Tax Expenditure Review Commission Meeting

Friday, November 22, 2024

1:00 PM

Via Zoom

Commission Members in Attendance:

* Chairperson Rebecca Forter, MA Department of Revenue
* Lindsay Janeczek, Designee, MA Auditor
* Sue Perez, Designee, MA Treasurer
* Stephen Maher, Designee, Joint Revenue Committee, Senate Co-Chair
* Amar Patel, Designee, Senate Ways and Means Committee
* Chris Carlozzi, Designee, Senate Minority Leader
* Professor Natasha Varyani, Governor’s Appointee
* Professor Thomas Downes, Governor’s Appointee

Commission Members Absent:

* Tim Sheridan, Designee, House Ways and Means Committee
* Ryan Sterling, Designee, Joint Revenue Committee, House Co-Chair
* Representative Michael Soter, Designee, House Minority Leader

List of Documents:

* Meeting Agenda
* Draft Minutes
  + October 1, 2024 Meeting
* Presentation of October tax expenditure evaluation ratings, discuss and vote on ratings
  + 1.203 & 2.204 Excess Natural Resource Depletion Allowance
  + 1.310 & 2.311 Five-Year Amortization of Pollution Control Facilities
  + 1.041 Earnings of Pre-paid and Tuition Savings ("529" plans)
  + 1.427 Prepaid Tuition or College Savings Plan Deduction
  + 1.414 Tuition Tax Deduction
  + 1.425 Student Loan Interest Deduction
  + 3.408 Exemption for Textbooks
  + 1.035 Department of Defense Homeowners Assistance Plan

Meeting Minutes:

Chairperson Forter welcomed Commission members, and a quorum was recognized. The meeting via teleconference was called to order at 1:01 PM. Chairperson Forter put the Commission and public on notice that the meeting is recorded for the purpose of minutes. The recording of the meeting will be kept for public record.

Chairperson Forter noted a change in membership. Stephen Maher will no longer be serving the Commission as the designee for Senator Susan L. Moran, Senate Chair, Joint Revenue Committee. Nicole Manfredi will be serving as the replacement designee. Chairperson Forter welcomed Nicole and Nicole introduced herself.

Chairperson Forter asked for any comments or changes on the October 1, 2024 draft meeting minutes. Members did not provide any comment. Members voted to approve the October ‘24 meeting minutes as drafted. The meeting minutes will be posted to the TERC website.

Lindsay Janeczek led a discussion on the Excess Natural Resource Depletion Allowance. This tax expenditure was adopted in 1976 and has an annual revenue impact of $2.8 - $4.0 million per year for corporate excise filers, and $0.4 million per year for personal income tax filers during FY22 - FY26 with no sunset date.

Due to Massachusetts’ reliance on the Internal Revenue Code (Code) for purposes of determining income, taxpayers in extractive industries such as mining or drilling for natural resources may deduct a percentage of gross mining income as a depletion allowance ("percentage depletion") without regard to their cost basis in the income producing property and may continue to claim the depletion allowance even after the cost of the property has been reduced to zero. This method of cost recovery is often more beneficial to taxpayers than the traditional cost recovery method applicable to natural resource property.

All states that impose an individual or corporate income tax adopt the depletion allowance unless they decouple from the Code in that regard. The Commission is not aware of any state that has decoupled. States that adopt the exclusion include California, Connecticut, Maine, New Hampshire, New York, Rhode Island, and Vermont.

The Commission assumes that the tax expenditure is intended to stimulate extractive industries’ investment in natural resource property such as mines, wells, and other mineral deposits.

The administration of the depletion percentage method for recovering the cost of natural resource property does not present any special challenges for the DOR. Conformity with the federal system of cost recovery for natural resources simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. DOR assumes that this consistency of treatment also eases the compliance burden for taxpayers and practitioners.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Excess Natural Resource Depletion Allowance evaluation template with a change from Strongly Agree to Somewhat Agree on the question of whether the amount claimed per taxpayer is meaningful as an incentive/benefit.

Natasha Varyani led a discussion on the Five-Year Amortization of Pollution Control Facilities. This tax expenditure was adopted in 1969 and has an annual revenue impact of $0.3 million per year for corporate excise tax filers and $0.0 for personal income tax filers during FY22 - FY26 with no sunset date.

Due to Massachusetts’ reliance on the Internal Revenue Code (Code) for purposes of determining income, taxpayers may elect to amortize the cost of a certified pollution control facility over a five-year period, potentially allowing for accelerated recovery of these costs.

All states that impose an income tax adopt the amortization unless they decouple from the Code in that regard. The Commission is not aware of any state that has decoupled. States that adopt the amortization include California, Connecticut, Maine, New Hampshire, New York, Rhode Island, and Vermont.

The Commission assumes the goal of the expenditure is to incentivize the construction of pollution control facilities by allowing accelerated recovery of the cost of such facilities.

The administration of the five-year, or seven-year, amortization of pollution control facilities does not present any special challenges for the DOR. Conformity with the federal treatment simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. DOR assumes that this consistency of treatment also eases the compliance burden for taxpayers and practitioners.

Members discussed why the group of claimants may be small. Members noted that this tax expenditure was adopted in 1969 and that the types of pollution control facilities, and the technology used, has since changed. Members also questioned the potential impact of Governor Healey’s ClimateTech Initiative on this tax expenditure.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Five-Year Amortization of Pollution Control Facilities evaluation template as presented.

Thomas Downes led a discussion on Earnings of Pre-paid and Tuition Savings ("529" plans). This tax expenditure was adopted in 1996 and has an annual revenue impact of $15.9 - $37.3 million per year during FY22 - FY26 with no sunset date.

Due to Massachusetts’ reliance on the Internal Revenue Code (Code) for purposes of determining income, Massachusetts allows an income exclusion for amounts earned by pre-paid tuition programs and tuition savings accounts.

States that conform to the Code for individual income tax purposes provide an exclusion for the earnings of pre-paid tuition programs and tuition savings accounts unless they specifically decouple from the Code in this regard. The Commission is not aware of any states that have decoupled.

The Commission assumes the goal of the expenditure is to encourage taxpayers to save for higher education costs.

The administration of this exclusion does not present any special challenges for the Department of Revenue (DOR). The consistency of treatment of pre-paid tuition programs and tuition savings accounts for federal and Massachusetts purposes allows the DOR and taxpayers to rely on the federal rules and definitions pertaining to such programs and accounts.

Members noted that this tax expenditure is mostly claimed by higher income earners and questioned whether this tax expenditure produces savings or shifts the way in which people save. Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Earnings of Pre-paid and Tuition Savings ("529" plans) evaluation template with a change from Somewhat Disagree to Somewhat Agree on the question of whether the tax expenditure is claimed by a broad group of taxpayers.

Amar Patel led a discussion on the Prepaid Tuition or College Savings Plan Deduction. This tax expenditure was adopted in 2016 and has an annual revenue impact of $3.2 - $3.7 million per year during FY22 - FY26 with no sunset date.

Massachusetts allows taxpayers a deduction of up to $1,000 per individual or $2,000 per married couple filing jointly for contributions to an account in a pre-paid tuition program or college savings program.

Many states allow a deduction for contributions to education savings accounts. The amount of the deduction varies. States that allow a deduction include Connecticut (up to $5,000 for single filers and $10,000 for joint filers), New York (up to $5,000 for single filers and $10,000 for joint filers), and Rhode Island (up to $500 for single filers and $1,000 for joint filers). Vermont allows a credit for 10% of contributions up to $2,500 of contributions by single filers and up $5,000 of contributions by joint filers. California and Maine do not allow a deduction or a credit.

The Commission assumes the goal of the expenditure is to encourage taxpayers to save for higher education costs.

The administration of the deduction for contributions to pre-paid tuition programs and college savings accounts presents some challenge for the Department of Revenue (DOR) as it is not based on any current federal deduction. However, plan sponsors are required to report contributions, earnings and withdrawals with respect to such programs and plans for both state and federal purposes. Such reporting assists the DOR in monitoring the deduction and helps taxpayers comply with the rules pertaining to the deduction.

Members agreed that this tax expenditure should not be flagged for legislative review. Members discussed the similarities between this tax expenditure and the Earnings of Pre-paid and Tuition Savings ("529" plans) and agreed to reconcile evaluation template ratings. Members voted to approve the Prepaid Tuition or College Savings Plan Deduction evaluation template with a change from Strongly Agree to Somewhat Agree on the question of whether the tax expenditure’s benefit justifies its fiscal cost and a change from Somewhat Agree to Somewhat Disagree on the question whether the tax expenditure is primarily beneficial to lower income taxpayers.

Chairperson Forter led a discussion on the Tuition Tax Deduction. This tax expenditure was adopted in 1996 and has an annual revenue impact of $17.4 - $17.7 million per year during FY22 - FY26 with no sunset date.

A deduction is allowed for tuition payments made by taxpayers, for themselves or their dependents, for programs that would lead to a degree or certificate from a two or four-year college. The deduction is equal to the amount by which the net tuition payments exceed 25% of the filer's Massachusetts adjusted gross income.

Few states offer a deduction for tuition payments. New York allows a credit of up to $400 or an itemized deduction of up to $10,000 for tuition payments, with no income limitations. Maine allows a credit of up to $3,500 for student loan repayments made by low-income taxpayers. No deduction is available in California, Connecticut, Rhode Island, or Vermont.

The Commission assumes the goal of the expenditure is to decrease the financial barriers to higher education by helping students and their parents defray tuition costs.

The administration of the tuition deduction presents some challenge for the Department of Revenue (DOR). As there is no corresponding federal deduction, the DOR cannot rely on federal enforcement measures to monitor the deduction. However, there are federal credits for tuition. Educational institutions must provide most students with a US Form 1098-T (tuition statement) for purposes of reporting these credits. Form 1098-T includes a box for payments received for qualified tuition. This information can be used to monitor compliance with the Massachusetts tuition deduction.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Tuition Tax Deduction evaluation template as presented.

Sue Perez led a discussion on the Student Loan Interest Deduction. This tax expenditure was adopted in 1999 and has an annual revenue impact of $15.6 - $17.5 million per year during FY22 - FY26 with no sunset date.

Massachusetts allows two alternative deductions for student loan interest. The first is the deduction for student loan interest allowed under the Internal Revenue Code (Code), to which Massachusetts conforms. The Code allows a deduction of up to $2,500 of interest paid on loans used to pay for undergraduate or graduate education, subject to income limitations. The second deduction is a Massachusetts deduction that applies to interest on undergraduate student loans. This deduction is not limited in amount and is not subject to income limitations. Taxpayers cannot take both deductions for the same interest payments.

Most states that adopt the Code for individual income tax purposes allow the federal deduction of up to $2,500 for student loan interest. California, Connecticut, Maine, Rhode Island, and Vermont allow such a deduction. New York allows an uncapped deduction for interest on undergraduate student loans similar to the second Massachusetts deduction summarized above.

The Commission assumes the goal of the expenditure is to decrease the financial barriers to higher education by helping students defray interest expenses related to student loans.

The administration of this expenditure does not present any special challenges for the Massachusetts Department of Revenue (DOR). Conformity with the federal deduction simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. Although the second Massachusetts deduction is not based on the Code, it poses no particular administrability challenge. Educational institutions must provide students with a US Form 1098-E, which includes a box for student loan interest. DOR can use this information to monitor compliance with both deductions.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Student Loan Interest Deduction evaluation template with an additional comment noting that it may be worthwhile to evaluate the state and federal expenditures separately when this tax expenditure is revisited by the Commission during the next evaluation cycle.

Thomas Downes led a discussion on the Exemption for Textbooks. This tax expenditure was adopted in 1968and has an annual revenue impact of $10.2 - $12.2 million per year during FY22 – FY26 with no sunset date

Sales of textbooks and other books required for instructional purposes at educational institutions are exempt from sales and use tax.

States vary in their sales and use tax treatment of textbooks required for courses at educational institutions. The Massachusetts exemption is broader than similar exemptions in most other states. For example, Connecticut, New York, and Rhode Island generally limit the exemption to college-level textbooks. A substantial number of states, including California, Maine and Vermont do not provide any exemption for textbooks.

The Commission assumes the goal of the expenditure is to help defray the cost of course materials that students are required to purchase for classes at educational institutions.

The administration of the exemption for textbooks and other books required for courses at educational institutions presents some challenge for the Department of Revenue (DOR). Vendors of textbooks at the retail level are likely to have a variety of exempt and non-exempt sales. The only way to monitor the exemption is by auditing vendors. However, vendors are generally aware of the exemption for textbooks and take steps to collect sales and use tax appropriately. Thus, although audits are necessary to monitor compliance with the exemption, the DOR does not view non-compliance as a widespread problem. Vendors should maintain adequate records to demonstrate that exempt sales were properly classified in the case they are audited.

Members discussed that reducing the cost of textbooks for low-income students, and thus reducing the cost of attending college, is a reasonable goal. But that this exemption is a blunt tool to do that. At the K-12 level, most public schools do not require students to purchase books. Any benefits to consumers go disproportionately to higher-income families. Private schools are more likely to require purchases. At the college level, attendees tend to have higher lifetime incomes. Further, given that demand for textbooks has become increasing elastic, a significant portion of benefits goes to textbook publishers and, to a lesser extent, authors. Nevertheless, an important group of lower-income students find textbooks prohibitively expensive. With the growth of electronic books, a better strategy to support those students may be to provide the libraries of public colleges and universities with the resources to make electronic versions of textbooks available for students.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Exemption for Textbooks evaluation template as presented.

Chairperson Forter led a discussion on the Department of Defense Homeowners Assistance Plan. This tax expenditure was adopted in 1984 and has an annual revenue impact of $0.0 - $0.2 million per year during FY22 - FY26 with no sunset date.

Due to Massachusetts’ conformity with the Internal Revenue Code (Code), Massachusetts adopts the federal exclusion for qualified military base realignment and closure fringe benefits paid by the Department of Defense (DOD) to military personnel, eligible civilian personnel, or their spouses. Such benefits are paid to eligible individuals to compensate them for certain losses incurred on the sale of their homes as a result of having to move because of base closures or injury related to military service.

States that conform to the Code for individual income tax purposes allow the federal exclusion for qualified military base realignment and closure fringe benefits, unless they decouple from the Code in that regard. The Commission is not aware of any state that has decoupled.

The Commission assumes the goal of the expenditure is to allow the DOD to make tax-free payments to military personnel, eligible civilian personnel, or their spouses, to compensate such individuals for loss of home property values owing to relocation resulting from military base closures or because of injury from military service.

The administration of the exclusion for qualified military base realignment and closure fringe benefits does not present any special challenges for the Department of Revenue (DOR) as it is based on a federal exclusion that is monitored by the Internal Revenue Service (IRS). The Commission assumes that the consistency of treatment of such payments for federal and Massachusetts purposes also eases the compliance burden for taxpayers.

Members agreed that this tax expenditure should not be flagged for legislative review. Members voted to approve the Department of Defense Homeowners Assistance Plan evaluation template as presented.

Members agreed to reconvene in January. The purpose of the next meeting is to discuss the next batch of tax expenditures. Chairperson Forter thanked members for their contributions to the Commission and concluded the meeting at 2:09 PM.