCOME

- 1.001 Exemption of Premiums on Accident and Accidental Death Insurance¹
Employer contributions for premiums on accident and accidental death insurance are not included in the income of the employee and are deductible by the employer.

Origin: IRC § 106
Estimate: \$1.5

- 1.002 Exemption of Premiums on Group-Term Life Insurance¹
Employer payments of employee group-term life insurance premiums for coverage up to \$50,000 per employee are not included in income by the employee and are deductible by the employer.

Origin: IRC § 79
Estimate: \$15.4

- 1.003 Exemption of Interest on Life Insurance Policy and Annuity Cash Value
Interest which is credited annually on the cash value of a life insurance policy or annuity contract is not included in the income of the policy holder or annuitant. Only when a life insurance policy is surrendered before death or when annuity payments commence does the interest become subject to tax. (Interest on dividends left on deposit is taxable.)

Origin: IRC § 101
Estimate: \$187.2

- 1.004 Exemption of Employer Contributions for Medical Insurance Premiums and Medical Care¹
Employer contributions for medical insurance premiums and reimbursements for medical care are not included in the income of the employee and are deductible by the employer.

Origin: IRC §§ 105 and 106
Estimate: \$470.5

- 1.005 Exemption of Annuity or Pension Payments to Fire and Police Personnel
Income from noncontributory annuities or pensions to certain retired fire and police personnel or their survivors is tax-exempt.

Origin: M.G.L. c. 32
Estimate: N.A.

- 1.006 Exemption of Distributions from Certain Contributory Pension and Annuity Plans²
Certain pensions and annuity distributions are tax-exempt under

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Massachusetts law. They are payments from contributory plans of the U.S. government, Massachusetts and its subdivisions, and other states which do not tax such income from Massachusetts. The nontaxation of the benefits in excess of contributions taxed by Massachusetts is a tax expenditure.

Origin: M.G.L. c. 62, §§ 2(a)(2)(E) and 3B(a)(4)
Estimate: \$6.4

- 1.007 Exemption of Railroad Retirement Benefits
Railroad retirement benefits are not taxed. (Massachusetts has not adopted Internal Revenue Code section 86, which taxes some of these benefits if a taxpayer's income is above a certain level.)

Comment: No adjustment is made for any prior payments taxpayers may have made to fund this system since employee payments to this system are taxes rather than contributions.

Origin: M.G.L. c. 62, § 2(a)(2)(H)
Estimate: \$4.5

- 1.008 Exemption of Public Assistance Benefits
Public assistance or welfare benefits are not taxed. These include Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI) benefits, and the like.

Origin: Rev. Rul. 71-425, 1971-2 C.B. 76
Estimate: \$95.6

- 1.009 Exemption of Social Security Benefits
Social Security benefits paid to persons age 65 or older and their dependents, to persons under 65 who are survivors of deceased workers, and to disabled workers and their dependents are not taxed. Massachusetts has not adopted Internal Revenue Code section 86, which taxes a portion of these payments where a taxpayer's income is above a certain level.

Comment: The comment under item 1.007 applies to this item as well.

Origin: M.G.L. c. 62, § 2 (a)(2)(H)
Estimate: \$514.2

- 1.010 Exemption of Workers' Compensation Benefits
Workers' compensation benefits are not taxed. These are benefits paid to disabled employees or their survivors for employment-related injuries or diseases.

Origin: IRC § 104 (a)(1)
Estimate: \$4.2

- 1.011 Exemption for Dependent Care Expenses¹

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Day care paid for or provided by an employer to an employee that does not exceed the employee's or employee's spouse's "earned" income, and does not exceed the amount of \$5,000, is not included in the income of the employee and is deductible by the employer.

Origin: IRC § 129
Estimate: \$4.1

- 1.012 Exemption of Certain Foster Care Payments
Qualified foster care payments are not includible in the income of a foster parent.

Comment: The exclusion from income for foster care payments has been expanded in Massachusetts to include payments for foster care individuals age 19 or over.

Origin: IRC § 131
Estimate: \$4.0

- 1.013 Exemption of Payments Made to Coal Miners
Coal miners or their survivors may exclude from income payments for disability or death from black lung disease.

Origin: IRC § 104(a)(1)
Estimate: N.A.

- 1.014 Exemption of Rental Value of Parsonages¹
A minister may exclude from gross income a rental allowance or the rental value of a parsonage furnished to him or her.

Origin: IRC § 107
Estimate: \$3.0

- 1.015 Exemption of Scholarships and Fellowships
Degree candidates can exclude scholarships and fellowship income if the amounts are not compensation for services or for the payment of room, board or travel expenses.

Origin: IRC § 117
Estimate: \$11.5

- 1.016 Exemption of Certain Prizes and Awards
Prizes and awards are generally required to be included in income. The exemption of certain prizes and awards is generally limited to taxpayers who donate the proceeds to a charitable organization. Certain employee achievement awards are also excluded from gross income.

Origin: IRC § 74
Estimate: N.A.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

- 1.017 Exemption of Cost-Sharing Payments
Portions of government cost-sharing payments to assist in water and soil conservation projects are not includible in the recipient's income.

Origin: IRC § 126
Estimate: N.A.
- 1.018 Exemption of Meals and Lodging Provided at Work¹
The value of meals and lodging furnished to the employee by the employer on the business premises for the employer's convenience is not included in the income of the employee. The employer's expenses are deductible.

Origin: IRC § 119
Estimate: \$6.1
- 1.019 Treatment of Business-Related Entertainment Expenses¹
With certain limitations, a business may take a deduction of up to 80% of the cost of business-related entertainment expenses. Generally, the value of the entertainment is not taxed as income to the persons who benefit from the expenditures. The effect is to provide the hosts and their guests with a nontaxable fringe benefit. .

Origin: IRC § 162
Estimate: N.A.
- 1.020 Exemption of Income from the Sale, Lease, or Transfer of Certain Patents
Income from the sale, lease or other transfer of approved patents for energy conservation, and income from property subject to such patents, are excluded from gross income for a period of five years.

Origin: M.G.L. c. 62, § 2(a)(2)(G)
Estimate: N.A.
- 1.021 Exemption of Capital Gains on Home Sales
This expenditure and 1.105 (Deferral of Capital Gains on Home Sales) were changed by the Taxpayer Relief Act of 1997. 1.105 (based on IRC 1034, the roll-over of capital gains on the sale of a home), was repealed. In effect, both 1.105 and 1.021 were replaced with a modified IRC 121. The new IRC 121, which is the basis for Massachusetts tax expenditure 1.021, removed the age requirement and the "one-time-only" limitation. Now taxpayers may exclude up to \$250,000 of capital gain (or \$500,000 if filing jointly) on the sale of a principle residence. This exclusion from gross income may be taken any number of times, provided the home was the filer's primary residence for an aggregate of at least two of the previous five years.

Origin: IRC § 121

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Estimate: \$61.3

- 1.022 Nontaxation of Capital Gains at Death
Ordinarily, capital gains are taxed at the time appreciated property is transferred. However, no tax is imposed on a capital gain when appreciated property is transferred at death. The appreciation that accrued during the lifetime of the transferor is never taxed as income.
- Comment: The estimate also covers item 1.106 below.
- Origin: IRC §§ 1001 and 1014
Estimate: \$86.3
- 1.023 Exemption of Interest from Massachusetts Obligations
Interest earned on Massachusetts bonds is exempt. The exclusion applies to bonds of Massachusetts agencies and local subdivisions as well.
- Origin: M.G.L. c. 62, § 2 (a)(1)(A)
Estimate: \$106.1
- 1.024 Exemption of Benefits and Allowances to Armed Forces Personnel¹
Armed forces personnel can exclude from income mustering out payments and compensation for service in a combat zone. They and specified other U.S. government employees may exclude certain allowances and in-kind benefits.
- Origin: IRC §§ 112-113
Estimate: \$4.5
- 1.025 Exemption of Veterans' Pensions, Disability Compensation and G.I. Benefits
These veterans' benefits are not taxed.
- Origin: 38 U.S.C. § 5301
Estimate: \$15.5
- 1.026 Exemption of Military Disability Pensions
Disability pensions paid to service personnel are fully excluded from gross income. The portion of a regular pension that is paid on the basis of disability may also be excluded.
- Origin: IRC § 104(a)(4)
Estimate: \$0.4
- 1.027 Exemption of Compensation to Massachusetts-Based Nonresident Military Personnel
Compensation paid by the U.S. to nonresident uniformed military personnel on duty at bases within Massachusetts for services rendered while on active duty is defined as compensation from sources outside Massachusetts. It is therefore not taxed.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Comment: This tax treatment follows U.S. statutory law.

Origin: 50 U.S.C. App. § 574; M.G.L. c. 62, § 5A(c)

Estimate: \$5.3

- 1.028 Exemption for Taxpayers Killed in Military Action or by Terrorist Activity
Massachusetts residents who die in combat while in active military service, or who die as a result of terrorist or military action outside of the U.S. while serving as military or civilian employees of the U.S. are exempt from income taxation.

Origin: M.G.L. c. 62, § 25

Estimate: N.A.

- 1.029 Exemption for Retirement Pay of the Uniformed Services
Effective January 1, 1997, income received from the United States government as retirement pay and survivorship benefits for a retired member of the Uniformed Services of the United States is exempt from the personal income tax. The Uniformed Services of the United States are: the Army, Navy, Air Force, Marine Corps, Coast Guard, and the Commissioned Corps of the Public Health Service and National Oceanic and Atmospheric Administration.

Origin: M.G.L. c. 62, § 2

Estimate: \$18.0

1.100 DEFERRALS OF GROSS INCOME

- 1.101 Net Exemption of Employer Contributions and Earnings of Private Pension Plans²
Employer contributions to private, qualified employee pension plans are deductible by the employer up to certain amounts and are not included in the income of the employees. Income earned by the invested funds is not currently taxable to the employees. Benefits in excess of any employee contributions previously taxed by Massachusetts are taxable when paid out. The value of the tax deferral on contributions and on the investment income is a tax expenditure.

Origin: IRC §§ 401-415 in effect January 1, 1985 and M.G.L. c. 62 §§ 2(a)(2)(F) and 5(b)

Estimate: \$601.0

- 1.102 Treatment of Incentive Stock Options
Massachusetts has adopted the federal rules for employee stock options. Generally, employers may offer employees options to purchase at a later date company stock at a price equal to the fair market value of the stock when the

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

option was granted. At the time employees exercise the option, they do not include in income the difference between the fair market value and the price they pay. If they later sell the stock, they are taxed on the amount by which the price they receive for the stock exceeds the price they paid. Thus, income is deferred and is taxed as a capital gain instead of as compensation. However, the employer gets no business deduction from granting the option, and the effective tax rates on capital gains and "earned" income differ only slightly in Massachusetts. Therefore, the revenue effect cannot be determined.

Origin: IRC §§ 421-425
Estimate: N.A.

- 1.103 Exemption of Earnings on Stock Bonus Plans or Profit Sharing Trusts
Investment income earned by stock bonus plans or profit sharing trusts is not taxed currently to employees.

Origin: M.G.L. c. 62, § 5(b)
Estimate: N.A.

- 1.104 Exemption of Earnings on IRA and Keogh Plans²
Massachusetts taxes contributions made by individuals to private pension plans. However, income earned on the contributed funds is not taxed currently. Upon retirement, payments in excess of contributions are taxed. The deferral of tax on the investment income is a tax expenditure.

Origin: M.G.L. c. 62, §§ 2(a)(2)(F) and 5(b)
Estimate: 144.7

- 1.105 Deferral of Capital Gains on Home Sales
This expenditure and 1.021(exclusion of Capital Gains on Home Sales) were changed by the Taxpayer Relief Act of 1997. 1.105 (based on IRC 1034, the roll-over of capital gains on the sale of a home), was repealed. In effect, both 1.105 and 1.021 were replaced with a modified IRC 121. The new IRC 121, which is the basis for Massachusetts tax expenditure 1.021, removed the age requirement and the "one-time-only" limitation. Now taxpayers may exclude up to \$250,000 of capital gain (or \$500,000 if filing jointly) on the sale of a principle residence. This exclusion from gross income may be taken any number of times, provided the home was the filer's primary residence for an aggregate of at least two of the previous five years.

Origin: IRC § 1034
Estimate: N.A.

- 1.106 Nontaxation of Capital Gains at the Time of Gift
Ordinarily, capital gains are taxed at the time appreciated property is transferred. However, no tax is imposed on a capital gain when appreciated

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

property is transferred by gift. The taxation of appreciation is deferred until the recipient transfers the property.

Origin: IRC §§ 1001, 1015

Estimate: Included in item 1.022

1.200 DEDUCTIONS FROM GROSS INCOME

1.201 Capital Gains Deduction

Long-term capital gains realized from the sale of collectibles (as defined by sec. 408 (m) of the I.R.C.) are eligible for a 50% deduction from the 12% capital gains tax.

Origin: M.G.L. c. 62, § 2(c)(3)

Estimate: N.A.

1.202 Deduction of Capital Losses Against Interest and Dividend Income

Taxpayers may deduct up to \$1,000 of net capital loss against interest and dividend income, which is taxed as "unearned" income. Any excess net capital loss may be carried forward to succeeding years and applied to such income, up to \$1,000 per year, to the extent there is no net capital gain for the year. Net capital losses are carried over to succeeding years, where they can be used to offset any capital gains. The carryover provisions create a tax expenditure.

Origin: M.G.L. c. 62, § 2(c)(2)

Estimate: N.A.

1.203 Excess Natural Resource Depletion Allowance

Individuals or investors in extractive industries (mining or drilling natural resources) may deduct a percentage of gross mining income as a depletion allowance. The allowance may exceed the actual cost of the resource property. For a more detailed description of this tax expenditure, see corporate excise item 2.204.

Origin: IRC §§ 613 and 613A in effect January 1, 1985

Estimate: \$0.9

1.204 Abandoned Building Renovation Deduction

Businesses renovating eligible buildings in Economic Opportunity Areas may deduct 10% of the cost of renovation from gross income. This deduction may be in addition to any other deduction for which the cost of renovation may qualify. To be eligible for this deduction, renovation costs must relate to buildings designated as abandoned by the Economic Assistance Coordinating

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Council.

Origin: M.G.L. c. 62, § 3(B)(a)(10)

Estimate: N.A.

1.300 ACCELERATED DEDUCTIONS FROM GROSS INCOME

1.301 Accelerated Depreciation on Rental Housing

Landlords and investors in rental housing may use accelerated methods of depreciation for new and used rental housing. Rental housing placed in service after 1988 is depreciated on a straight-line basis over a 27.5-year period. Rental housing placed in service before 1988 was depreciable over shorter periods (generally 19 or 20 years), and, instead of straight-line depreciation, the 175% declining balance method was permitted. Straight-line depreciation over the property's expected useful life is the generally accepted method for recovering the cost of building structures. The excess of allowable depreciation over such generally accepted depreciation is a tax expenditure, resulting in a deferral of tax or an interest-free loan.

Origin: IRC § 168(b)

Estimate: \$10.5

1.302 Accelerated Depreciation for Rehabilitation of Low-Income Housing

Landlords and other investors in low-income housing may amortize rehabilitation expenditures initiated before 1987 over a five-year period. For a more detailed description of this tax expenditure, see corporate excise item 2.302.

Origin: IRC § 167(k)

Estimate: N.A.

1.303 Accelerated Depreciation on Buildings (Other Than Rental Housing)

Individuals or investors in a trade or business may use accelerated methods of depreciation for buildings. Construction may be depreciated under methods which produce faster depreciation than economic depreciation. The precise rates have been changed repeatedly in recent years as the result of revisions in the federal tax code. Structures (other than rental housing) placed in service after 1987 are depreciated on a straight-line basis over a 31.5-year life. The excess of accelerated depreciation over economic depreciation is a tax expenditure.

Origin: IRC §§ 167(j) and 168(b)

Estimate: \$6.4

1.304 Accelerated Cost Recovery System (ACRS) for Equipment

For depreciable tangible personal property placed in service after 1980, capital costs must be recovered using the Accelerated Cost Recovery System

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

(ACRS) which applies accelerated methods of depreciation over set recovery periods. For property placed in service after 1987, Massachusetts has adopted the Modified Accelerated Cost Recovery System (MACRS), which generally uses double declining balance depreciation over specified periods that are substantially shorter than actual useful lives (200% declining balance for 3-, 5-, 7- and 10-year recovery property and 150% declining balance for 15- and 20-year property). The excess of accelerated depreciation over what is considered to be normal depreciation for tangible personal property (double declining balance) is a tax expenditure.

Origin: IRC § 168

Estimate: \$36.1

1.305 Deduction for Excess First-Year Depreciation

Individuals or investors in a trade or business may elect to expense certain business assets purchased during the taxable year up to a maximum amount of \$10,000. Any remaining cost must be depreciated according to MACRS, as described in the preceding item. The immediate deduction results in a deferral of tax or an interest-free loan.

Origin: IRC § 179

Estimate: \$1.1

1.306 Five-Year Amortization of Business Start-Up Costs

Individuals or investors in a trade or business may elect to treat business start-up expenditures as deferred expenses and amortize them over five years. For a more detailed description of this tax expenditure, see corporate excise item 2.304.

Origin: IRC § 195

Estimate: \$1.3

1.307 Five-Year Amortization of Certain Operating Rights

Individuals or investors in a trade or business may amortize over five years the cost of bus route, freight forwarding and certain other operating rights that have lost their economic value due to federal deregulation. For a more detailed description of this tax expenditure, see corporate excise item 2.310.

Origin: Tax Reform Act of 1986, § 243

Estimate: N.A.

1.308 Expensing Exploration and Development Costs

Individuals or investors in extractive industries (mining or drilling natural resources) may take an immediate deduction for certain exploration and development costs. For a more detailed description of this tax expenditure, see corporate excise item 2.309; the provisions for individual taxpayers are somewhat more liberal than those that apply to corporations.

Origin: IRC §§ 263(c), 616 and 617 in effect January 1, 1985

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Estimate: N.A.

- 1.309 Expensing Research and Development Expenditures in One Year
Individuals or investors in a trade or business may take an immediate deduction for research and development expenditures. For a more detailed description of this tax expenditure, see corporate excise item 2.308.
- Origin: IRC § 174
Estimate: N.A.
- 1.310 Five-Year Amortization of Pollution Control Facilities
Individuals or investors in a trade or business may elect to amortize the cost of a certified pollution control facility over a five-year period. For a more detailed description of this tax expenditure, see corporate excise item 2.311.
- Origin: IRC § 169
Estimate: N.A.
- 1.311 Seven-Year Amortization for Reforestation
Individuals or investors in the forestry business may amortize the costs of reforestation over a seven-year period. For a more detailed description of this tax expenditure, see corporate excise item 2.313.
- Origin: IRC § 194
Estimate: N.A.
- 1.312 Expensing Certain Capital Outlays of Farmers
Farmers may use certain favorable accounting rules. For instance, they may use the cash basis method of accounting and may deduct up to 50% of non-paid farming expenses as current expenses even though these expenditures are for inventories on hand at the end of the year. They also may deduct certain capital outlays, such as expenses for fertilizers and soil and water conservation if they are consistent with a federal- or state-approved plan. Generally, these special rules are not available to farming corporations and syndicates.
- Origin: IRC §§ 175, 180 and 182 and Reg. §§ 1.61-4, 1.162-12 and 1.471-6
Estimate: \$0.6
- 1.400 DEDUCTIONS FROM ADJUSTED GROSS INCOME**
- 1.401 Deduction for Employee Social Security and Railroad Retirement Payments
Taxes paid by employees to fund the Social Security and Railroad Retirement systems are deductible against "earned" income up to a maximum of \$2,000 per individual.
Comment: The estimate also covers item 1.402 below.
- Origin: M.G.L. c. 62, § 3B(a)(3)
Estimate: \$281.1

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

- 1.402 Deduction for Employee Contributions to Public Pension Plans²
Employee contributions to federal and state contributory pension plans are deductible against "earned" income up to a maximum of \$2,000 per individual.

Origin: M.G.L. c. 62, § 3B(a)(4)
Estimate: Included in item 1.401
- 1.403 Additional Exemption for the Elderly
A taxpayer age 65 or over is entitled to an additional exemption against "earned" income of \$700 (\$1,400 for a married couple filing jointly if both spouses are age 65 or over).

Origin: M.G.L. c. 62, §§ 3B(b)(1)(C) and (2)(C)
Estimate: \$13.1
- 1.404 Additional Exemption for the Blind
A blind taxpayer is allowed an additional exemption against "earned" income of \$2,200 (\$4,400 for a married couple filing jointly if both spouses are blind).

Origin: M.G.L. c. 62, §§ 3B(b)(1)(B) and (2)(B)
Estimate: \$ 0.7
- 1.405 Dependents Exemption Where the Child Earns Income³
Taxpayers are allowed an additional exemption of \$1,000 for a dependent child even when the child earns income against which a \$2,200 personal exemption can be taken.

Comment: The estimate cannot be separated from the figure for the dependents exemption in endnote 3.

Origin: IRC § 151(c) in effect January 1, 1988 and M.G.L. c. 62 § 3B(b)(3)
Estimate: N.A.
- 1.406 Deduction for Dependents under 12
Individual taxpayers and married taxpayers filing jointly with one or more dependents under age 12 may deduct \$1,200 against "earned" income if they do not claim the deduction for child care described in item 1.409 below.

Origin: M.G.L. c. 62, § 3B(a)(8)
Estimate: \$28.2
- 1.407 Personal Exemption for Students Age 19 or Over
A taxpayer may claim a dependent exemption of \$1,000 for a child who is a full-time student even if he or she is 19 or over.

Origin: IRC § 151(c) in effect January 1, 1988 and M.G.L. c. 62 § 3B(b)(3)
Estimate: \$6.9

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

- 1.408 Deduction for Adoption Fees
Adoption fees paid to a registered adoption agency are deductible against "earned" income to the extent they exceed 3% of adjusted gross "earned" income.
- Origin: M.G.L. c. 62, § 3B(b)(5)
Estimate: \$0.6
- 1.409 Deduction for Business-Related Child Care Expenses
Taxpayers qualifying for the credit for employment-related child care expenses in the Internal Revenue Code are allowed a deduction against "earned" income for the amount of the expenses which qualify for the credit.
- Comment: For federal tax purposes, the requirement that employment-related child care expenses relate only to children under age 15 was further restricted to children under age 13. In addition, a federal change now requires a taxpayer to include employer-provided dependent care expenses when calculating the limitation amount of qualifying expenses.
- Origin: IRC § 21, in effect January 1, 1988 and M.G.L. c. 62, § 3B(a)(7)
Estimate: \$13.7
- 1.410 Exemption of Medical Expenses
Medical and dental expenses in excess of 7.5% of federal adjusted gross income are deductible against "earned" income for taxpayers who itemize on their federal returns.
- Origin: IRC § 213 and M.G.L. c. 62, § 3B(b)(4)
Estimate: \$27.4
- 1.411 Rent Deduction
Renters may deduct against "earned" income one-half of the rent paid for a principal residence located in Massachusetts, up to a maximum of \$2,500 per year.
- Origin: M.G.L. c. 62, § 3B(a)(9)
Estimate: \$95.0
- 1.412 Nontaxation of Charitable Purpose Income of Trustees, Executors or Administrators
The adjusted gross income of trustees, executors or administrators which is currently payable to or irrevocably set aside for public charitable purposes is tax-exempt.
- Origin: M.G.L. c. 62, §§ 3A(a)(2) and B(a)(2)
Estimate: N.A.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

1.413 Exemption of Interest on Savings in Massachusetts Banks
Up to \$100 (\$200 on a joint return) of interest from savings deposits or savings accounts in Massachusetts banks is excluded from "earned" income.
Origin: M.G.L. c. 62, § 3B(a)(6)
Estimate: \$12.3

1.414 Tuition Tax Deduction
A deduction is allowed for tuition payments to a two or four year college in which a taxpayer or taxpayer's dependent is enrolled. The deduction is equal to the amount by which the tuition payment, less any scholarships, grants or financial aid received, exceeds 25% of the taxpayer's Massachusetts adjusted gross income, exclusive of this deduction.
Origin: M.G.L. c. 62, § 3B(a)(11)
Estimate: \$13.0

1.500 PREFERENTIAL RATE OF TAXATION

1.501 Preferential Treatment of Interest on Savings in Massachusetts Banks
Interest paid on savings deposits in Massachusetts banks is taxed as "earned" income while other interest income is taxed at the higher "unearned" income tax rate. The difference is a tax expenditure. As of 1/1/99, all income, whether earned or unearned, will be taxed at the same rate.
Origin: M.G.L. c. 62, § 2(b)(1)(A)
Estimate: \$0.0

1.600 CREDITS AGAINST TAX

1.601 Renewable Energy Source Credit
Owners and tenants of residential property located within Massachusetts who are not dependents and who occupy the property as a principal residence are allowed a credit up to \$1,000, or an amount equal to 35% of the cost of a renewable energy source.

Comment: The tax credit for taxable years commencing after December 31, 1988 and before January 1, 1991 was limited to 25% of the cost of a renewable energy source up to a maximum of \$1,000. After 1990 the credit was further limited to 15% with the same \$1,000 cap.

Origin: M.G.L. c. 62, § 6(d)
Estimate: \$0.8

1.602 Credit for Removal of Lead Paint
A tax credit is provided in the amount of the cost of removing or covering lead paint on each residential unit up to \$1,000. A five-year carryover of any unused credit is provided.

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

Origin: M.G.L. c. 62, § 6(e)
Estimate: \$1.8

- 1.603 Economic Opportunity Area Credit
Businesses investing in qualified property in an Economic Opportunity Area are entitled to a credit against tax of 5% of the cost of the property. To qualify for this credit, the property must be used exclusively in a certified project in an Economic Opportunity Area. To be certified, a project must be approved by the Economic Assistance Coordinating Council.

Origin: M.G.L. c. 62, § 6(g)
Estimate: \$ 0.1

- 1.604 Credit for Employing Former Full-Employment Program Participants
Employers who continue to employ former participants of the §110(1) full employment program in non-subsidized positions are eligible to receive a tax credit equal to \$100 per month for each month of non-subsidized employment, up to a maximum of \$1,200 per employee, per year.

Origin: St. 1995, c. 5, § 110(m)
Estimate: N.A.

- 1.605 Earned Income Credit
Effective January 1, 1997, taxpayers will be allowed a refundable credit against Massachusetts tax equal to 10% of the amount of the earned income credit claimed on their federal individual income tax return.

Origin: M.G.L. c. 62, § 6(h)
Estimate: \$30.0

- 1.606 Septic System Repair Credit
Taxpayers required to repair or replace a failed cesspool or septic system pursuant to the provisions of Title V, as promulgated by the Department of Environmental Protection in 1995, are allowed a credit equal to 40% of the design and construction costs incurred (less any subsidy or grant from the Commonwealth), up to a maximum of \$1,500 per tax year and \$6,000 in total. Unused credits can be carried forward for up to three years.

Origin: M.G.L. c. 62, § 6(i)
Estimate: \$18.0

Fiscal Year 2000 Tax Expenditure Budget -- Personal Income Tax

KEY	ORIGIN
	IRC Federal Internal Revenue Code (26 U.S.C.)
	U.S.C. United States Code
	M.G.L. Massachusetts General Laws
	Rev. Rul.; C.B. Revenue Ruling; Cumulative Bulletin of the U.S. Treasury
	ESTIMATES

All estimates are in \$ millions.

ENDNOTES:

¹This item and others citing this endnote cover employee fringe benefits. We accept as standard the following treatment of these benefits: the expense incurred by the employer in providing the benefit is properly deductible as a business expense and the benefit is taxed as compensation to the employee as if the employee had received taxable compensation and then used it to purchase the benefit. Of course, there are problems with this analysis. In some cases, the "benefit" is more a condition of employment than a true benefit. For example, a teacher required to have lunch in the school cafeteria may prefer to eat elsewhere even if the school lunch is free. On the other hand, in many cases the provision of tax-free employee benefits is clearly a substitution for taxable compensation.

²This item and others citing this endnote cover contributory pension plans. The standard tax treatment of these plans is as follows:

<u>Component</u>	<u>Standard Treatment</u>
Contributions:	Made out of income which is currently taxed to the employee.
Investment Income:	Taxed to the employee as "earned" income.
Distributions from Pension Funds:	Tax-free to the extent they are made out of dollars previously taxed to the employee as contributions or investment income.

The non-standard treatment of contributions, investment income, or distributions as described in items 1.006, 1.101, 1.104, and 1.402, results in either nontaxation or deferrals of tax.

³FY2000 estimates for the basic personal exemptions and the no tax status threshold discussed in the introduction to the personal income tax are (in millions):

Personal exemption for single taxpayers:	\$295
Personal exemption for married couples:	\$618
Personal exemption for married taxpayers filing separately:	\$15
Dependents exemption:	\$98
Personal exemption for heads of households:	\$82
No tax status/Limited income credits:	\$137

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

In 1780, the Massachusetts Constitution gave to the General Court the power to levy "reasonable duties and excises upon any produce, wares, merchandise and commodities brought into, produced, manufactured, or being within the Commonwealth."

The corporate excise was enacted in 1919, replacing a corporate franchise tax which was levied on the value of capital stock. Initially, the corporate excise was imposed on corporate excess (similar to net worth) and on net income.

In 1962, the corporate excess measure was repealed. The tax is now levied on tangible property or net worth (depending on the mix of property held by the corporation) and on net income.

Revenues from the corporate excise represented 7.6% of total tax revenues for Fiscal Year 1998. The tax ranked third in Fiscal Year 1998, after the individual income tax and sales and use tax, in amounts collected.

Corporate Excise: Basic Structure

Tax Base: Generally, corporations doing business in Massachusetts are subject to a tax based on net income and on either tangible property or net worth. Together, these two measures of tax constitute the corporate excise.

The net income measure of the tax is based on gross income for federal tax purposes with certain additions such as interest earned on state obligations, less certain deductions, most of which are allowable under the provisions of the Internal Revenue Code. Many of these deductions are considered to be part of the basic structure. For example, in providing for depreciation deductions, the basic structure would allow the cost of property to be written off over its useful life. However, rules which allow accelerated depreciation deductions are listed as tax expenditures.

Corporations whose qualifying tangible assets in Massachusetts equal or exceed 10% of their qualifying total assets in Massachusetts apportioned according to the income apportionment percentage are taxed on the value of their tangible property. Other corporations are taxed on a net worth basis.

Banks, security corporations, utility corporations, and insurance companies are taxed in a different manner, and are generally not included in this budget. Tax expenditures for these separately taxed corporations are included, however, where they enjoy the benefit of federal and state tax expenditures catalogued in this section, because the taxes to which they are subject are based at least in part on net income.

Taxable Unit: A corporation is a taxpayer separate and distinct from its shareholders.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

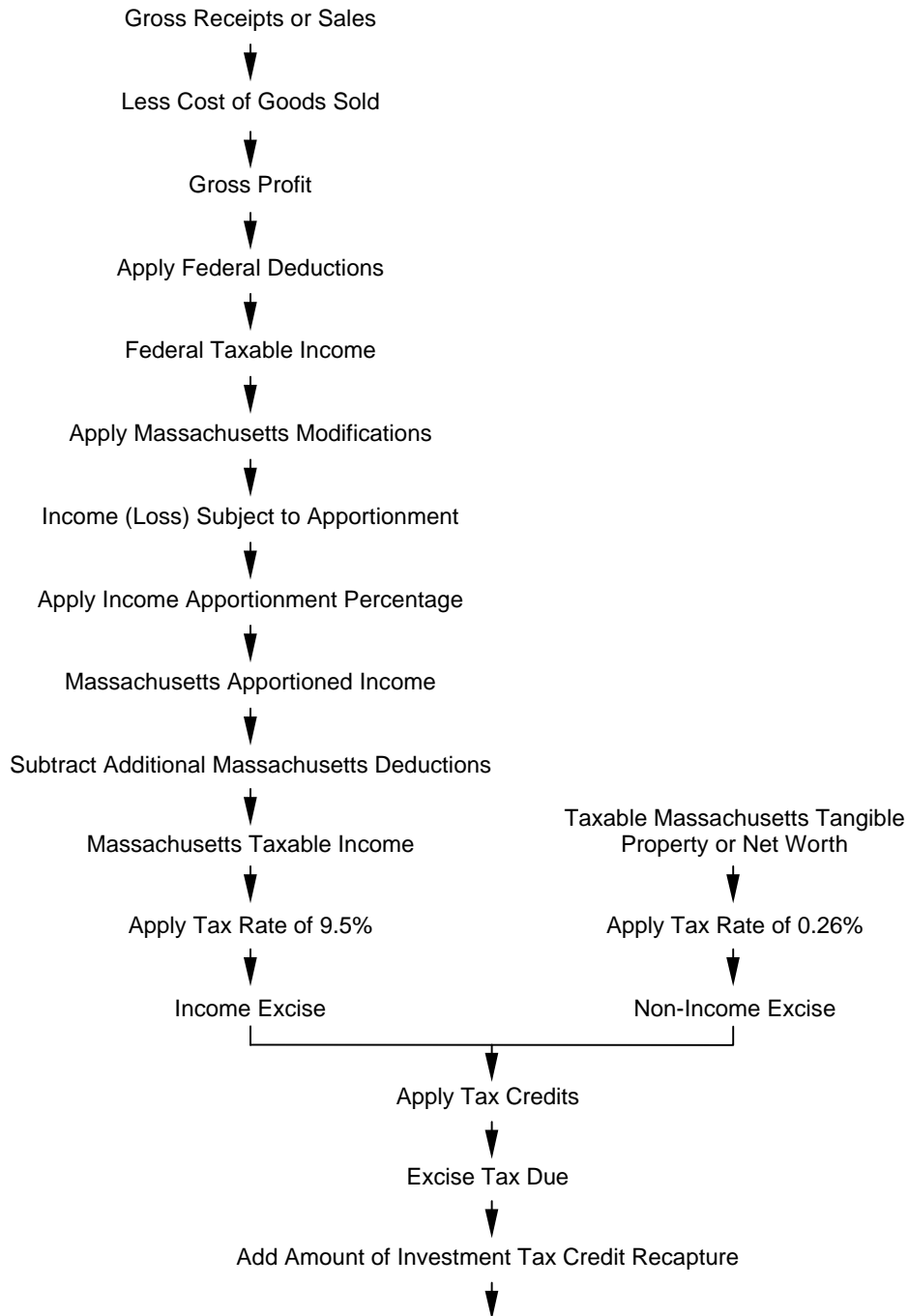
Rate Structure: The effective excise rate on corporations is 9.5% of net income apportioned to Massachusetts, and \$2.60 per \$1,000 of the value of Massachusetts tangible property or net worth allocable to Massachusetts. The minimum tax is \$456.

Taxable Period: The taxable period for corporations is either the calendar year or the corporation's fiscal year. Estimated payments are made every three months during the taxable year. Federal accounting periods and methods have been adopted. Net operating loss carry-forwards are allowed. Qualifying losses may be carried forward for no more than five years.

Interstate and International Aspects: All domestic corporations are subject to the corporate excise by reason of corporate existence at any time during the taxable year. Foreign corporations doing business within the state or owning property in the state are also subject to the excise. Corporations doing business both within and without Massachusetts are entitled to apportion net income if they have income from business activity which is taxable in another jurisdiction using a formula based on the proportions of corporate real and tangible personal property, payroll, and sales that are located in Massachusetts. Under certain circumstances, taxpayers may petition for, or the Commissioner may impose, alternate methods of accounting to reflect more fairly a taxpayer's income from business operations in Massachusetts.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Computation of Massachusetts Business Corporation Excise



Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Types of Tax Expenditures under the Corporate Excise

As with the personal income tax, the basic structure of the corporate excise is subject to several different types of modifications that can produce tax expenditures.

Exclusions from Gross Income: Gross income is the starting point in calculation of the income component of the corporate excise. In the absence of tax expenditures, it would include all income received from all sources. Items of income that are excluded from gross income are not taxed.

Deferrals of Gross Income: Where an item of income is not included in gross income in the year when it is actually received, but is instead included in a later year, the result is a tax expenditure in the form of an interest-free loan from the state to the taxpayer in the amount of the tax payment that is postponed.

Deductions from Gross Income: Certain amounts are subtracted from gross income to arrive at taxable income. Many of these deducted amounts reflect the costs of producing income (business expenses) and are not included in the corporate excise's measure of income; such deductions are not tax expenditures. Other deductions, which do not reflect business expenses, constitute tax expenditures, which permit corresponding amounts of income to escape taxation permanently.

Accelerated Deductions from Gross Income: In a number of cases, corporations are allowed to deduct business expenses from gross income at a time earlier than such expenses would ordinarily be recognized under accepted accounting principles. The total amount of the permissible deduction is not increased but it can be utilized more quickly to reduce taxable income. The result is to defer taxes, thus in effect occasioning an interest-free loan from the state to the taxpayer.

Adjustments to Apportionment Formula: In the case of a business that earns income both inside and outside the Commonwealth, an apportionment formula is used to determine what portion of the total business income to allocate to Massachusetts for calculation of the corporate excise. When the standard formula is adjusted to reduce the apportionment factor for certain businesses, a tax expenditure results. The practical effect is to exclude a portion of those businesses' income from taxation.

Exclusions from Property Component: In addition to the excise based on income, corporations pay a component of the excise based on the value of their property in the state. To the extent that certain classes of property are not included in the excise's property measure, tax expenditures result.

Credits Against Tax: After a corporation's basic tax liability has been computed, it may subtract certain credit amounts in determining the actual amount of taxes due. It is important to note that, whereas a one dollar exclusion or deduction results in a tax savings of only a few cents (one dollar times the applicable tax rate), a one dollar credit results in a one dollar tax savings.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Entity Exempt from Taxation: In some cases, a business or other entity may be completely exempt from taxation. To the extent business or investment income goes untaxed, tax expenditures result.

List of Corporate Excise Tax Expenditures

2.000 EXCLUSIONS FROM GROSS INCOME

2.001 Small Business Corporations

Certain corporations with no more than 35 shareholders may elect to be taxed, for both federal and state tax purposes, as "small business corporations" or "S corporations." The earnings of an S corporation with total receipts of less than \$6 million are not generally subject to taxation at the corporate level. S corporations with total receipts of \$6 million or more are subject to a reduced corporate excise; 3% if receipts are \$6 million or more but less than \$9 million; and 4.5% if receipts are \$9 million or more. In addition, S corporation net earnings (and losses) are attributed directly to the shareholders (whether or not they are distributed as dividends) and are taxed at the individual shareholder level, generally at a 5.95% rate. By contrast, ordinary corporate earnings are taxed twice, once when earned by the corporation at a 9.5% rate, and once when distributed to shareholders, generally at a 5.95% rate.

The difference between the manner in which income is taxed to a C corporation and its shareholders and an S corporation and its shareholders constitutes a tax expenditure. Massachusetts first adopted this preferential treatment for closely-held corporations in 1986.

Origin: IRC § 1361-1363 and M.G.L. c. 62, IRC § 17A and c. 63, IRC § 32D
Estimate: \$16.0

2.002 Exemption of Income from the Sale, Lease or Transfer of Certain Patents
Income from the sale, lease or other transfer of approved patents for energy conservation, and royalties and income from the sale, lease or other transfer of property subject to such patents are excluded from gross income for a period of five years.

Origin: M.G.L. c. 63, IRC § 30(5)(a)
Estimate: N.A.

2.100 DEFERRALS OF GROSS INCOME

2.101 Deferral of Tax on Certain Shipping Companies

Certain shipping companies receive up to a 25-year deferral of tax on that portion of their net income which is set aside for construction, modernization and major repair of ships.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Origin: 46 U.S.C. § 1177 and IRC § 7518
Estimate: \$0.1

2.200 DEDUCTIONS FROM GROSS INCOME

2.201 Charitable Deduction

In computing net income, corporations may deduct charitable donations up to 10% of taxable income computed without the deductions. There is a carryover of excess contributions available for five succeeding taxable years.

Origin: IRC § 170
Estimate: \$12.3

2.202 Additional Deduction for Certain Businesses in a Poverty Area (UJIP)

In determining net income, corporations certified by the Urban Job Incentive Bureau of the Executive Office of Economic Affairs as operating in a poverty area may deduct an additional 25% of a portion of compensation paid to their employees who live in a poverty area. The effect of the provision is to allow businesses to deduct 125% of the wages of these employees.

Origin: M.G.L. c. 63, § 38F
Estimate: \$0.3

2.203 Net Operating Loss Carry-Over

Taxpayers may carry-over for no more than five years (but not carry back) net operating losses (NOL) as defined under section 172 of the Internal Revenue Code.

Origin: IRC § 172 and M.G.L. c. 63, § 305(b) and (ii)
Estimate: \$121.2

2.204 Excess Natural Resource Depletion Allowance

Taxpayers in extractive industries (mining or drilling for natural resources) may deduct a percentage of gross mining income as a depletion allowance ("percentage depletion") even if the cost basis of the property has been reduced to zero. The deduction may not exceed 50% (in some cases, 65%) of net income from the property. In the case of oil and gas, percentage depletion is available only to domestic oil and gas sold by "independent producers" (nonintegrated companies). The excess of the deduction available using the percentage of gross income method of depletion over a depletion deduction based on cost is a tax expenditure.

Origin: IRC §§ 613 and 613A
Estimate: \$0.1

2.205 Deduction for Certain Dividends of Cooperatives

Farmers' cooperatives and certain corporations acting as cooperatives may deduct patronage dividends and other amounts out of gross income. Cooperatives meeting certain requirements may deduct dividends on capital

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

stock and certain payments to patrons such as investment income. Under generally accepted rules for taxing corporations, dividends paid to shareholders cannot be deducted by the corporation.

Origin: IRC §§ 1381-1388
Estimate: N.A.

- 2.206 Abandoned Building Renovation Deduction
Businesses renovating eligible buildings in Economic Opportunity Areas may deduct 10% of the cost of renovation from gross income. This deduction may be in addition to any other deduction for which the cost of renovation may qualify. To be eligible for this deduction, renovation costs must relate to buildings designated as abandoned by the Economic Assistance Coordinating Council.

Origin: M.G.L. c. 63, § 38O
Estimate: \$1.8

2.300 ACCELERATED DEDUCTIONS FROM GROSS INCOME

- 2.301 Accelerated Depreciation on Rental Housing
Landlords and investors in rental housing may use accelerated methods of depreciation for new and used rental housing. Rental housing placed in service after 1986 is depreciated on a straight-line basis over a 27.5 year period. Rental housing placed in service before 1987 was depreciable over shorter periods (generally 19 or 20 years), and, instead of straight-line depreciation, the 175% declining balance method was permitted. Straight-line depreciation over the property's expected useful life is the generally accepted method for recovering the cost of buildings. The excess of allowable depreciation over such generally accepted depreciation is a tax expenditure, resulting in a deferral of tax or an interest-free loan.

Origin: IRC § 168
Estimate: \$1.5

- 2.302 Accelerated Depreciation for Rehabilitation of Low-Income Housing
Expenditures made for the rehabilitation of low-income rental housing may be depreciated over a five-year period, using the straight-line method of depreciation and ignoring salvage value, if the expenditures are made under a binding contract in existence before 1987. Generally, the aggregate expenditures qualifying for the deduction cannot exceed \$20,000 per unit, though they must equal at least \$3,000 per unit over two consecutive years. Any remaining cost may be depreciated under the accelerated methods described in item 2.301. The accelerated recovery of costs which otherwise would be depreciable over a longer period amounts to a deferral of tax or an interest-free loan.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Origin: IRC § 167(k)

Estimate: N.A.

- 2.303 Expensing for Removal of Barriers to the Handicapped
Taxpayers may elect to deduct up to \$35,000 of the costs of removing architectural or transportation barriers to the handicapped in the year these costs are incurred. The immediate deduction of these expenditures which would otherwise have to be capitalized and depreciated over a longer period results in a deferral of tax or an interest-free loan.

Origin: IRC § 190

Estimate: N.A.

- 2.304 Five-Year Amortization of Start-Up Costs
Taxpayers may elect to treat certain capital costs of starting a business as deferred expenses and amortize them over five years. Without the election, only costs for particular assets could be recovered through depreciation deductions. Other costs would be part of the basis in the business and generally could not be recovered until the business was sold or discontinued. The election to amortize these costs allows for a deferral of tax or an interest-free loan.

Origin: IRC § 195

Estimate: \$0.4

- 2.305 The Accelerated Cost Recovery System (ACRS) for Equipment
For depreciable tangible personal property placed in service after 1980, capital costs must be recovered using the federal Accelerated Cost Recovery System (ACRS) which applies accelerated methods of depreciation over set periods. For property placed in service after 1986, the Federal Tax Reform Act of 1986 prescribes revised ACRS depreciation schedules, generally using double-declining balance depreciation over specified periods that are substantially shorter than actual useful lives. The excess of accelerated depreciation over what is considered to be normal depreciation for tangible personal property (double-declining balance over expected useful lifetimes) is a tax expenditure.

Origin: IRC § 168

Estimate: \$170.7

- 2.306 Deduction for Excess First-Year Depreciation
Taxpayers may elect to expense certain business assets purchased during the taxable year. The total deduction cannot exceed \$17,500; for taxpayers whose investment in eligible assets exceeds \$200,000 in the year, the \$17,500 ceiling is reduced by \$1 for each dollar of investment above \$200,000. Any remaining cost may be depreciated according to ACRS as described in item 2.305. The immediate deduction results in a deferral of tax or an interest-free loan.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Origin: IRC § 179
Estimate: \$3.4

- 2.307 Accelerated Depreciation on Buildings (other than Rental Housing)
Construction may be depreciated under methods which produce faster depreciation than economic depreciation. The precise rules have been changed repeatedly in recent years by revisions of the federal tax code. For structures (other than housing) placed in service after 1986, federal law requires straight-line depreciation over a 31.5 year life. The excess of accelerated depreciation over economic depreciation is a tax expenditure. For a more detailed description of accelerated depreciation, see item 2.301 above.

Origin: IRC § 168
Estimate: \$10.6

- 2.308 Expensing Research and Development Expenditures in One Year
Taxpayers may elect to treat research or experimental expenditures incurred in connection with a trade or business as immediately deductible expenses. Under generally accepted accounting principles, at least some of these costs would otherwise be treated as capital expenditures and depreciated or amortized over a period of years. Their immediate deduction results in a deferral of tax or an interest-free loan.

Origin: IRC § 174
Estimate: \$38.3

- 2.309 Expensing Exploration and Development Costs
Certain capital costs incurred in bringing a known mineral deposit into production are deductible in the year incurred. A portion of domestic mining exploration costs can also be expensed, although they will be recaptured if the mine reaches the production stage. Certain intangible drilling and development costs of domestic oil, gas, and geothermal wells are deductible when made, but to a certain extent may be recaptured upon disposition of oil, gas, or geothermal property to which they are properly chargeable. The immediate expensing of these costs, which would otherwise be capitalized and recovered through depreciation or through depletion as the natural resource is removed from the ground, results in a deferral of tax or an interest-free loan.

Origin: IRC §§ 193, 263(c), 616 and 617
Estimate: \$0.3

- 2.310 Five-Year Amortization of Certain Operating Rights
Certain bus, trucking and shipping companies may amortize over a five-year period the cost of bus route, freight forwarding and certain other operating rights that have lost their economic value due to federal deregulation of these

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

industries. The five-year amortization of these costs, which would otherwise be capitalized and recovered upon the sale of the business, results in a deferral of tax or an interest-free loan.

Origin: Tax Reform Act of 1986, § 243
Estimate: N.A.

- 2.311 Five-Year Amortization of Pollution Control Facilities
Taxpayers may elect to amortize the cost of a certified pollution control facility over a five-year period, allowing for accelerated recovery of these costs. Accelerated recovery is only available for pollution control facilities subsequently added to plants that were in operation before 1976. The excess of accelerated recovery over depreciation deductions otherwise allowable results in a deferral of tax or an interest-free loan.

Origin: IRC § 169
Estimate: N.A.

- 2.312 Expensing Certain Expenditures for Alternative Energy Sources
In determining net income, a corporation may elect to take an immediate deduction for expenditures made for certain solar or wind powered systems or units located in Massachusetts and used exclusively in the business, in lieu of all other deductions and credits including the deduction for depreciation. Without this provision, such expenditures would have to be capitalized and depreciated. The immediate deduction results in a deferral of tax or an interest-free loan.

Origin: M.G.L. c. 63, § 38H
Estimate: \$0.7

- 2.313 Seven-Year Amortization for Reforestation
Taxpayers may elect to amortize reforestation costs for qualified timber property over a seven-year period. In the absence of this special provision, these costs would be capitalized and depreciated over a longer period or recovered when the timber is sold. The accelerated cost recovery results in a deferral of tax or an interest-free loan.

Origin: IRC § 194
Estimate: N.A.

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

2.400 ADJUSTMENTS TO APPORTIONMENT FORMULA

2.401 Unequal Weighting of Sales, Payroll, and Property in the Apportionment Formula

Corporations with a presence in Massachusetts and other states allocate income to the Commonwealth using a three-factor apportionment formula. A corporation's sales, payroll, and property in Massachusetts are compared to those outside Massachusetts.

Exporters benefit from an apportionment formula that weights sales more heavily than the other factors. Effective January 1, 1996, eligible defense corporations are allowed a formula that weights sales 100%. For other manufacturers, a 100% sales weight is phased-in over five years. All other corporations will continue to use a formula that weights sales 50%.

Effective January 1, 1997 mutual fund corporations are allowed to attribute mutual fund sales to Massachusetts based on the domicile of shareholders in the mutual funds. Effective July 1, 1997, mutual fund corporations are allowed to apportion their income to Massachusetts based solely on the percentage of sales attributed to Massachusetts.

Comment: In listing this item, it is assumed that a standard apportionment formula gives equal weight to sales, property and payroll. The estimate is of the impact of departing from this standard formula.

Origin: M.G.L. c. 63, § 38 (c)
Estimate: \$247.4

2.500 EXCLUSIONS FROM PROPERTY COMPONENT

2.501 Nontaxation of Certain Energy Property

Tangible property qualifying for the deduction for expenditures for alternative energy described in item 2.312 above is not subject to taxation under the tangible property measure of the corporate excise.

Origin: M.G.L. c. 63, § 38H(f)
Estimate: N.A.

2.502 Exemption for Property Subject to Local Taxation

In computing the state corporate excise on tangible property, property subject to tax at the local level is exempt. Generally, the state taxes only the machinery of manufacturing corporations and exempts business real estate and tangible personal property.

Comment: For purposes of estimating revenue loss from this tax expenditure the state's rate on property, \$2.60 per \$1,000, has been applied. It should be

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

noted that the tax burden on property taxed at the state level under the corporate excise is less than a fifth of the average burden on property taxed locally.

Origin: M.G.L. c. 63, § 30(7)
Estimate: \$102.3

2.600 CREDITS AGAINST TAX

2.601 Tax Credit for Building in a Poverty Area (UJIP)

A corporation operating an eligible business in a poverty area may take a credit against the corporate excise equal to the excess of the relevant local property tax rate over the average statewide property tax rate, multiplied by the assessed value of the corporation's real estate, and divided by \$1,000.

Origin: M.G.L. c. 63, § 38E
Estimate: \$0.1

2.602 Investment Tax Credit

Manufacturing corporations, research and development corporations and corporations engaged primarily in agriculture or commercial fishing are entitled to a credit against tax for investments in qualified tangible property. The amount of the credit is 3% of the cost or other basis of the property for federal income tax purposes. Total credits taken by a given corporation in a taxable year cannot exceed 50% of tax liability. Unused credits may be carried over to subsequent years. If property qualifying for the investment credit is disposed of or no longer in use, a corporation must repay in the year of disposition the portion of the credit allocable to the remaining useful life of the property.

Comment: Past estimates of this tax expenditure have been "dynamic." That is, they have included estimates of increased economic activity and tax collections that result from this credit. To be consistent with all other estimates in this document, this estimate is based on actual ITC claims of corporations from the most recent Corporate Excise Returns Report. The estimate assumes that ITC rate will remain at 3% in FY 2000.

Origin: M.G.L. c. 63, § 31A
Estimate: \$32.2

2.603 Vanpool Credit

A corporation may take a credit against excise due equal to 30% of the cost incurred during the taxable year for the purchase or lease of company shuttle vans used in the Commonwealth for employee transportation.

Origin: M.G.L. c. 63, §§ 31D, 31E, and 31F
Estimate: \$0.2

2.604 Research Credit

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

Corporations are entitled to a credit against tax for research and development expenditures. The amount of the credit is equal to the sum of 10% of qualified research expenses each year in excess of a base amount, and 15% of basic research payments, in excess of a base amount. The credit is limited to the first \$25,000 of excise plus 75% of any excise in excess of \$25,000. Unused credits may be carried over to subsequent years. Effective January 1, 1995, qualified defense corporations may calculate this credit separately for defense related research expenditures and non-defense related expenditures.

Origin: M.G.L. c. 63, § 38M
Estimate: \$80.3

- 2.605 Economic Opportunity Area Credit
Businesses investing in qualified property in an Economic opportunity Area are entitled to a credit against tax of 5% of the cost of the property. To qualify for this credit, the property must be used exclusively in a certified project in an Economic Opportunity Area. To be certified, a project must be approved by the Economic Assistance Coordinating Council.

Origin: M.G.L. c. 63, § 38N
Estimate: \$3.4

- 2.606 Credit for Employing Former Full-Employment Program Participants
Employers who continue to employ former participants of the §110(1) full employment program in non-subsidized positions are eligible to receive a tax credit equal to \$100 per month for each month of non-subsidized employment, up to a maximum of \$1,200 per employee, per year.

Origin: St. 1995, c. 5, § 110(m)
Estimate: N.A.

- 2.607 Credit for Harbor Maintenance Taxes Paid
Effective July 1, 1996, a credit against the corporate excise is provided for federal harbor maintenance taxes paid.

Origin: M.G.L. c. 63, § 38P
Estimate: \$4.2

2.700 ENTITY EXEMPT FROM TAXATION

- 2.701 Exemption of Credit Union Income
Credit unions, which are in effect mutual business organizations, are considered tax-exempt organizations for federal income tax purposes and therefore are exempt from the corporate excise as well.

Comment: The estimate applies to state-chartered credit unions only.

Origin: IRC § 501(c)(14)(A) and M.G.L. c. 63, § 30(1)
Estimate: \$4.0

Fiscal Year 2000 Tax Expenditure Budget -- Corporate Excise Tax

2.702 Tax-Exempt Organizations
Corporations considered to be tax-exempt under section 501 of the Internal Revenue Code (such as religious, scientific and educational organizations) are exempt from tax under the corporate excise. The nontaxation of their net income and property creates a tax expenditure.

Origin: IRC § 501 and M.G.L. c. 63, § 30(1)
Estimate: N.A.

2.703 Exemption for Regulated Investment Companies
Corporate Regulated Investment Companies are exempt from the corporate excise. The nontaxation of their net income and property creates a tax expenditure.

Origin: M.G.L. c. 63, §§ 30 and 38B
Estimate: N.A.

KEY: ORIGIN
IRC Federal Internal Revenue Code (26 U.S.C.)
M.G.L. Massachusetts General Laws
U.S.C. United States Code

ESTIMATES

All estimates are in \$ millions.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Massachusetts imposes a sales and use tax on retail sales. In addition to the sales and use tax, there are several separate excises, each limited to a particular type of commodity. These special excises have not been included in this tax expenditure budget.

The Massachusetts sales and use tax, first imposed in 1966, is levied at a rate of 5%. The sales tax applies to sales made within the state, and the use tax to property and services purchased outside of Massachusetts but intended for use within the state.

Revenues from the sales and use tax represented 21.2% of total tax revenues for Fiscal Year 1998.

Sales and Use Tax: Basic Structure

Tax Base: For the purposes of this tax expenditure budget, we have chosen not to make any assumptions about the base of the Massachusetts sales and use tax. Some people take a narrow view of what a retail sale is, limiting the term to sales to final consumers, i.e., individuals. Others would include sales to businesses, especially in instances where the purchase will not become an ingredient or component in a product to be sold. In an effort to acknowledge both theories, we will simply list the various exemptions under the sales tax. Some or many of these exemptions would be considered to be properly excluded from the tax base depending upon one's point of view.

Taxable Unit: The sales and use tax is an *in rem* tax; that is, it is levied on the property or service to be sold or used.

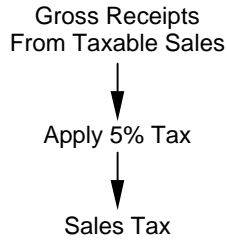
Rate Structure: The sales and use tax rate is 5% of the purchase price.

Taxable Period: The tax is imposed at the time of sale or use and remitted at specified intervals by the vendor.

Interstate and International Aspects: Massachusetts applies the destination principle to international and interstate sales. Accordingly, exports are exempt and imports are taxable under either the sales or the use tax. Similarly, taxable services performed in the Commonwealth but used outside of the Commonwealth are exempt from sales tax. Statutory exemptions for exports of property and for services used outside of the Commonwealth are therefore not listed as tax expenditures.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Computation of Massachusetts Sales and Use Tax by Vendor*



* A purchaser is also responsible for paying use tax directly to the Commonwealth on the sales price of taxable property or services purchased out-of-state and stored, used, or otherwise consumed in the Commonwealth, provided that a sales and use tax of 5% or more has not been paid separately to another state.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Types of Tax Expenditures under the Sales Tax

In the case of the sales tax, all tax expenditures are of a single type. They all result from the exclusion of certain transactions from the taxable base. The exclusion can be based on any of a number of characteristics of the transaction - who the buyer is, who the seller is, what the product or service is, what the product or service will be used for, etc. - but structurally all such tax expenditures operate in the same way. Hence, we have omitted the designation of tax expenditure types from the descriptions in this section.

List of Sales and Use Tax Expenditures

3.000 EXEMPT ENTITIES

3.001 Exemption for Sales to the Federal Government
Sales to the federal government are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(d)
Estimate: N.A.

3.002 Exemption for Sales to the Commonwealth
Sales to the Commonwealth, its agencies and political subdivisions are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(d)
Estimate: N.A.

3.003 Exemption for Sales to Tax-Exempt Organizations
Non-profit organizations are exempt from sales tax on purchases of goods and services to be used in carrying out their tax-exempt purposes.

Comment: This estimate excludes sales of building materials and supplies used in construction contracts, which are covered under item 3.412.

Origin: M.G.L. c. 64H, § 6 (e) and (x)
Estimate: \$331.8

3.100 EXEMPT PRODUCTS/SERVICES

3.101 Exemption for Food
Food for human consumption is exempt from sales tax, including food purchased with federal food stamps. The exemption does not cover meals served in restaurants and similar establishments. Meals are taxed under the sales tax at a rate of 5%.

Origin: M.G.L. c. 64H, § 6(h) and (kk)
Estimate: \$354.3

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

- 3.102 Exemption for Certain Food and Beverages Sold in Restaurants
Although generally food and beverages sold in restaurants are taxed, there are certain exceptions. These are: a) food sold by weight, measure, count, or in unopened original containers or packages (for example, milk, meat, bread); b) beverages in unopened original containers which have a capacity of at least 26 fluid ounces; and c) bakery products sold in units of six or more.
- Origin: M.G.L. c. 64H, § 6(h)
Estimate: N.A.
- 3.103 Exemption for Clothing
Sales of clothing or footwear up to \$175 per item are exempt from sales tax. The exemption does not include special clothing or footwear designed for athletic or protective uses and not normally worn except for these uses.
- Origin: M.G.L. c. 64H, § 6(k)
Estimate: \$206.8
- 3.104 Exemption for Medical and Dental Supplies and Devices
Medical and dental supplies and devices, such as prescription drugs, oxygen, blood, artificial limbs and eyeglasses, are exempt from sales tax.
- Comment: Data was only available for some of the exempt items.
- Origin: M.G.L. c. 64H, § 6(l) and (z)
Estimate: \$93.7
- 3.105 Exemption for Water
Sales and service of water are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(i)
Estimate: \$30.6
- 3.106 Exemption for Newspapers and Magazines
Newspapers and magazines are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(m)
Estimate: \$22.9
- 3.107 Exemption for the American Flag
The American flag is exempt from sales tax.
Origin: M.G.L. c. 64H, § 6(w)
Estimate: N.A.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

- 3.108 Exemption for Certain Precious Metals
Sales valued at \$1,000 or more of the following precious metals are exempt from the sales tax: rare coins of numismatic value; gold or silver bullion or coins; and gold or silver tender of any nation which is traded and sold according to its value as precious metal. Fabricated precious metals which have been processed or manufactured for industrial, professional, or artistic use do not qualify for the exemption.
- Origin: M.G.L. c. 64H, § 6(II)
Estimate: N.A.
- 3.109 Exemption for Cement Mixers
Concrete mixing units mounted on the back of trucks are exempt from sales tax. Spare parts for such units are also exempt. The truck chassis is subject to sales tax.
- Origin: M.G.L. c. 64H, § 6(y)
Estimate: N.A.
- 3.110 Exemption for Fertilizers, Insecticides and Fungicides
Fertilizers, insecticides and fungicides are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(p)
Estimate: \$1.1
- 3.111 Exemption for Meals Served by Continuing Care Facilities
Meals served by continuing care facilities to residents of those facilities are exempt from the sales tax on meals.
- Origin: Uncodified
Estimate: N.A.
- 3.200 EXEMPT, TAXED UNDER ANOTHER EXCISE**
- 3.201 Exemption for Alcoholic Beverages
Alcoholic beverages, except those sold in restaurants and similar establishments, are exempt from sales tax. They are subject to an excise at a rate which is in most cases higher than 5% of the retail price. Exceptions are cider and beer. On these two items, the excise is equivalent to a sales tax rate of approximately 1% on cider and 2% on beer.
- Comment: Revenues collected under the alcoholic beverages excise for Fiscal Year 1998 were \$60.1 million.
- Origin: M.G.L. c. 64H § 6(g)
Estimate: \$60.3

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

- 3.202 Exemption for Motor Fuels
Motor fuels are exempt from sales tax. They are subject to an excise at a rate higher than 5% of the retail price.
- Comment: The estimate represents revenues that would be collected under the sales tax if all motor fuels were taxed at 5%. The Massachusetts motor fuels tax rate is currently 19.1% of the average price per gallon, with a \$.21 minimum.
- Origin: M.G.L. c. 64H, § 6(g)
Estimate: \$163.1
- 3.300 EXEMPT COMPONENT OF A PRODUCT OR CONSUMED IN PRODUCTION**
- 3.301 Exemption for Items Used in Making Clothing
Sales of materials used in making clothes, such as thread and fabric, are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(v)
Estimate: \$1.1
- 3.302 Exemption for Materials, Tools, Fuels and Machinery Used in Manufacturing
Materials, tools, fuels and machinery, including spare parts, used in manufacturing are exempt from sales tax if they become components of a product to be sold or are consumed or directly used in the manufacturing process.
- Comment: The estimate is only for machinery and equipment. Components are not included to avoid double counting.
- Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$181.0
- 3.303 Exemption for Materials, Tools, Fuels and Machinery Used in Research and Development
Materials, tools, fuels and machinery, including spare parts, used in research and development by certified manufacturing or research and development corporations are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$25.1
- 3.304 Exemption for Materials, Tools, Fuels, and Machinery Used in Furnishing Power to Consumers
Materials, tools, fuels, and machinery, including spare parts, used in

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

furnishing gas, water, steam, or electricity to consumers through mains, lines or pipes are exempt from sales tax if they are consumed or directly used in furnishing the power.

Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$56.6

- 3.305 Exemption for Materials, Tools, Fuels, and Machinery Used in Furnishing Power to an Industrial Manufacturing Plant
Materials, tools, fuels, and machinery, including spare parts, used in furnishing power to an industrial manufacturing plant are exempt from sales tax if they are consumed or directly used in furnishing the power.

Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$18.9

- 3.306 Exemption for Materials, Tools, Fuels, and Machinery Used in Newspaper Printing
Materials, tools, fuels, and machinery, including spare parts, used in newspaper printing are exempt from sales tax if they become components of a product to be sold or are consumed or directly used in newspaper publishing.

Comment: The estimate below excludes fuel inputs which are included in items 3.401, 3.402 and 3.403.

Origin: M.G.L. c. 64H, § 6(r)&(s)
Estimate: \$19.0

- 3.307 Exemption for Certain Items Used in the Manufacturing of Cast Metal Products
Patterns, molds, dies, tools, sandhandling equipment, and machinery, including spare parts, used exclusively in the manufacturing of cast metal products are exempt from sales tax.

Comment: To the extent the exemption covers machinery used in manufacturing, the estimate is included in item 3.302.

Origin: M.G.L. c. 64H, § 6(ee)
Estimate: N.A.

- 3.308 Exemption for Materials, Tools, Fuels, and Machinery Used in Agricultural Production
Materials, tools, fuels, and machinery, including spare parts, used in agricultural production are exempt from sales tax if they become components

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

of products to be sold or are consumed or directly used in agricultural production. The exemption includes the same items when used for the production of livestock, poultry and animals in research.

Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$4.3

- 3.309 Exemption for Materials, Tools, Fuels, and Machinery Used in Commercial Fishing
Materials, tools, fuels, and machinery, including spare parts, used in commercial fishing are exempt from sales tax if they become components of a product to be sold or are consumed or directly used in commercial fishing.

Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$1.1

- 3.310 Exemption for Materials, Tools, Fuels and Machinery Used in Commercial Radio and TV Broadcasting
Materials, tools, fuels and machinery, including spare parts, used in commercial radio and TV broadcasting are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(r) and (s)
Estimate: \$1.5

3.400 EXEMPTIONS FOR SPECIFIED USES OF PRODUCTS/SERVICES

- 3.401 Exemption for Electricity
Residential electricity, electricity purchased by businesses with five or fewer employees, and electricity purchased for qualified industrial use are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(i) and (qq)
Estimate: \$137.8

- 3.402 Exemption for Fuel Used for Heating Purposes
Residential heating fuel, heating fuel purchased by businesses with five or fewer employees and heating fuel purchased for qualified industrial use are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(j) and (qq)
Estimate: \$56.4

- 3.403 Exemption for Piped and Bottled Gas
Residential gas, gas purchased by businesses with five or fewer employees and gas purchased for qualified industrial use are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(i) and (qq)

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Estimate: \$45.7

- 3.404 Exemption for Steam
Residential steam, steam purchased by businesses with five or fewer employees and steam purchased for qualified industrial use are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(i) and (qq)
Estimate: \$4.0
- 3.405 Exemption for Certain Energy Conservation Equipment
Equipment for a solar, wind or heat pump system used as a primary or auxiliary energy source in a principal residence is exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(dd)
Estimate: N.A.
- 3.406 Exemption for Funeral Items
Coffins, caskets, and other funeral items are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(n)
Estimate: \$9.5
- 3.407 Exemption for a Motor Vehicle for a Paraplegic
A motor vehicle owned and registered for the personal use of a paraplegic is exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(u)
Estimate: \$1.0
- 3.408 Exemption for Textbooks
Textbooks and other books required for instruction in educational institutions are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(m)
Estimate: \$8.3
- 3.409 Exemption for Books Used for Religious Worship
Bibles, prayer books and other books used for religious worship are exempt from sales tax.
- Origin: M.G.L. c. 64H, § 6(m)
Estimate: N.A.
- 3.410 Exemption for Containers
Most containers are exempt from sales tax. These include sales of empty

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

returnable and non-returnable containers to be filled and resold, containers whose contents are exempt from the sales tax and returnable containers when sold with the contents or resold for refilling.

Origin: M.G.L. c. 64H, § 6(q)
Estimate: \$96.8

- 3.411 Exemption for Certain Sales by Typographers, Compositors Color Separators
Sales by typographers, compositors or color separators of composed type, film positives and negatives and reproduction proofs, or transfers of such items to a printer, publisher, or manufacturer of folding boxes for use in printing, are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(gg)
Estimate: N.A.

- 3.412 Exemption for Sales of Building Materials and Supplies to be Used in Connection with Certain Construction Contracts
Materials and supplies used in connection with construction contracts with the United States and Massachusetts and its subdivisions are tax exempt where the construction is for public purposes. Materials and supplies used in connection with construction contracts with a tax-exempt organization are tax exempt where the construction is to be used exclusively in carrying out the organization's charitable purpose. The exemption includes rentals of equipment as well.

Origin: M.G.L. c. 64H, § 6(f)
Estimate: \$92.8

- 3.413 Exemption for Plants and Seeds
Plants and parts of plants suitable for planting to produce food for human consumption are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(p)
Estimate: \$1.0

- 3.414 Exemption for Feed
Feed for livestock and poultry to be sold or to be used for human consumption or research, and feed for pelt-producing animals, is exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(p)
Estimate: \$1.4

- 3.415 Exemption for Livestock and Poultry
Livestock and poultry of a kind ordinarily used for human consumption are exempt from sales tax.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Origin: M.G.L. c. 64H, § 6(p)
Estimate: N.A.

- 3.416 Exemption for Commercial Fishing Vessels
Vessels, machinery, equipment and spare parts used exclusively in commercial fishing are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(o)
Estimate: \$1.1

- 3.417 Exemption for Commuter Boats
Vessels, materials, tools, repair and spare parts used exclusively to provide scheduled commuter passenger service are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(pp)
Estimate: N.A.

- 3.418 Exemption for Fuels, Supplies and Repairs for Vessels Engaged in Interstate or Foreign Commerce
Fuels, supplies and repairs for vessels engaged in interstate or foreign commerce are exempt from sales tax.

Comment: Data were available only for fuels sold to bunkering vessels.

Origin: M.G.L. c. 64H, § 6(o)
Estimate: \$1.6

- 3.419 Exemption for Fuel Used in Operating Aircraft and Railroads
Fuel used in operating aircraft and railroads is exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(j)
Estimate: \$14.5

- 3.420 Exemption for Sales of Certain New or Used Buses
New and used buses which provide scheduled intra-city local service and are used by common carriers certified by the Department of Public Utilities are exempt from sales tax. The exemption includes replacement parts, materials and tools used to maintain or repair these buses.

Origin: M.G.L. c. 64H, § 6(aa)
Estimate: N.A.

- 3.421 Exemption for Films
Motion picture films for commercial exhibition are exempt from sales tax.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Origin: M.G.L. c. 64H, § 6(m)
Estimate: N.A.

- 3.422 Exemption for Telephone and Telegraph Services
Sales of residential telecommunications services of up to \$30 per month are exempt from sales tax.

Origin: M.G.L. c. 64H, § 6(i)
Estimate: \$41.8

3.500 EXEMPT NOT TAXABLE AS TANGIBLE PERSONAL PROPERTY

- 3.501 Nontaxation of Transfers of Real Property
Real estate is exempt from sales tax but is subject to a deeds excise at a rate of 0.456% of the taxable price of the property. The estimate represents revenues that would be collected under the sales tax if sales of real property were taxed at 5%.

Origin: General exclusion of real property transactions
Estimate: \$1,142.9

- 3.502 Nontaxation of Rentals of Real Property
Rental charges for real property are exempt from sales tax. However, rentals of rooms in hotels, motels or lodging houses are subject to a state excise at a rate of 5.0% of the rental price and, at a community's option, to a local excise of up to 4% of the rental price.

Origin: General exclusion of real property transactions
Estimate: \$557.6

- 3.503 Nontaxation of Certain Services
Certain services are not subject to sales tax.

Comment: This estimate includes a range of services to individuals and businesses which are excluded from taxation by their omission from the statutory definition of services.

Origin: M.G.L. c. 64H
Estimate: \$4,750.0

- 3.504 Nontaxation of Internet Access and Related Services
Internet access services, electronic mail services, electronic bulletin board services, web hosting services or similar on-line computer services are not subject to the sales and use tax.

Origin: M.G.L. c. 64H § 1

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Estimate: \$12.5

3.600 MISCELLANEOUS EXEMPTIONS

3.601 Exemption for Casual or Isolated Sales

Casual or isolated sales (sales by private parties) are exempt from sales tax, except casual sales of motor vehicles, trailers, airplanes and boats. Sales of these listed items are exempt only when they are between family members.

Origin: M.G.L. c. 64H, §§ 6(c) and M.G.L. c. 64I, § 7(b)

Estimate: N.A.

3.602 Exemption for Vending Machine Sales

Vending machine sales of ten cents or less are exempt from sales tax. In addition, sales through vending machines which exclusively sell snacks and candy with a sales price of less than one dollar are exempt from the sales tax on meals.

Origin: M.G.L. c. 64H, § 6(h) and (t)

Estimate: N.A.

3.603 Exemption for Certain Meals

Meals prepared by churches and hospitals, meals provided to organizations for the elderly, and meals provided by educational institutions are exempt from sales tax.

Comment: Estimate is for school lunches only.

Origin: M.G.L. c. 64H, § 6(cc)

Estimate: \$6.0

3.604 Exemption for Certain Bed and Breakfast Establishments from Sales Tax on Meals and Room Occupancy Excise

Owner-occupied one, two and three-room bed and breakfast establishments are exempt from both the sales tax on meals and the room occupancy excise.

Origin: M.G.L. c. 64G, § 1, 2, 3, 3A and 6, and M.G.L. c. 64H, § 6(h)

Estimate: N.A.

3.605 Exemption for Certain Summer Camps from Sales Tax on Meals and Room Occupancy Excise

An exemption from both the sales tax on meals and the room occupancy excise is provided for summer camps for children age 18 and under, or for summer camps for developmentally disabled individuals. Camps that satisfy the above criteria but offer their facilities during the off-season to individuals

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

60 years of age or over for 30 days or less in any calendar year will not lose their exemption.

Comment: Estimate is for meals only.

Origin: M.G.L. c. 64G, § 2 and M.G.L. c. 64H, § 6(cc)

Estimate: \$0.5

- 3.606 Exemption for Trade-in Allowances for Motor Vehicles and Trailers
Motor vehicles and trailers bought in a trade-in transaction are only subject to sales tax on the excess of the purchase price over the amount credited for the trade-in.

Origin: M.G.L. c. 64H, 26, c. 64I, § 27

Estimate: \$52.0

- 3.607 Exemption for Publications of Tax-Exempt Organizations
The publications of tax-exempt organizations are exempt from sales tax.

Comment: Data were available only for books published by tax-exempt organizations.

Origin: M.G.L. c. 64H, § 6(m)

Estimate: \$2.5

- 3.608 Exemption for Gifts of Scientific Equipment
Gifts of scientific equipment or apparatus by manufacturers to non-profit educational institutions or to the Massachusetts Technology Park Corporation are exempt from sales tax..

Origin: M.G.L. c. 64H, §§ 6(jj)

Estimate: \$12.4

- 3.609 Exemption for Vessels or Barges of 50 Tons or Over
Vessels or barges weighing 50 tons or over are exempt from sales tax when constructed in-state and sold by the builder.

Origin: M.G.L. c. 64H, § 6(o)

Estimate: N.A.

- 3.610 Exemption for Rental Charges for Refuse Containers
Rental charges in connection with service contracts by and between waste service firms and customers for refuse containers or bins are exempt from sales tax when the containers are placed on the customer's premises by waste service firms.

Fiscal Year 2000 Tax Expenditure Budget: Sales and Use Tax

Origin: M.G.L. c. 64H, § 6(ii)
Estimate: N.A.

- 3.611 Exemption for Honor Trays
Food items purchased from honor trays are exempt from sales and meals taxes, provided that no item on the honor tray is sold for \$1 or more.

Comment: Honor trays are vending carts in workplaces from which snacks may be purchased on the honor system.

Origin: M.G.L. c. 64H, § 6 (h)
Estimate: N.A.

KEY: **ORIGIN**
 M.G.L. Massachusetts General Laws

ESTIMATES

All estimates are in \$ millions.

Fiscal Year 2000 Tax Expenditure Budget: Appendix A Recent Law Changes Affecting Tax Expenditures

In recent years the following tax expenditures were revised or created due to law changes:

The Personal Income Tax :

Deduction for Dependent Under 12 (budget item 1.406) Effective January 1, 1997, the deduction for taxpayers with a dependent under the age of 12 who does not claim the deduction for business-related dependent care expenses (budget item 1.409) increased from \$600 to \$1,200.

Earned Income Credit (budget item 1.605) Effective January 1, 1997, taxpayers are allowed a refundable credit against Massachusetts tax equal to 10% of the amount of the earned income credit claimed on their federal individual income tax return.

Septic System Repair Credit (budget item 1.606) Effective January 1, 1997, taxpayers required to repair or replace a failed cesspool or septic system pursuant to the provisions of Title V, as promulgated by the Department of Environmental Protection in 1995, are allowed a credit equal to 40% of the design and construction costs incurred (less any subsidy or grant from the Commonwealth), up to a maximum of \$1,500 per tax year and \$6,000 in total. Unused credits can be carried forward for up to three years.

Exemption for Retirement Pay of the Uniformed Services (budget item 1.029) Effective January 1, 1997, income received from the United States government as retirement pay and survivorship benefits for a retired member of the Uniformed Services of the United States is exempt from the personal income tax. The Uniformed Services of the United States are: the Army, Navy, Air Force, Marine Corps, Coast Guard, and the Commissioned Corps of the Public Health Service and National Oceanic and Atmospheric Administration.

Doubling of Personal Exemptions. The allowance for Personal Exemptions will be doubled over the Tax Years 1998 and 1999. (Note that tax year 1999 spans the last half of FY99 and the first half of FY2000). Strictly speaking, this is not a tax expenditure, since it applies to all filers. The exemption for single filers increased from \$2,200 to \$3,815 for tax year 1998 and will be further increased to \$4,400 for tax year 1999. For joint fillers, exemptions increase from \$4,400 to \$7,630 to \$8,800 in tax year 1999. The Head of Household exemption increases from \$3,400 to \$5,895 to \$6,800 over the same period.

Allow income exclusion for contributions to "403b" annuity plans. Effective January 1, 1998, contributions to so-called "403b" annuity plans, which are pension plans for employees of non-profit entities and public schools, are exempt from taxation.

Capital Gains Deduction (budget item 1.201). Effective January 1, 1996, only long-term capital gains realized from the sale of collectibles (as defined by sec. 408 (m) of the IRC) will be eligible for a 50% deduction from the 12% capital gains tax. Capital gains from the sale of assets other than collectibles will no longer be eligible for a 50% deduction from the 12% capital

Fiscal Year 2000 Tax Expenditure Budget: Appendix A Recent Law Changes Affecting Tax Expenditures

gains tax, but will be subject to the following tax rates depending upon how long the assets are held:

<u>Holding Period</u>	<u>Tax Rate</u>
up to one year	12%
more than one, but less than two years	5%
more than two, but less than three years	4%
more than three, but less than four years	3%
more than four, but less than five years	2%
more than five, but less than six years	1%
more than six years	0%

Assets acquired prior to January 1, 1996 are deemed to have been acquired on the later of January 1, 1995 or the actual date of acquisition.

Several tax changes have taken place to update Massachusetts tax laws to conform to the Federal code. These include exemption of earnings and distributions for Roth and Education IRA's, and the \$250,000/\$500,000 capital gains exclusion for the sale of principle residences.

The tax rate on interest and dividend income, also referred to as Part A or unearned income, has been cut from 12% to 5.95%, effective January 1, 1998. It will now be taxed at the same rate as Part B or regular earned income.

Sales and Use Tax:

Exemption for Internet Access and Related Services (budget item 3.504). Retroactive to January 1, 1990, internet access services, electronic mail services, electronic bulletin board services, web hosting services or similar on-line computer services are not subject to the sales and use tax.

Fiscal Year 2000 Tax Expenditure Budget: Appendix A Recent Law Changes Affecting Tax Expenditures

Corporate Excise:

Unequal Weighting of Sales, Payroll, and Property in the Apportionment Formula (budget item 2.401). Prior to FY98, this item was referred to as *Double Weighting of Sales*. Effective January 1, 1996, eligible defense corporations may apportion income to Massachusetts based solely on their sales in the Commonwealth, creating a 100% sales weighted formula. Other qualified manufacturers will be required to apportion income using the following formulas:

<u>Tax Year</u>	<u>Sales Weight</u>	<u>Property Weight</u>	<u>Payroll Weight</u>
1996	60%	20%	20%
1997	70%	15%	15%
1998	80%	10%	10%
1999	90%	5%	5%
2000	100%	0%	0%

Non-manufacturers will continue to be required to apportion income to Massachusetts using a formula that weights sales 50%, property 25%, and payroll 25%.

Effective January 1, 1997 mutual fund corporations are allowed to attribute mutual fund sales to Massachusetts based on the domicile of shareholders in the mutual funds. Effective July 1, 1997, mutual fund corporations are allowed to apportion their income to Massachusetts based solely on the percentage of sales attributed to Massachusetts.

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

The following table shows tax expenditure estimates for the three major taxes from Fiscal Year 1998 to Fiscal Year 2000. In general, the revenue estimate for a tax expenditure tends to follow the anticipated growth of tax collections. However, year-to-year changes in estimates may vary for four other principal reasons: we have new data sources; we have refined our methodology; we have relied on federal tax expenditure estimates which have changed; or we have revised estimates to account for changes in tax laws.

Where possible, we have recalculated past estimates based on revised data, improved methodologies, and changes in statute.

Tax Expenditure	Item Number	Fiscal Year Estimates (in \$ millions)		
		FY98 ¹	FY99 ¹	FY2000
PERSONAL INCOME TAX				
Exclusions from Gross Income				
Exemption of Premiums on Accident and Accidental Death Insurance	1.001	1.5	1.5	1.5
Exemption of Premiums on Group-Term Life Insurance	1.002	12.8	14.6	15.4
Exemption of Interest on Life Insurance Policy and Annuity Cash Value	1.003	245.6	273.8	187.2
Exemption of Employer Contributions for Medical Insurance Premiums and Medical Care	1.004	417.8	444.4	470.5
Exemption of Annuity or Pension Payments to Firefighters and Police Officers	1.005	NA	N.A.	N.A.
Exemption of Distributions from Certain Contributory Pension and Annuity Plans	1.006	6.4	6.4	6.4
Exemption of Railroad Retirement Benefits	1.007	4.4	4.5	4.5
Exemption of Public Assistance Benefits	1.008	89.8	93.3	95.6
Exemption of Social Security Benefits	1.009	493.1	505.2	514.2

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Exemption of Workers' Compensation Benefits	1.010	4.2	4.0	4.2
Exemption of Dependent Care Expenses	1.011	9.1	4.1	4.1
Exemption of Certain Foster Care Payments	1.012	3.9	4.0	4.0
Exemption of Payments Made to Coal Miners	1.013	NA	N.A.	N.A.
Exemption of Rental Value of Parsonages	1.014	0.6	2.2	3.0
Exemption of Scholarships and Fellowships	1.015	10.4	10.4	11.5
Exclusion of Certain Prizes and Awards	1.016	NA	N.A.	N.A.
Exemption of Cost-Sharing Payments	1.017	NA	N.A.	N.A.
Exemption of Meals and Lodging Provided at Work	1.018	5.3	5.4	6.1
Treatment of Business-Related Entertainment Expenses	1.019	5.0	N.A.	N.A.
Exemption of Income from the Sale, Lease or Transfer of Certain Patents	1.020	NA	N.A.	N.A.
Exemption of Capital Gains on Home Sales for Persons 55 and Over	1.021	39.8	79.6	61.3
Nontaxation of Capital Gains at Death	1.022	72.8	89.4	86.3
Exemption of Interest from Massachusetts Obligations	1.023	118.5	194.1	106.1
Exemption of Benefits and Allowances to Armed Forces Personnel	1.024	4.8	4.3	4.5
Exemption of Veterans' Pensions, Disability Compensation and G.I. Benefits	1.025	13.5	14.2	15.5
Exemption of Military Disability Pensions	1.026	0.3	0.4	0.4

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Exemption of Compensation to Massachusetts-Based Nonresident Military Personnel	1.027	7.0	5.3	5.3
Exemption of Income Received by Persons Killed in Military Action or Terrorist Activity	1.028	N.A.	N.A.	N.A.
Exemption of Retirement Pay of the Uniformed Services	1.029	25.0	18.0	18.0
Deferrals of Gross Income				
Net Exemption of Employer Contributions and Earnings of Private Pension Plans	1.101	556.1	584.1	601.0
Treatment of Incentive Stock Options	1.102	N.A.	N.A.	N.A.
Exemption of Earnings on Stock Bonus Plans or Profit Sharing Trusts	1.103	N.A.	N.A.	N.A.
Exemption of Earnings on IRA and Keogh Plans	1.104	N.A.	134.0	144.7
Deferral of Capital Gains on Home Sales	1.105	40.0	N.A.	N.A.
Nontaxation of Capital Gains at Time of Gift	1.106	--- included in 1.022 ---		
Deductions from Gross Income				
Capital Gains Deduction	1.201	N.A.	N.A.	N.A.
Deduction of Capital Losses against Interest and Dividend Income	1.202	N.A.	N.A.	N.A.
Excess Natural Resource Depletion Allowance	1.203	1.4	1.8	0.9
Abandoned Building Renovation Deduction	1.204	NA	N.A.	N.A.
Accelerated Deductions from Gross Income				
Accelerated Depreciation on Rental Housing	1.301	5.6	11.2	10.5
Accelerated Depreciation on Rehabilitation of Low Income Housing	1.302	N.A.	N.A.	N.A.

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Accelerated Depreciation on Buildings (other than Rental Housing)	1.303	7.7	8.2	6.4
Accelerated Cost Recovery System (ACRS) for Equipment	1.304	42.8	33.9	36.1
Deduction for Excess First-Year Depreciation	1.305	1.7	1.6	1.1
Five-Year Amortization of Start-Up Cost	1.306	0.8	1.3	1.3
Five-Year Amortization of Certain Operating Rights	1.307	NA	N.A.	N.A.
Expensing of Exploration and Development Costs	1.308	0.3	0.0	0.0
Expensing of Research and Development Expenditures in One Year	1.309	0.6	0.0	-
Five-Year Amortization of Pollution Control Facilities	1.310	NA	N.A.	N.A.
Seven Year Amortization for Reforestation	1.311	NA	N.A.	N.A.
Expensing of Certain Capital Outlays of Farmers	1.312	0.2	0.4	0.6
Deductions from Adjusted Gross Income				
Deduction for Employee Social Security and Railroad Retirement Payments	1.401	273.4	278.9	281.1
Deduction for Employee Contributions to Public Pension Plans	1.402	--- included in 1.401 ---		
Additional Exemption for the Elderly	1.403	12.7	13.3	13.1
Additional Exemption for the Blind	1.404	0.8	0.7	0.7
Dependents Exemption where the Child Earns Income	1.405	N.A.	N.A.	N.A.
Deduction for Dependent Under 12	1.406	31.5	28.3	28.2
Personal Exemption for Students Aged 19 or Over	1.407	4.9	6.9	6.9
Deduction for Adoption Fees	1.408	0.6	0.6	0.6

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Deduction for Business-Related Child Care Expenses	1.409	15.2	14.0	13.7
Exemption of Medical Expenses	1.410	24.1	26.7	27.4
Rent Deduction	1.411	90.6	93.0	95.0
Nontaxation of Charitable Purpose Income of Trustees, Executors or Administrators	1.412	NA	N.A.	N.A.
Exemption of Interest on Savings in Massachusetts Banks	1.413	10.4	11.8	12.3
Tuition Tax Deduction	1.414	13.0	13.0	13.0
Preferential Rate of Taxation				
Preferential Treatment of Interest on Savings in Massachusetts Banks	1.501	86.5	39.0	0.0
Credits Against Tax				
Renewable Energy Source Credit	1.601	N.A.	0.7	0.8
Credit for Removal of Lead Paint	1.602	1.7	1.7	1.8
Economic Opportunity Area Credit	1.603	NA	N.A.	0.1
Credit for Employing Former Full-Employment Program Participants	1.604	NA	N.A.	N.A.
Earned Income Credit	1.605	29.0	30.0	30.0
Septic System Repair Credit	1.606	17.0	18.0	18.0
Subtotal ²		2,860.2	3,132.2	2970.9

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Tax Expenditure	Item Number	Fiscal Year Estimates (in \$ millions)		
		FY98 ¹	FY99 ¹	FY2000
CORPORATE EXCISE				
Exclusions from Gross Income				
Small Business Corporations	2.001	16.8	16.4	16.0
Exemption of Income from the Sale, Lease or Transfer of Certain Patents	2.002	N.A.	N.A.	N.A.
Deferrals of Gross Income				
Deferral of Tax on Certain Shipping Companies	2.101	0.1	0.1	0.1
Deductions from Gross Income				
Charitable Deduction	2.201	10.2	11.1	12.3
Additional Deduction for Certain Businesses in a Poverty Area (UJIP)	2.202	0.2	0.3	0.3
Net Operating Loss (NOL) Carryover	2.203	118.8	120.0	121.2
Excess Natural Resource Depletion Allowance	2.204	0.1	0.1	0.1
Deduction for Certain Dividends of Cooperatives	2.205	N.A.	N.A.	N.A.
Abandoned Building Renovation Deduction	2.206	1.8	1.8	1.8
Accelerated Deductions from Gross Income				
Accelerated Depreciation on Rental Housing	2.301	8.0	1.5	1.5
Accelerated Depreciation for Rehabilitation of Low-Income Housing	2.302	N.A.	N.A.	N.A.
Expensing for Removal of Barriers to the Handicapped	2.303	0.3	N.A.	N.A.
Five-Year Amortization of Start-Up Cost	2.304	0.4	0.4	0.4

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Accelerated Cost Recovery System (ACRS) for Equipment	2.305	174.2	163.1	170.7
Deduction for Excess First-Year Depreciation	2.306	4.8	3.4	3.4
Accelerated Depreciation on Buildings (other than Rental Housing)	2.307	18.3	13.4	10.6
Expensing Research and Development Expenditures in One Year	2.308	41.5	30.3	38.3
Expensing of Exploration and Development Costs	2.309	0.2	0.3	0.3
Five-Year Amortization of Certain Operating Rights	2.310	N.A.	N.A.	N.A.
Five-Year Amortization of Pollution Control Facilities	2.311	N.A.	N.A.	N.A.
Expensing of Certain Expenditures for Alternative Energy Sources	2.312	0.6	0.6	0.7
Seven-Year Amortization for Reforestation	2.313	N.A.	N.A.	N.A.
Adjustments to Apportionment Formula				
Unequal Weighting of Sales, Payroll, and Property in Apportionment Formula	2.401	198.4	222.0	247.4
Exclusions from Property Component				
Nontaxation of Certain Energy Property	2.501	N.A.	N.A.	N.A.
Exemption for Property Subject to Local Taxation	2.502	91.8	97.8	102.3
Credits Against Tax				
Tax Credit for Building in a Poverty Area (UJIP)	2.601	0.1	0.1	0.1
Investment Tax Credit	2.602	16.9	27.7	32.2
Vanpool Credit	2.603	0.2	0.2	0.2
Research Credit	2.604	77.3	78.6	80.3
Economic Opportunity Area Credit	2.605	3.0	3.3	3.4
Credit for Employing Former Full-Employment Program Participants	2.606	N.A.	N.A.	N.A.
Credit for Harbor Maintenance Taxes Paid	2.607	3.9	4.0	4.2

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Entity Exempt from Taxation				
Exemption of Credit Union Income	2.701	3.5	3.7	4.0
Tax-Exempt Organizations	2.702	N.A.	N.A.	N.A.
Exemption for Regulated Investment Companies	2.703	N.A.	N.A.	N.A.
Subtotal²		791.4	800.2	851.8
 SALES AND USE TAX				
Exempt Entities				
Exemption for Sales to the Federal Government	3.001	N.A.	N.A.	N.A.
Exemption for Sales to the Commonwealth	3.002	N.A.	N.A.	N.A.
Exemption for Sales to Tax-Exempt Organizations	3.003	295.3	313.0	331.8
Exempt Products/Services				
Exemption for Food	3.101	349.4	352.0	354.3
Exemption for Certain Food and Beverages Sold in Restaurants	3.102	N.A.	N.A.	N.A.
Exemption for Clothing	3.103	204.0	205.6	206.8
Exemption for Medical and Dental Supplies and Devices	3.104	92.4	93.1	93.7
Exemption for Water	3.105	30.1	30.3	30.6
Exemption for Newspapers and Magazines	3.106	22.6	22.8	22.9
Exemption for the American Flag	3.107	N.A.	N.A.	N.A.
Exemption for Certain Precious Metals	3.108	N.A.	N.A.	N.A.
Exemption for Cement Mixers	3.109	N.A.	N.A.	N.A.
Exemption for Fertilizers, Insecticides and Fungicides	3.110	1.1	1.1	1.1

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Exemption for Meals Served by Continuing Care Facilities	3.111	N.A.	N.A.	N.A.
Exempt, Taxed Under Another Excise				
Exemption for Alcoholic Beverages	3.201	61.6	60.9	60.3
Exemption for Motor Fuels	3.202	147.9	153.6	163.1
Exempt Component of a Product or Consumed in Production				
Exemption for Items Used in Making Clothing	3.301	1.1	1.1	1.1
Exemption for Materials, Tools, Fuels, and Machinery Used in Manufacturing	3.302	164.1	172.3	181.0
Exemption for Materials, Tools, Fuels, and Machinery Used in Research and Development	3.303	21.8	23.5	25.1
Exemption for Materials, Tools, Fuels, and Machinery Used in Furnishing Power to Consumers	3.304	52.0	54.2	56.6
Exemption for Materials, Tools, Fuels, and Machinery Used in Furnishing Power to an Industrial Manufacturing Plant	3.305	17.3	18.1	18.9
Exemption for Materials, Tools, Fuels, and Machinery Used in Newspaper Printing	3.306	18.7	18.9	19.0
Exemption for Materials, Tools, Fuels, and Machinery Used in Manufacturing of Cast Metal Products	3.307	N.A.	N.A.	N.A.
Exemption for Materials, Tools, Fuels, and Machinery Used in Agricultural Production	3.308	4.1	4.2	4.3
Exemption for Materials, Tools, Fuels, and Machinery Used in Commercial Fishing	3.309	1.1	1.1	1.1
Exemption for Materials, Tools, Fuels, and Machinery Used in Radio and TV Broadcasting	3.310	1.4	1.5	1.5
Exemptions for Specified Uses of Products/Services				

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Tax Expenditure	Item Number	Fiscal Year Estimates (in \$ millions)		
		FY98 ¹	FY99 ¹	FY2000
Exemption for Electricity	3.401	135.9	137.0	137.8
Exemption for Fuel Used for Heating Purposes	3.402	55.6	56.0	56.4
Exemption for Piped and Bottled Gas	3.403	45.1	45.4	45.7
Exemption for Steam	3.404	4.0	4.0	4.0
Exemption for Certain Energy Conservation Equipment	3.405	N.A.	N.A.	N.A.
Exemption for Funeral Items	3.406	9.4	9.5	9.5
Exemption for a Motor Vehicle for a Paraplegic	3.407	1.0	1.0	1.0
Exemption for Textbooks	3.408	8.2	8.3	8.3
Exemption for Books used for Religious Worship	3.409	N.A.	N.A.	N.A.
Exemption for Containers	3.410	90.8	92.7	96.8
Exemption for Certain Sales by Typographers, Compositors and Color Separators	3.411	N.A.	N.A.	N.A.
Exemption for Sales of Building Materials and Supplies to be Used in Connection with Certain Construction Contracts	3.412	91.0	91.9	92.8
Exemption for Plant and Seed	3.413	1.0	1.0	1.0
Exemption of Feed	3.414	1.4	1.4	1.4
Exemption for Livestock and Poultry	3.415	N.A.	N.A.	N.A.
Exemption for Commercial Fishing Vessels	3.416	1.0	1.1	1.1
Exemption for Commuter Boats	3.417	N.A.	N.A.	N.A.
Exemption for Fuels, Supplies, and Repairs for Vessels Engaged in Interstate or Foreign Commerce	3.418	1.6	1.6	1.6

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Exemption for Fuel Used in Operating Aircraft and Railroads	3.419	14.2	14.4	14.5
Exemption for Sales of Certain New and Used Buses	3.420	N.A.	N.A.	N.A.
Exemption for Films	3.421	N.A.	N.A.	N.A.
Exemption for Telephone and Telegraph Services	3.422	39.2	40.5	41.8
Exempt, Not Taxable as Tangible Personal Property				
Nontaxation of Transfers of Real Property	3.501	1,158.9	1,071.4	1,142.9
Nontaxation of Rentals of Real Property	3.502	513.5	535.1	557.6
Nontaxation of Certain Services	3.503	4,204.2	4,477.1	4,750.0
Nontaxation of Internet Access and Related Services	3.504	N.A.	10.0	12.5
Miscellaneous Exemptions				
Exemption for Casual or Isolated Sales	3.601	N.A.	N.A.	N.A.
Exemption for Vending Machine Sales	3.602	N.A.	N.A.	N.A.
Exemption for Certain Meals	3.603	5.6	5.8	6.0
Exemption for Certain Bed and Breakfast Establishments from Sales Tax on Meals and Room Occupancy Excise	3.604	N.A.	N.A.	N.A.
Exemption for Certain Summer Camps from Sales Tax on Meals and Room Occupancy Excise	3.605	0.5	0.5	0.5
Exemption for Trade-in Allowances for Motor Vehicles and Trailers	3.606	50.0	51.0	52.0
Exemptions for Publications of Tax-Exempt Organizations	3.607	2.3	2.4	2.5
Exemption for Gifts of Scientific Equipment	3.608	11.6	12.0	12.4
Exemption for Vessels or Barges 50 Tons and Over	3.609	N.A.	N.A.	N.A.

Fiscal Year 2000 Tax Expenditure Budget: Appendix B Summary Table

Fiscal Year Estimates (in \$ millions)				
Tax Expenditure	Item Number	FY98 ¹	FY99 ¹	FY2000
Exemption for Rental Charges for Refuse Containers	3.610	N.A.	N.A.	N.A.
Exemption for Honor Trays	3.611	N.A.	N.A.	N.A.
Subtotal²		7932.0	8,198.4	8623.3
GRAND TOTAL		11,583.6	12,130.8	12,446.0

ENDNOTES:

1. Estimates have been revised because of new data or improved methodology, and reflect current tax law.
2. Subtotals and totals have been provided to give an idea of the revenue costs of tax expenditures by tax and in total. However, these sums should be used with extreme caution. The underlying estimates do not take into account such factors as the interaction of tax expenditures and taxpayer behavior. Also it should be noted that many estimates are not available due to a lack of data. These estimates are shown as N.A. and are not included in the subtotals and totals.

Fiscal Year 2000 Tax Expenditure Budget: Appendix C Glossary

Amortization: Annual deduction allowed for the gradual exhaustion or obsolescence of intangible assets having a limited useful life which are used in the production of income, such as patents and copyrights; analogous to depreciation of tangible assets.

Capital Expenditure: An expenditure made in acquiring, adding to or bettering a fixed asset. For accounting purposes, capital expenditures are not charged against current revenue. They are added to capital account or "capitalized" and then may be depreciated, amortized, or recovered when a business is sold. To be distinguished from an expense.

Credit: Amount by which a taxpayer is allowed to reduce a tax liability, as computed by applying the tax rates to the tax base; to be distinguished from a deduction from the tax base.

Deduction: Amount which a taxpayer is allowed to subtract from the gross tax base.

Depreciation: Annual deduction allowed for the gradual exhaustion or obsolescence of tangible property used in the production of income.

Exclusion: The legal elimination from the tax base of items recognized as falling within its definition. The federal term for what is sometimes called an exemption for Massachusetts. (See below.)

Exemption: The legal elimination from the tax base of items or transactions recognized as falling within its definition, or of taxable units which would normally be subject to tax.

Expense: A revenue expenditure or cost which, for accounting purposes, is charged against current revenue. To be distinguished from a capital expenditure.

Gross income: The total of all items included in the concept of income that a taxpayer receives during the taxable period.

Net income: Amount remaining after subtracting exempt income and deductions from gross income.

Personal exemption: A specific amount or percentage of net income on which the tax rate is zero. To be distinguished from an exemption as defined above, which applies to a class of income or taxpayers. Sometimes called an "allowance".

Taxable income: Amount to which the tax rates are applied in computing tax liability, after subtracting personal exemptions from net income.