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April 30, 2012

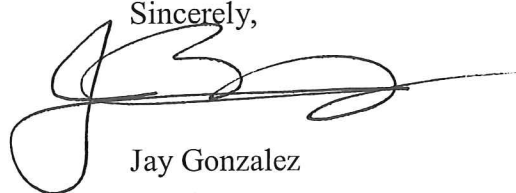
William F. Welch  
Clerk of the Senate  
State House, Room 335  
Boston, MA 02133

Steven T. James  
Clerk of the House of Representatives  
State House, Room 145  
Boston, MA 02133

Dear Mr. Welch and Mr. James:

I have the honor to transmit to the General Court the report of the Tax Expenditure Commission, established by Section 160 of Chapter 68 of the Acts of 2011.

Thank you for your attention to this.

Sincerely,  
  
Jay Gonzalez



*The Commonwealth Of Massachusetts*

REPORT OF THE  
TAX EXPENDITURE COMMISSION

April 30, 2012

Available online at:

<http://www.mass.gov/dor/tax-professionals/news-and-reports/tax-expenditure-commission-materials/>

**Report of the Tax Expenditure Commission**  
**Commonwealth of Massachusetts**  
**April 30, 2012**

**I. Executive Summary**

Last year, in its fiscal year 2012 budget, the Legislature established and Governor Patrick approved a Tax Expenditure Commission to study carefully for the first time the various exemptions, deductions, and credits in the Massachusetts tax code, and to recommend methods for measuring and reviewing their effectiveness. This Commission met publicly nine times from October 2011 until April 2012, reviewed reams of data and analysis assembled by the Department of Revenue and others, and now makes this report.

The Commission concluded that Massachusetts tax expenditures have become quite complicated, and are large when compared both with Massachusetts tax revenues collected and with other states' tax expenditures in proportion to their revenues. While many Massachusetts tax expenditures serve important public policy objectives, some may not, and there is a lack of adequate data and of opportunity for regular review and consideration of existing tax expenditures' cost and effectiveness by policymakers. Finally, certain types of tax expenditures are worthy of more intense oversight and review.

The Commission adopted formal findings and guiding principles, and ultimately several recommendations to the Governor and Legislature, including the following:

- The Legislature and Governor should work together to identify and publish for each tax expenditure a clearly articulated public policy purpose and desired outcome.
- The A&F Office of Commonwealth Performance, Accountability, and Transparency (CPAT), working with DOR, should identify metrics for assessing tax expenditures' effectiveness at achieving these purposes and outcomes, collect the necessary data, and report periodically to the Governor and Legislature with analysis (including analysis of Massachusetts tax payment obligations) and recommendations for elimination or modification of tax expenditures to meet these purposes and outcomes.
- Based on these reports, the Legislature should periodically review all tax expenditures (with consideration of Massachusetts' effective tax payment obligations relative to other states):
  - discretionarily awarded grant-like tax expenditures should periodically expire or "sunset" every 5 years unless affirmatively renewed by law;

- other business tax expenditures for specific industries or having clearly defined public policy objectives should receive enhanced periodic review every 5 years, but without sunseting;
  - all other tax expenditures should be reviewed every 10 years.
- Discretionarily awarded grant-like tax expenditures should be administered in accordance with certain best practices and be subject to specific enforcement mechanisms, including clear written conditions and commitments, and if those conditions are not met, thresholds for further review and enforcement, including the possibility of “clawbacks” where appropriate.
  - In the interest of simplicity and equity, the Legislature and the Governor should work together to reduce the number of existing tax expenditures and the total amount of forgone revenue from the Tax Expenditure Budget, to the extent appropriate to ensure that tax expenditures are limited to those that are highly effective at achieving the identified public policy purpose.
  - Before approving any new tax expenditure, the Legislature and the Governor should include in the formal legislative proposal:
    - the new tax expenditure’s clearly specified public policy purpose and desired outcome;
    - a finding that the tax expenditure is expected to be highly effective at achieving the identified public policy purpose;
    - for discretionarily awarded grant-like tax expenditures, an overall annual dollar cap on forgone revenue;
    - estimates of the anticipated forgone revenue from any new tax expenditure such that these estimates can be considered by CPAT, the Legislature, and the Governor in the course of their subsequent periodic evaluations of tax expenditures;
    - for discretionarily awarded grant-like tax expenditures, criteria to be applied by the administering agency in making discretionary awards within the cap;
    - a provision requiring that the tax expenditure sunset or be reviewed periodically (see above);
    - for discretionarily awarded grant-like tax expenditures, provisions for administration in accordance with certain best practices and for specific enforcement mechanisms, including:
      - clear written conditions and commitments;
      - if conditions are not met, thresholds for further review and enforcement, including the possibility of “clawbacks” where appropriate;
      - public disclosure of recipients and tax benefits; and



- a competitive award process.

A reduction in size of the Tax Expenditure Budget provides the opportunity to reduce tax rates paid by everyone, or to generate more revenue to support government programs and services. The Tax Expenditure Commission is expressly not making recommendations on the extent to which revenue resulting from elimination of tax expenditures should be used to reduce rates, as opposed to being used for government programs and services. Such a discussion is outside the scope of the Tax Expenditure Commission and involves a policy decision for the Legislature and the Governor to determine.

## II. The Tax Expenditure Commission

### A. Genesis and Mandate of the Commission

The Tax Expenditure Commission (the “Commission”) was established in 2011 pursuant to an “outside section” of the Massachusetts fiscal year 2012 General Appropriation Act (Acts of 2011, Chapter 68, Section 160). The Commission’s mandate, mission, and composition are described in that legislation, as follows:

“Notwithstanding any general or special law to the contrary, there shall be established a tax expenditure commission that shall review and evaluate the administration and fiscal impact of tax expenditures, as defined in section 1 of chapter 29 of the General Laws, and make recommendations to the General Court on the administrative efficiency and cost benefit of tax expenditures. The commission shall consider the public policy objectives behind the grant of any tax expenditure, the metrics for measuring success in meeting those objectives and the need for additional reporting, sunset or clawback provisions. A report of the commission’s findings shall be filed with the general court on or before April 30, 2012, which shall include any recommendations regarding changes to the administration or evaluation of current tax expenditures and criteria for evaluating proposals for new tax expenditures.

The commission shall be comprised of the secretary of administration and finance or the secretary’s designee, who shall serve as chair; the state auditor or the auditor’s designee; the state treasurer and receiver general or the treasurer’s designee; the minority leader of the house of representatives or the house leader’s designee; the minority leader of the senate or the senate leader’s designee; the chair of the house committee on ways and means or the chair’s designee; the chair of the senate committee on ways and means or the chair’s designee; the house and senate chairs of the joint committee on revenue or their respective designees; and 2 members of the governor’s council of economic

advisors, as designated by the governor, who shall have an expertise in economics or tax policy.”

As described further in Part III of this Report, and in substantial detail in the minutes and other materials recording the discussions of, and presentations to, the Commission (and reflected in the various Appendices to this Report), the term “tax expenditures” generally refers to provisions of the tax laws -- including various exemptions, exclusions, deductions, credits, and other features -- that convey an economic benefit designed for particular taxpayers or classes thereof (e.g., one or more industries or types of business, students, lower-income taxpayers, etc.) or to incentivize particular economic, social, or other activities on the part of taxpayers or other institutions. As examples, the concept of a tax expenditure would generally include tax deductions or credits designed as a stimulus to encourage capital investment in machinery for manufacturing, the conduct of scientific research, the production of motion pictures, educational pursuits, or energy conservation. Tax expenditures would also encompass various exemptions from sales tax, such as those for groceries and items of clothing, or for certain medical devices.

Tax expenditures provide a form of governmental assistance to particular taxpayers, industries, or activities where such assistance is furnished through the tax system rather than by direct appropriations of government funds. Because the benefits accorded via tax expenditures may be substantial, and may not receive the same form of government attention in the budget process as do direct appropriations, the practice of preparing an annual tax expenditure budget developed, first at the federal level more than 40 years ago and more recently among 41 States and the District of Columbia (see Part III of this Report below). The practice of preparing and publishing a tax expenditure budget in Massachusetts is required by Massachusetts law, and dates back to 1986.

Tax expenditures do not generally include provisions of the tax law that are viewed as an inherent part of the “normative” structure of a particular tax. For example, in the context of business income taxes, a tax law provision that allows a deduction for ordinary and necessary business expenses, such as reasonable compensation of employees or depreciation of capital equipment, is generally not viewed as a tax expenditure, because it is part of the normative structure of a tax that in its very concept is designed to tax net income (gross income less deductions reasonably incurred in generating that income). On the other hand, tax law provisions allowing accelerated types of depreciation, or even expensing (essentially, 100% depreciation in the year of acquisition), of capital plant and equipment, for the purpose of stimulating investment in such capital assets, are generally viewed as tax expenditures designed to encourage a certain type of investment.

A tax expenditure budget is a technique to provide a compilation of the cost in forgone revenue to the government of all of the tax expenditures accorded to



taxpayers in a particular year or other stated period. After originating with the federal government in the late 1960's, tax expenditure budgets are now commonly compiled and published by most of the States as well, and are prepared and published in Massachusetts by the Department of Revenue pursuant to Massachusetts law. See Part III of this Report below.

## B. Members and Staffing

Pursuant to the terms of the legislation establishing the Tax Expenditure Commission (above), the members of the Commission who have participated in the Commission's work are:

Jay Gonzalez, Secretary of Administration and Finance, *Chair of the Commission*  
Hon. Suzanne Bump, State Auditor, or designee  
Hon. Steven Grossman, State Treasurer and Receiver General, or designee  
Sen. Katherine Clark, Senate Chair of Joint Committee on Revenue<sup>1</sup>, or designee  
Rep. Jay Kaufman, House Chair of Joint Committee on Revenue, or designee  
Sen. Stephen Brewer, Chair of Senate Committee on Ways and Means, or designee  
Rep. Brian Dempsey, Chair of House Committee on Ways and Means, or designee (often Rep. Stephen Kulik, Vice-Chair of House Committee on Ways and Means)  
Sen. Michael Knapik, designee of Senate Minority Leader Bruce Tarr  
Rep. Steven Levy, designee of House Minority Leader Bradley Jones  
Alan Clayton-Mathews, Member of Governor's Council of Economic Advisors  
James Stock, Member of Governor's Council of Economic Advisors

Staffing for the work of the Commission has been provided from several different sources. The Chair of the Commission, Secretary Gonzalez, has been assisted with respect to the organization of the Commission and the conduct of its meetings by David Sullivan, General Counsel of the Executive Office for Administration and Finance (A&F), and minutes of the meetings (described below and included in Appendix 12 to this report) have been prepared under the supervision of Mr. Sullivan by A&F legal interns Jennifer Mathews and Alexander Elder and by Paola Maynard-Moll of the Joint Committee on Revenue staff. Data and other information with respect to tax expenditures and the Tax Expenditure Budget (in Massachusetts, as well as at the federal level and in other States and foreign countries) has been compiled, analyzed, and presented by the Department of Revenue (DOR), primarily by and under the direction of Amy Pitter, Commissioner of Revenue, and Kazim Ozyurt, Director of DOR's Office of Tax Policy Analysis (OTPA). Mr. Ozyurt and the OTPA staff have been assisted in these endeavors by DOR's Legal Division, and in particular by the Rulings and Regulations Bureau of the Legal Division, led on these matters by

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<sup>1</sup> For the first several meetings of the Commission, the Senate Chair of the Joint Committee on Revenue was Sen. Gale Candaras.

Elizabeth Moynihan, Deputy Chief of the Rulings and Regulations Bureau. DOR Deputy Commissioner and Senior Policy Counsel David Davenport was the lead drafter of this report. OTPA has also received technical and research assistance from staff of the Joint Committee on Revenue: Brendan Michael Greally (Chief Legal Counsel and Research Director), Jessica Whitman (Deputy Legal Counsel), Lexie Kuznick (Former Deputy Legal Counsel), Katherine Ryan (Senior Analyst), and legal interns Shudan Zhou, Greg Corbin, and Alyssa Holmes.

C. Meetings of the Commission; Areas of Study

The Commission conducted its work over a span of seven months, from October 2011 through April 2012. In the course of its work, the Commission held nine formal meetings, on the following dates:

October 12, 2011  
November 2, 2011  
December 7, 2011  
February 6, 2012  
March 6, 2012  
March 21, 2012  
March 27, 2012  
April 3, 2012  
April 23, 2012

Detailed minutes reporting on and recording the Commission's discussions and votes taken at these meetings, and various presentations made to the Commission, are set out in Appendix 12 to this Report.

D. Availability of Materials on the Tax Expenditure Commission, the Tax Expenditure Budget, and Tax Expenditures in Massachusetts and Elsewhere

In the course of the Commission's work, the Commission requested and reviewed extensive data and other information relating to, among other things, tax expenditures in Massachusetts (and the Tax Expenditure Budget) and tax expenditures at the federal level and in other States and countries. This information included a large body of literature relating to tax systems and tax expenditures in the Commonwealth and elsewhere.

In addition, a number of presentations were made to the Commission over the course of its deliberations, beginning with a presentation at the Commission's first meeting by Massachusetts Commissioner of Revenue Amy Pitter and OTPA Director Kazim Ozyurt concerning the nature of tax expenditures and the Massachusetts Tax Expenditure Budget (see part III.C. of this Report below). Presentations were also made to the Commission by representatives of the Executive Office of Housing and Economic Development (EOHED) and of the



Massachusetts Life Sciences Center (see Part III.F. of this Report below).

All of the data and other information, literature, reports, and presentations compiled and reviewed by and on behalf of the Commission are set out in the Appendices to this Report. An index of those Appendices immediately follows this summary of the Commission's work and its Recommendations.

Throughout the Commission's deliberations, most of these data, presentations, and reports, as well as the Commission's agendas and minutes, have been continuously available on a public website maintained by DOR.

### III. Tax Expenditures and the Tax Expenditure Budget

#### A. Federal Origins of the "Tax Expenditure" concept and the Tax Expenditure Budget

The concept of "tax expenditures" was developed at the federal level by the U.S. Department of the Treasury in 1969 under the leadership of Harvard Law School Professor Stanley Surrey, who served as Assistant Secretary of the Treasury under Presidents Kennedy and Johnson. Professor Surrey championed and described the concept in a number of articles. See, e.g., Surrey, Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures, 33 *Harvard L. Rev.* 705 (1970). As Surrey put it in that article:

"[T]he present federal income tax is replete with tax incentive provisions. Some were adopted to assist particular industries, business activities, or financial transactions. Others were adopted to encourage non-business activities considered socially useful, such as contributions to charity . . . .

The term 'tax expenditure' has been used to describe those special provisions of the federal income tax system which represent government expenditures made through that system to achieve various social and economic objectives. These special provisions provide deductions, credits, exclusions, exemptions, deferrals, and preferential rates, and serve ends similar in nature to those served by direct government expenditures or loan programs."

Surrey went on to describe the initial discussion and analysis of federal tax expenditures contained in the fiscal 1968 report to the Secretary of the Treasury, and the guidelines used in that report to try to distinguish between tax expenditures, i.e., "items that would be generally recognized as more or less intended use of the tax system to achieve results commonly obtained by government expenditures", and those items that are treated as part of the *structure* of the federal income tax based on ability to pay (such as personal exemptions) or

that are otherwise excluded from the concept of tax expenditures because of other factors, e.g., because the case for treatment as a tax expenditure would have been more “theoretical” in nature (as with the non-taxation of *imputed* rent on owner-occupied homes, which is traditionally not taxed, at least in American tax jurisdictions).

As described in a leading federal income tax casebook on which Professor Surrey had been the original and lead author, the development of the Tax Expenditure Budget was designed to permit

“tax expenditure provisions [to] be analyzed under criteria applied to spending programs rather than under criteria employed to test the operation of provisions that are part of the normative component of the income tax. Thus, with respect to each tax expenditure, it is necessary to inquire whether federal spending is needed or desirable; if so, how the program should be designed to distribute its benefits fairly, effectively, and efficiently; what controls, if any, should be placed on the program, and, finally, whether the program should be run directly or through the tax system.” Surrey, McDaniel, Ault, & Koppelman, *Federal Income Taxation – Cases & Materials* 70 (Successor ed., 1986).

B. Tax Expenditure Budget in Massachusetts; History and Scope of Statutory Requirement and Implementation

1. Statutory Foundation: Pursuant to Massachusetts statute, the Department of Revenue is directed to prepare an annual Tax Expenditure Budget reflecting “estimates of the tax expenditures which . . . will occur during the ensuing fiscal year”. Specifically, Chapter 29 of the General Laws provides:

“Section 1. [Definitions] . . . . “Tax expenditures”, state tax revenue foregone as a direct result of the provisions of any general or special law which allows exemptions, exclusions, deductions from, or credits against, the taxes imposed on income, corporations, and sales. . . .

\* \* \*

Section 5B. The commissioner, with the approval of the governor, shall annually on or before December fifteenth, prepare estimates of the tax expenditures which in his judgment will occur during the ensuing fiscal year. Such estimates of tax expenditures shall be prepared to facilitate a comparison of increases or decreases from actual

collections of the preceding fiscal year the estimates of such revenue for the then current fiscal year.

The commissioner shall transmit the estimates of total state revenue and the estimates of tax expenditures to the commissioner of capital asset management and maintenance, to every secretary, to every statutory officer of the commonwealth, who shall transmit to each subordinate agency such of the information which each such officer or secretary determines is appropriate to assist each such agency in its budget preparations, to the house and senate committees on ways and means, and to the joint committee on taxation.

\* \* \*

In accordance with section twenty-one of chapter sixty-two C, the commissioner of revenue shall provide the commissioner of administration the data necessary to estimate tax expenditures.”

2. 2008 Expansion of Public Reporting on Tax Expenditure Budget via the Internet. Beginning in 2008, the Patrick-Murray Administration has made the Tax Expenditure Budget reports available on the Massachusetts government website as part of the Governor’s House 1 budget filings, with easily navigable features and options (e.g., the ability to drill down on details and to link to statutory material on each of the Tax Expenditure Budget items). See [http://www.mass.gov/bb/h1/fy13h1/tax\\_13/hdefault.htm](http://www.mass.gov/bb/h1/fy13h1/tax_13/hdefault.htm)
3. 2010 Transparency Legislation Providing for Disclosure of Recipients of Benefits from those Tax Expenditures that involve Refundable or Transferable Tax Credits. Pursuant to General Laws, Chapter 62C, Section 89, enacted in 2010 (see Acts of 2010, Chapter 131), certain tax credits that are “refundable” or “transferable” (i.e., capable of being sold to a third party taxpayer) by a person or entity entitled to such credits have been made subject to new transparency and reporting rules. These new rules will result in annual public disclosure, beginning in May 2012, of the identity of the party entitled to the credit and the amount of the credit, among other information. Because these credits are refundable or transferable, the party entitled to the credit is able to monetize the tax benefit of the credit irrespective of whether that party owes any Massachusetts tax that could otherwise be reduced by the credit, and thus the credit operates more like a direct grant of funds from the government. See Appendix 7, describing the



credits that are subject to these new reporting and disclosure rules.

4. Expansion of Types of Massachusetts Taxes Included in the Tax Expenditure Budget. As noted in the definition of tax expenditures quoted in the preceding section, the legislation mandating the Tax Expenditure Budget directs DOR to provide information as to the impact of tax expenditures within the Commonwealth's taxes imposed on "income, corporations, and sales". Because traditionally the excise taxes on financial institutions, utilities, and insurance companies under Chapter 63 of the General Laws were viewed as separate from the general corporation excise, information as to tax expenditures that benefit financial institutions, utilities, and insurance companies has not historically been included in the Tax Expenditure Budget in the same manner as information relating to tax expenditures under the corporate tax, the personal income tax, or the sales tax. Nevertheless, DOR has historically supplemented the Tax Expenditure Budget with comparable data and information relating to financial institutions, utilities, and insurance companies.

Taking into account the recent reforms to the Massachusetts tax structure that, beginning generally in 2009, treat all entities classified as corporations for tax purposes (including those that are financial institutions, utilities, or insurance companies) as business corporations, the Tax Expenditure Commission concluded, early in the course of its deliberations, that it would make sense to treat all such entities as corporations for purposes of the Tax Expenditure Budget, and that judgment has already been implemented by DOR and reflected in the Tax Expenditure Budget prepared for Fiscal Year 2013.

C. Presentation by Commissioner of Revenue Pitter and OTPA Director Ozyurt on the Massachusetts Tax Expenditure Budget as Implemented in the Commonwealth; and Commission Discussion

At the Commission's initial meeting in October 2011, Commissioner of Revenue Amy Pitter and OTPA Director Kazim Ozyurt presented an overview of the Massachusetts tax system and the Massachusetts Tax Expenditure Budget (TEB), covering, among other things, the legal requirement for the annual preparation by DOR of the Massachusetts TEB, and the extensive data and other information that is compiled for and reflected in the TEB. See Appendix 4.

The presentation explained the concept of tax expenditures as reflected in Massachusetts law and the Massachusetts TEB, and as generally understood and applied by economists and tax experts. Consistent with the federal origins of the TEB discussed in Part III.a. above, Commissioner Pitter and OTPA Director Ozyurt noted that defining what constitutes a tax expenditure and



determining particular tax expenditures within a specific tax type requires an exercise in distinguishing between (a) those provisions of the tax code that are part of the *basic structure* of a given tax and (b) those exclusions, exemptions, deductions, credits, and other provisions that represent *tax expenditures* designed to encourage or fulfill a desired public policy objective apart from simply raising revenue through imposition of a given tax type.

The DOR presentation also noted that a large number of the Massachusetts tax expenditures simply “piggy back” on federal tax expenditures, through adoption in Massachusetts law of provisions that are part of the federal Internal Revenue Code. One of the many examples of these would be the provisions for accelerated depreciation of capital equipment (but not so-called “bonus depreciation” as provided for in the federal Code, as Massachusetts legislation has specifically “decoupled” from that federal provision).

The DOR presentation showed the total Massachusetts tax expenditures for fiscal year 2011, broken down by tax type and categories within those types. The total tax expenditures of some \$24.1 billion exceeded the total tax revenues in the Commonwealth for the corresponding period. The breakdown among tax types showed that roughly 71% of the aggregate tax expenditures in dollars were in the sales and use tax, about 23% in the personal income tax, and 6% in the corporate excise tax. A high percentage of the tax expenditures in the sales and use tax (about three-quarters) was related to the *non-taxation* of certain property and services.

It was noted that the non-taxation of most services under the sales tax represents a good example of the many instances where one can debate whether a particular legislative decision reflected in the tax law -- in this case not to tax most services -- should be viewed as a tax expenditure or as simply part of the structure of the tax in question. Those holding the former view take a relatively broad view of the sales tax as a retail sales tax on the consumption of goods and services, whereas those who would view this as simply part of the structure of the tax see the non-taxation of services as simply flowing from the fact that the Massachusetts sales tax has historically applied primarily to sales of tangible personal property. In this case, the Massachusetts Tax Expenditure Budget reflects the more inclusive view of tax expenditures. It was noted in this regard that the sales and use tax already applies to some services (primarily telecommunications) and that a great many States impose their sales taxes on a variety of types of services. Given those considerations, treatment of the non-taxation of services as a tax expenditure provides a means for policymakers and the public to at least be aware of the revenue forgone by not taxing various services. In the absence of that treatment, there would be no transparency as to the cost of the decisionmaking in determining what goods or services should be taxed.

A similar definitional issue arises from the exemption from the sales tax of certain inputs to the manufacture of goods. Arguably, without such exemptions, the sales tax would more closely resemble a “gross receipts tax.” See the minutes of the Commission’s December 7 meeting (in Appendix 12) for a discussion of this point. Again, the Massachusetts Tax Expenditure Budget shows these exemptions as tax expenditures for the sake of transparency.

There appeared to be general consensus among the Commission that this more inclusive approach – as illustrated by recording the cost of not taxing various services and of exempting certain business inputs -- would make sense for purposes of the Commission’s examination of tax expenditures and the Massachusetts Tax Expenditure Budget. There was recognition both that the treatment of certain tax provisions as either a tax expenditure or an inherent part of the structure of a tax is a matter on which reasonable minds can disagree, and that the more inclusive approach would be helpful to the Commission so that it could examine the full range of decisions as to what items to tax, or not, or for which to provide an exemption, exclusion, deduction, credit, income apportionment method, etc.

Finally, the DOR presentation focused on the more recent adoption in Massachusetts of provisions for making certain tax credits *refundable* or *transferable* (i.e., capable of being sold to a third party taxpayer that can use the tax credit to reduce its tax), irrespective of whether the original generator/recipient of the credit actually has any tax liability against which a credit could have been applied to reduce tax in the absence of the ability to obtain a refund of or to sell the credit. In 2010, legislation was enacted and signed by the Governor (Acts of 2010, Chapter 131) to require disclosure to the public of the recipients of these credits and of the amount awarded to each taxpayer for each qualifying project. See Part III.B.3 of this Report, above.

In addition to the greater transparency now provided as to these refundable and transferable credits, the DOR presentation to the Commission also focused on some other issues and trends with respect to these types of credits, which provide a benefit that is more like a direct government grant. Among these issues are whether to provide a limit on the dollar amount of credits awarded (whether to individual taxpayers or in the aggregate), and whether to provide specific “sunset” dates when particular credit programs would terminate unless specifically reauthorized by legislation.

D. Assembly and Presentation of Data and other Information for Tax Expenditure Commission by DOR/OTPA

In the course of the Commission’s work, DOR (and, in particular, its Office of Tax Policy Analysis) was charged with compiling, analyzing, and presenting a wide variety of data and other information for review and discussion by the



Commission. This data and other information, analyses and presentations are referenced in the Appendices to this Report.<sup>2</sup> Among other things, DOR presented the Commission with charts and spreadsheets reflecting every tax expenditure in the Massachusetts Tax Expenditure Budget; the value of each such tax expenditure in forgone revenues; the statutory authority for the particular tax provision(s), including federal authority where applicable; the typical recipients or other beneficiaries of the various tax expenditures, including the estimated count of such beneficiaries; broad public policy categories in which various tax expenditures may be placed, such as “Fairness”, “Economic Competitiveness”, and “Targeted Policy Priorities” (more specifically, see Recommendation #2 in Part V. of this Report, below); more detailed descriptions of the stated or apparent public policy purpose of each tax expenditure (e.g., “promoting education” or the “protecting the environment”, within the “Targeted Policy Priorities” category, or “job creation” within the “Economic Competitiveness” category); and whether particular tax expenditures are subject to clawbacks or sunset dates.

DOR also provided the Commission with material focused on tax expenditures and tax expenditure budgets, best practices, pertinent tax literature in other States and foreign countries, and the relative effectiveness of various tax expenditure “tools” (e.g., a generalized deduction versus a targeted credit) and other governmental means of encouraging a particular economic, social, or other activity. See Appendices 3 through 9. See also Part III.E., immediately below.

The data and other information assembled, made public, and reviewed by the Commission in the course of the Commission’s work is believed to be more extensive and comprehensive than any body of similar tax material previously examined in a public review in this Commonwealth or in other States.

#### E. Tax Expenditures in Other Jurisdictions

As noted above, DOR provided the Commission with extensive material focused on tax expenditures and tax expenditure budgets in other States. Some forty-one other States and the District of Columbia also have tax expenditure budgets. While an examination of every tax expenditure provision in every other State would not have been feasible, DOR’s examination covered a wide array of tax provisions in a number of other states considered to be useful jurisdictions for purposes of comparison, on the basis of their economies, geography, and competitive and other factors. See Appendices 8 and 9.

Among other things, the DOR’s examination looked at the degree to which

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<sup>2</sup> It should be noted that in accordance with standard practice on the part of OTPA and other state revenue estimators, DOR’s estimates of forgone revenues, as with its estimates of tax revenues and impacts generally, are based on *static* as opposed to *dynamic* modeling.

many other states subject a variety of services to their sales and use taxes. See Appendix 9.

F. Presentations to Tax Expenditure Commission with respect to the EDIP Program and the Life Sciences Tax Incentive Program

At the Commission's 7<sup>th</sup> meeting, on March 27, 2012, the Commission heard presentations by Maureen Flynn, General Counsel of EOHED, and Bradley Rosenblum, Chief Financial Officer of the Massachusetts Life Sciences Center. Each presentation focused on a recent tax incentive program adopted in Massachusetts. Ms. Flynn's presentation described the new investment tax credit within the Economic Development Incentive Program (EDIP) administered by EOHED, and Mr. Rosenblum's presentation focused on the Life Sciences Tax Incentive Program administered by the Life Sciences Center.

The presentations and the Commission's discussion concentrated on practices that the Legislature and the administering agencies have sought to adopt in these relatively new programs, with an objective of considering how such practices might be considered and potentially implemented in the context of other tax expenditures. Commission members questioned the presenters on a wide range of topics, including their competitive processes in awarding tax credits and other incentives, transparency of the processes and reporting thereon, the pros and cons of credits being made refundable or transferable, periodic reviews of tax incentive programs and awards made thereunder, clawbacks, sunsets, and caps or other limitations on awards made.

IV. Commission's Adoption of Findings and Principles

Based on the Commission's examination and discussions at its first four meetings of the data and other information presented to it, both in presentations and in quantitative and qualitative compilations, analyses, and other materials, the Commission determined that it would be helpful to state certain principles and key findings that would serve as a guide for the Commission's subsequent deliberations and Recommendations, as well as for future review by the Legislature and the Governor.

In the course of the Commission's deliberations, members made several observations that informed the principles and recommendations adopted. Massachusetts tax expenditures are quite complicated, and are large when compared both with Massachusetts tax revenues collected and with other states' tax expenditures in proportion to their revenues. While many Massachusetts tax expenditures serve important public policy objectives, some may not and there is a lack of adequate data and of opportunity for regular review and consideration of



existing tax expenditures' cost and effectiveness by policymakers. Finally, certain types of tax expenditures are worthy of more intense oversight and review.

Accordingly, at its meeting on February 6, 2012, the Commission voted unanimously to approve a set of principles and findings, as follows:

- 1) The Tax Expenditure Budget is one element of a tax system that should, in its entirety:
  - a. Provide adequate revenue to consistently support a desired level of government services;
  - b. Promote economic growth and overall economic welfare and opportunity;
  - c. Be as equitable as possible, including recognition of differences in taxpayers' capacity to pay taxes;
  - d. Reflect our values and our public policy objectives;
  - e. Be as simple and administratively efficient as possible.
- 2) Tax expenditures are a form of taxpayer spending and should be subject to the same scrutiny by government policymakers as direct expenditures.
- 3) In the interest of simplicity and equity, the total number of tax expenditures and the total amount of forgone revenues from the Tax Expenditure Budget (or the total cost of the Tax Expenditure Budget) should be limited to those that are highly effective at achieving the related public policy purpose.
- 4) There should be a comprehensive, rational, policy-driven, and analytic approach to our Tax Expenditure Budget. Each particular tax expenditure should meet the following criteria:
  - a. Each tax expenditure should have a clearly identified public policy purpose and desired outcome for clearly identified beneficiaries;
  - b. Each tax expenditure should be subject to a periodic, data-based, cost-benefit analysis that measures success in achieving the public policy

purpose and desired outcome for the intended beneficiaries;

- c. Each tax expenditure should be subject to a periodic review by the Legislature and the Governor for the purpose of determining the effectiveness of the tax expenditure and taking any action to eliminate, modify or preserve the tax expenditure that may be warranted based on that determination;
  - d. Each tax expenditure, to the extent it is dependent on certain conduct of the tax beneficiary and/or is approved and awarded pursuant to the discretion of an administering agency, should be subject to well-articulated standards of accountability with appropriate enforcement mechanisms, such as clawbacks.
- 5) Relevant and useful data regarding the Tax Expenditure Budget should be subject to full disclosure for the benefit of policymakers and the public, consistent with longstanding principles of taxpayer confidentiality.

#### V. Specific Recommendations of the Commission

After extensive discussion over the span of its meetings, the Tax Expenditure Commission voted unanimously at a series of meetings in March and April 2012, to approve eight detailed Recommendations of the Commission. These Recommendations reflect, among other things, the Commission's conclusions that the current tax expenditures in Massachusetts, as recorded in the Tax Expenditure Budget, warrant a careful, modern, and periodic examination by the Legislature and the Administration together to determine:

- the particular public policy purposes of the various tax expenditures;
- whether existing tax expenditures are an effective means of accomplishing those public policy purposes;
- areas where tax expenditures can be simplified and made more effective, or in some cases eliminated;
- appropriate metrics for assessing the effectiveness of tax expenditures (e.g., effectiveness in creating jobs);
- whether particular tax expenditures are structured so as to utilize best practices developed in the Commonwealth and in other jurisdictions;
- a schedule for periodic review of all tax expenditures, and for potential sunseting of discretionarily-awarded grant-like tax expenditures;
- a clear articulation of the public policy purpose and desired outcome of any new tax expenditure, specifying appropriate criteria, estimated revenue cost, provisions for review and potential sunset, enforcement mechanisms, and appropriate transparency provisions; and

- opportunities to work with other States on best practices for achieving effective tax expenditures.

Accordingly, the Commission recommends:

A. Recommendations for Determining Public Policy Purposes and Desired Outcomes for Existing Tax Expenditures

- 1) The Legislature and the Governor should work together to establish public policy purpose categories for tax expenditures to help articulate the various types of tax expenditures in the Tax Expenditure Budget in a more useful and effective way for policymakers and the public.

As an example of the process of establishing broad public policy purpose categories, the Commission approvingly cites the preliminary categorization presented to it by DOR's Office of Tax Policy Analysis (recognizing the limitations of time available for both this preliminary categorization and the Commission's discussion thereof), pursuant to which OTPA assigned the various items in the current Tax Expenditure Budget to one or more of five broad public purpose categories: (i) Fairness, (ii) Economic Competitiveness, (iii) Targeted Policy Priorities, (iv) Structural, and (v) Other.<sup>3</sup> This preliminary categorization is in Appendix 1.

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<sup>3</sup> DOR describes these categories as follows:

1) Fairness: To address equity concerns, income distribution/redistribution.

Examples: Exemption for public assistance benefits, earned income tax credits, exemption for food, exemption for clothing, low income housing credit, etc.

2) Economic Competitiveness: To address competitiveness of MA businesses and the Commonwealth as a whole.

Examples: film tax credit, research credit, investment tax credit, five-year amortization of start-up costs, accelerated cost recovery system (ACRS) for equipment, unequal weighting of sales, payroll, and property in apportionment formula, small business corporation (S-corporations and their shareholders), etc.

3) Targeted Policy Priorities: To address market failures and externalities: eliminate/reduce negative externalities, increase positive externalities in housing, education, health, environment, energy (etc.), and promote market participation. Examples: renewable energy source credit, brownfields tax credit, expensing of certain expenditures for alternative energy sources, abandoned building renovation deduction, credit for removal of lead paint, exemption for medical expenses, septic system repair credit, historic buildings rehabilitation credit, exemption for textbooks, etc.

4) Structural: To avoid double taxation and tax pyramiding; structural decision not to tax certain activities, entities, individual, income. Examples: exemption for property subject to local taxation, exemption of credit union income, tax exempt organizations, [sales tax] exemption for motor fuels, exemption for materials, tools, fuels, and machinery used in furnishing power, water, and steam, exemption for items used in making clothing, exemption for materials, tools, fuels, and machinery used in manufacturing,



- 2) The Legislature and Governor should work together to identify and publish for each tax expenditure a clearly articulated public policy purpose and desired outcome. This process should begin with a recommendation by A&F's Office of Commonwealth Performance, Accountability and Transparency (CPAT), following consultation with DOR, A&F, appropriate stakeholders, and the Governor. The Legislature's Ways and Means Committees and Joint Committee on Revenue should then review these recommended purposes and outcomes. The Ways and Means Committees, the Joint Committee on Revenue, and the Secretary of Administration and Finance should then reach consensus on these tax expenditure purposes and outcomes, which could be adopted in joint resolution of the Legislature.

B. Recommendations for Tax Expenditure Process, Administration, and Enforcement

- 3) CPAT, working with DOR, should:

- identify metrics for assessing the effectiveness of tax expenditures at achieving identified purposes and outcomes – for example, the number of jobs created;
- collect the data necessary based on such metrics, including:
  - revenue forgone
  - beneficiaries and distribution of amounts received
  - other appropriate data depending on the metrics selected and the identified purposes and outcomes
- annually report such data to the Governor, the Legislature, and the public in a manner that allows for assessment of effectiveness of tax

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Nontaxation of transfers of real property, Nontaxation of rentals of real property, Nontaxation of certain services, Nontaxation of capital gains at time of gift, etc.

5) Other: All other goals. Examples: exemption for funeral items, exemption for books used for religious worship, nontaxation of internet access and related services, exemption for sales to the federal government, exemption of interest from Massachusetts obligations, etc.



expenditures;

- include in the report the date the tax expenditure was enacted, the statutory citation or federal law reference, the public policy purpose and desired outcome, and an updated analysis of the effective tax payment obligations for individuals and businesses in Massachusetts relative to other states; and
  - with its reports, and also based on studies and data from other states and academia, make any recommendations for elimination or modification of any tax expenditures to more effectively achieve their identified public policy purposes. Recommendations with respect to particular tax expenditures should be made on a schedule consistent with the anticipated periodic review of such tax expenditures by the Legislature and the Governor (see Recommendation #4 below), e.g., a recommendation would be made with the report for the year preceding the review period for the tax expenditure that is the subject of that recommendation.
- 4) The Legislature should periodically review all tax expenditures, based on the above annual CPAT reports, and may take appropriate action to renew, modify, or repeal them accordingly.
- To facilitate this review, discretionarily-awarded grant-like tax expenditures<sup>4</sup> should periodically expire or “sunset” every 5 years unless affirmatively renewed by law. Expiration of a tax expenditure would not affect any already-awarded credit or other tax benefit, even if not yet realized.
  - CPAT and the Executive Office of Housing and Economic Development should assist the Legislature with enhanced periodic review every 5 years, but without sunseting, of other business tax expenditures for specific industries or with clearly defined public policy objectives – including evaluation of the industry and the effects of the tax expenditure.
  - Other categories of tax expenditures, such as those on which taxpayers may rely for long-term financial planning or which derive from the

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<sup>4</sup> There are currently six such discretionary “grant-like” tax credit programs: historic rehabilitation credits, life sciences credits, low-income housing tax credits, economic development incentive program (EDIP) credits, certified housing development credits, and donated land (conservation) credits.

federal tax code, should be periodically reviewed every 10 years.

- In reviewing the effectiveness of tax expenditures, the Legislature should consider the effective tax payment obligations for individuals and businesses in Massachusetts relative to other states.

5) To ensure that their purposes are actually being fulfilled, discretionary grant-like tax expenditures should be administered in accordance with certain best practices and subject to specific enforcement mechanisms, including:

- a. Clear written conditions and commitments
- b. If conditions are not met, thresholds for further review and enforcement, including the possibility of “clawbacks” where appropriate
- c. Disclosure of beneficiaries of these discretionarily awarded grant-like tax expenditures
- d. Awards of these tax expenditures on a competitive basis
- e. New enforcement mechanisms, including clawbacks, should be prospective only; they should not apply to tax expenditures already awarded.

C. Recommendations for Reducing Existing Tax Expenditures and Limiting New Tax Expenditures

6) In the interest of simplicity and equity, the Legislature and the Governor should work together to reduce the number of existing tax expenditures and the total amount of forgone revenue from the Tax Expenditure Budget, to the extent appropriate to ensure that tax expenditures are limited to those that are highly effective at achieving the identified public policy purpose.

- In assessing opportunities to reduce tax expenditures consistent with these recommendations, the Legislature and the Governor should consider the following:
  - Tax expenditures demonstrated to be ineffective at achieving their purposes, as shown by analyses conducted by the Commonwealth

Performance, Accountability, and Transparency office (CPAT)

- Opportunities to simplify and more effectively target tax expenditures to achieve certain purposes (such as economic competitiveness or fairness)
  - Exploring areas in which Massachusetts is an outlier among the states
  - A reduction in size of the Tax Expenditure Budget provides the opportunity to reduce tax rates paid by everyone, or to generate more revenue to support government programs and services. The Tax Expenditure Commission is expressly not making recommendations on the extent to which revenue resulting from elimination of tax expenditures should be used to reduce rates, as opposed to being used for government programs and services. Such a discussion is outside the scope of the Tax Expenditure Commission and involves a policy decision for the Legislature and the Governor to determine.
- 7) Before approving any new tax expenditure, the Legislature and the Governor should include in the formal legislative proposal:
- a. the new tax expenditure's clearly specified public policy purpose and desired outcome;
  - b. a finding that the tax expenditure is expected to be highly effective at achieving the identified public policy purpose;
  - c. estimates of the anticipated forgone revenue from any new tax expenditure such that these estimates can be considered by CPAT, the Legislature, and the Governor in the course of their subsequent periodic evaluations of tax expenditures;
  - d. for discretionarily awarded grant-like tax expenditures, an overall annual dollar cap on forgone revenue;
  - e. as appropriate (see Recommendation #4 above), a provision requiring that the tax expenditure sunset or be reviewed periodically;



- f. for discretionarily awarded grant-like tax expenditures, criteria to be applied by the administering agency in making discretionary awards within the cap;
- g. for discretionarily awarded grant-like tax expenditures, provisions for administration in accordance with certain best practices and for specific enforcement mechanisms, including:
  - i. clear written conditions and commitments;
  - ii. if conditions are not met, thresholds for further review and enforcement, including the possibility of “clawbacks” where appropriate;
  - iii. public disclosure of recipients and tax benefits; and
  - iv. a competitive award process.

D. Working with Other States

- 8) State officials should explore opportunities to engage and work with other states (and appropriate associations of state officials), regionally and nationally, on implementing best practices both for reviewing tax expenditures and in deciding which tax expenditures are appropriate.

## VI. Appendices

Appendix 1. Tax Expenditure Categories

Appendix 2. FY 2013 Tax Expenditure Budget

Appendix 3. Massachusetts Tax Expenditure Budget Master Database

Appendix 4. Commissioner's Presentation on Tax Expenditure Budget

Appendix 5. 1991 Tax Expenditure Budget

Appendix 6. Selected DOR Reports

Appendix 7. Transferable and Refundable Tax Credits

Appendix 8. Research/Literature

Appendix 9. Tax Expenditure Budgets of Other States

Appendix 10. Historical Massachusetts Tax Expenditure Budgets

Appendix 11. Agendas of Tax Expenditure Commission's meetings

Appendix 12. Minutes of Tax Expenditure Commission's meetings

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