

Tax Expenditure Review Commission Meeting
Wednesday, April 24, 2024
1:00 PM
Via Zoom

Commission Members in Attendance:

Chairperson Rebecca Forter, MA Department of Revenue
Sue Perez, Designee, MA Treasurer
Amar Patel, Designee, Senate Ways and Means Committee
Eli Roerden, Designee, House Minority Leader
Chris Carlozzi, Designee, Senate Minority Leader
Professor Michelle Hanlon, Governor's Appointee
Lindsay Janeczek, Designee, MA Auditor
Professor Matthew Weinzierl, Governor's Appointee
Stephen Maher, Designee, Joint Revenue Committee, Senate Co-Chair

Commission Members Absent:

Tim Sheridan, Designee, House Ways and Means Committee
Ryan Sterling, Designee, Joint Revenue Committee, House Co-Chair

List of Documents:

- I. Meeting Agenda
- II. Draft Minutes
 - i. February 28, 2024 Meeting
- III. TERC 2024 Final Report
- IV. Presentation of April tax expenditure evaluation ratings, discuss and vote on ratings
 - i. 1.031 & 1.422 Health Savings Accounts (exemption & deduction)
 - ii. 1.040 & 1.420 Archer Medical Savings Accounts (exemption & deduction)
 - iii. 1.007 Exemption of Railroad Retirement Benefits
 - iv. 1.009 Exemption of Social Security Benefits
 - v. 1.011 Exemption of Dependent Care Expenses
 - vi. 1.013 Exemption of Payments Made to Coal Miners
 - vii. 1.028 Exemption of Income Received by Persons Killed in Military Action or Terrorist Activity

Chairperson Forter welcomed Commission members. Members were asked to announce themselves and a quorum was recognized by Chairperson Forter. The meeting via teleconference was called to order at 1:05AM. 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 asked for any comments or changes on the February 28, 2024 draft meeting minutes. Members did not provide any comment. Members voted to approve the February '24 meeting minutes as drafted. The meeting minutes will be posted to the TERC website.

Chairperson Forter provided a brief overview of the updates made to the draft TERC 2024 Report. Updates to the report are outlined in the February `24 meeting minutes. Members voted to approve the TERC 2024 Final Report as presented. Chairperson Forter noted that the report will be submitted to the Legislature and posted to the TERC website following this meeting.

Professor Michelle Hanlon led a discussion on the Exemption and Deduction of Health Savings Accounts. This tax expenditure was adopted in 2005 and has an annual revenue impact of \$36.0- \$68.5 million during FY22 – FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income and Massachusetts' adoption of the deductions included in Code § 62, eligible contributions to, earnings in, and qualified distributions from health savings accounts (HSAs) are not subject to the personal income tax. Specifically, Massachusetts adopts Code § 223, which sets out the federal tax treatment of HSAs. Code § 223 allows employees a deduction for eligible contributions to an HSA. Employer contributions may be excluded from employee income under Code § 106. (The exclusion for employer contributions is described in Tax Expenditure Report 1.004). In addition, Code § 223 allows earnings to accumulate in an HSA free of tax. Code § 223 also allows an exclusion from income for qualified distributions. Massachusetts adopts Code § 223 as currently in effect. An HSA is a tax-exempt trust created for the purpose of paying a taxpayer's qualified medical expenses. An HSA may receive cash contributions from the taxpayer or any other person (e.g., a family member or employer) on behalf of the taxpayer. Contributions other than those from an employer may be deductible from the taxpayer's gross income.

States that conform to the Code for income tax purposes provide an exemption, deduction, or exclusion for eligible contributions to, earnings in, and qualified distributions from HSAs, unless they have specifically decoupled from the Code in that regard. Connecticut, Maine, New York, Rhode Island, and Vermont follow the federal treatment of HSAs. California has decoupled from the federal treatment and taxes both employee and employer contributions to HSAs.

The Commission assumes the goal of the expenditure is to incentivize individuals with high deductible health care plans to save for medical expenses that they may incur before meeting their plan's annual deductible.

Members voted to approve the evaluation template for the Exemption and Deduction of Health Savings Accounts as presented.

Professor Matt Weinzierl led a discussion on the Exemption and Deduction of Archer Medical Savings Accounts. This tax expenditure was adopted in 1998 and has an annual revenue impact of \$0.09- \$0.18 million during FY22 – FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, and Massachusetts' adoption of the deductions included in Code § 62, eligible contributions to, earnings in, and qualified distributions from Archer medical savings accounts (Archer MSAs) are not subject to the personal income tax. Specifically, Massachusetts adopts Code § 220 as in effect for the 2022 tax year, which sets out the federal tax treatment of Archer MSAs. Archer MSAs have largely been discontinued and replaced by health savings accounts (HSAs) (the expenditures for HSAs are described in Tax Expenditure Reports 1.031 and 1.422). New Archer MSAs generally cannot be created. As such, the only

taxpayers with Archer MSAs are taxpayers with legacy Archer MSAs, and taxpayers working for legacy Archer MSA employers. For those taxpayers, eligible contributions are deductible, earnings accumulate free of tax, and income from qualified distributions is excluded. An Archer MSA is a tax-exempt trust created for the purpose of paying a taxpayer's qualified medical expenses. An Archer MSA can only be created for taxpayers who are self-employed or work for a small employer, and the spouses of such taxpayers. In any given year, an Archer MSA may receive cash contributions from either the taxpayer or the taxpayer's employer.

States that conform to the Code for income tax purposes provide an exemption, deduction, or exclusion for eligible contributions to, earnings in, and qualified distributions from Archer MSAs, unless they have specifically decoupled from the Code in that regard. California, Connecticut, Maine, New York, Rhode Island, and Vermont follow the federal treatment of Archer MSAs.

The Commission assumes the goal of the expenditure is to incentivize eligible individuals with high deductible health care plans to save for medical expenses that they may incur before meeting their plan's annual deductible.

Members voted to approve the evaluation template for the Exemption and Deduction of Archer Medical Savings Accounts as presented.

Chairperson Forter led a discussion on the Exemption of Railroad Retirement Benefits. This tax expenditure was adopted in 1985 and has an annual revenue impact of \$1.4- \$1.6 million during FY22 – FY26 with no sunset date.

Railroad Retirement benefits are excluded from Massachusetts gross income for personal income tax purposes. Railroad retirement benefits are paid in two parts: Tier 1, which is analogous to Social Security, and Tier 2, which is analogous to a pension plan. Neither Tier 1 nor Tier 2 benefits are included in Massachusetts gross income. The Massachusetts exclusion for Tier 1 Railroad Retirement benefits is effectuated by a modification to federal gross income, upon which the personal income tax is generally based. See M.G.L. c. 62, § 2(a)(2)(H). A portion of Tier 1 benefits is included in federal gross income if the recipient's income exceeds certain levels set out in Internal Revenue Code (Code) § 86. Note that the inclusion rule under Code § 86 applies to both Social Security and Tier 1 Railroad Retirement benefits. Up to 85% of Tier 1 Railroad Retirement benefits may be includable in federal gross income under the Code. Due to the Massachusetts modification, Tier 1 Railroad Retirement benefits are excluded from Massachusetts gross income entirely. The Massachusetts exclusion for Tier 2 Railroad Retirement benefits is the result of a federal law prohibiting states from taxing such benefits. See 45 USC, § 231m. Because the exemption for Tier 2 Railroad Retirement benefits is not the result of any Massachusetts general or special law, it is not considered a tax expenditure and therefore is not evaluated in this report. Railroad Retirement benefits are generally paid to retired railroad workers and their spouses, surviving dependents of deceased railroad workers, and disabled railroad workers. In the absence of the exclusion, such recipients would be required to include Tier 1 Railroad Retirement benefits in their Massachusetts gross income to the same extent that the benefits are included in federal gross income. The personal income tax revenue forgone as a result of the exclusion constitutes a Massachusetts tax expenditure.

Most states allow an exclusion or exemption for the full amount of Tier 1 Railroad Retirement benefits, as Massachusetts does. States that do so include California, Connecticut, Maine, New York, Rhode Island, and Vermont.

The Commission assumes the goal of the tax expenditure is to provide tax relief to recipients of Railroad Retirement benefits, who include retired railroad workers and their spouses, surviving dependents of deceased railroad workers, and disabled railroad workers.

Members voted to approve the evaluation template for Railroad Retirement Benefits as presented.

Chairperson Forter led a discussion on the Exemption of Social Security Benefits. This tax expenditure was adopted in 1985 and has an annual revenue impact of \$483.7- \$660.5 million during FY22 – FY26 with no sunset date.

Social Security benefits are excluded from Massachusetts gross income for personal income tax purposes. See M.G.L. c. 62, § 2(a)(2)(H). The exclusion is effectuated by a modification to federal gross income, upon which the personal income tax is generally based. A portion of such benefits is included in federal gross income if the recipient's income exceeds certain levels set out in Internal Revenue Code (Code) § 86. Up to 85% of Social Security benefits may be includable in federal gross income under the Code. Due to the Massachusetts modification, Social Security benefits are excluded from Massachusetts gross income entirely. The tax expenditure covered in this report is the exclusion of the amount of Social Security benefits that is otherwise includable in federal gross income, not the amount that is excluded for federal purposes. Social Security benefits are generally paid to retired workers and their spouses, surviving dependents of deceased workers, and disabled workers. In the absence of the exclusion, such recipients would be required to include Social Security benefits in their Massachusetts gross income to the same extent that the benefits are included in federal gross income. The personal income tax revenue forgone as a result of the exclusion constitutes a Massachusetts tax expenditure.

Most states allow an exclusion or exemption for the entire amount of Social Security benefits. States that do so include California, Maine, and New York. Other states exclude or exempt all or a portion of Social Security benefits only if the taxpayer's income is under a particular threshold. States that adopt this limited approach include Connecticut, Rhode Island, and Vermont.

The Commission assumes the goal of the tax expenditure is to provide tax relief to recipients of Social Security benefits, who include retired workers and their spouses, surviving dependents of deceased workers, and disabled workers.

Members voted to approve the evaluation template for the Exemption of Social Security Benefits as presented.

Amar Patel led a discussion on the Exemption of Dependent Care Expenses. This tax expenditure was adopted in 1981 and has an annual revenue impact of \$5.0- \$5.7 million during FY22 – FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, dependent care assistance provided by employers to employees is excluded from Massachusetts gross income for personal income tax purposes. Specifically, Massachusetts adopts Code § 129, which excludes dependent care assistance from employees' gross income. Dependent care assistance consists of the value of an employer's provision of, or payment for, the care of employees' qualifying dependents, which enables those employees to work. Qualifying dependents include dependent children under the age of thirteen, certain disabled dependents, and certain disabled spouses. For the exclusion to apply, the dependent care assistance must be paid pursuant to a plan that meets the administrative requirements set out in the Code. The amount of the exclusion under Code § 129 may not exceed \$5,000 (\$2,500 for married filing separately) during a taxable year. Further, the amount excluded may not exceed the earned income of the employee or, if the employee is married, the lesser of the earned income of the employee or the spouse for the taxable year. In the absence of the exclusion, employees would be required to pay Massachusetts personal income tax on amounts they receive from their employers as dependent care assistance. Personal income tax revenue foregone as a result of the exclusion constitutes a tax expenditure.

All states that conform to the Code for income tax purposes provide an exclusion for dependent care assistance unless they have specifically decoupled from the Code with regard to the exclusion. The Commission is not aware of any states that have decoupled. The actual amount of the exclusion in each state may vary depending on the Code conformity date in that state.

The Commission assumes that the goal of the expenditure is to help taxpayers defray the cost of dependent care so that they are better able to maintain their employment while caring for a dependent.

Members voted to approve the evaluation template for the Exemption of Dependent Care Expenses as presented.

Chris Carlozzi led a discussion on the Exemption of Payments Made to Coal Miners. This tax expenditure was adopted in 1972 and has an annual revenue impact of less than \$50,000 during FY22 – FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, amounts received by coal miners or their survivors as compensation for disability or death from black lung disease are excluded from Massachusetts gross income. Such compensation is payable under the federal Black Lung Benefits Act of 1972. Code § 104 provides that gross income does not include "amounts received under workman's compensation acts as compensation for personal injuries or sickness." In Revenue Ruling 72-400, the Internal Revenue Service ruled that compensation received by coal miners or their survivors as compensation for disability or death from black lung disease is excludable from gross income under Code § 104(a)(1). Note that the general exclusion for workers' compensation benefits is a separate tax expenditure (see tax expenditure number 1.010). In the absence of the exclusion, amounts paid to coal miners or their survivors as compensation for disability or death from black lung disease would be subject to personal income tax. The revenue foregone as a result of the exclusion constitutes a tax expenditure. All states that conform to the Code for income tax purposes provide an exclusion for amounts paid to coal miners or their survivors as compensation for disability or death from black lung

disease, unless they decouple from the Code with regard to the exclusion. The Commission is not aware of any state that has decoupled.

The Commission assumes the goal of the expenditure is to prevent the amounts paid to coal miners or their survivors as compensation for disability or death from black lung disease from being diminished by subjecting the compensation to income tax.

Members voted to approve the evaluation template for the Exemption of Dependent Care Expenses as presented.

Amar Patel led a discussion on the Exemption of Income Received by Persons Killed in Military Action or Terrorist Activity. This tax expenditure was adopted in 1988 for deaths in active military service; 2002 for deaths related to certain terrorist acts and has an annual revenue impact of less than \$50,000 during FY22 – FY26 with no sunset date.

Certain individuals that died as a result of injuries sustained in (i) military service in a combat zone, (ii) military or civilian service in a military action or terrorist attack, or (iii) specified terrorist attacks on civilians are exempted from the Massachusetts personal income tax, subject to certain limitations. M.G.L. c. 62, § 25. Section 25 is a Massachusetts-specific exemption, but it generally follows the same rules and definitions as are used in a similar federal exemption set out in Internal Revenue Code (Code) § 692. See Technical Information Release (TIR) 02-19. The Massachusetts and federal exemptions from personal income tax apply only to eligible tax years. For deaths resulting from injuries sustained in military service in a combat zone, eligible tax years are the tax year in which the death occurred and all immediately preceding tax years starting with the tax year in which the decedent first served in the combat zone. M.G.L. c. 62, § 25(b); Code § 692(a). For other deaths, the exemption applies to the year of death and all immediately preceding tax years starting with the year immediately preceding the year the injury occurred. M.G.L. c. 62, § 25(b); Code § 692(c), (d). Note that the exemption for civilian victims of terrorist attacks who were not employees of the United States applies only to individuals who died: (i) of wounds or injury incurred as a result of the terrorist attacks against the United States on April 19, 1995, or September 11, 2001, or (ii) of illness incurred as a result of an attack involving anthrax occurring on or after September 11, 2001 and before January 1, 2002. Combat zones are designated by the President by Executive Order. A military action is defined as any military action involving the US armed forces and resulting from violence or aggression against the US or any of its allies (or threat thereof). See M.G.L. c. 62, § 25(b), referring to Code § 692(c)(2)(B). Terrorist attacks are limited to the Oklahoma City bombing of April 1995, the World Trade Center attack of September 2001, and attacks involving anthrax occurring on or after September 11, 2001, and before January 1, 2002. See M.G.L. c. 62, § 25(c)(4); 26 USC, see also Code § 692(d)(4). In the absence of the exemption, individuals who die as a result of service in combat zones, military actions, or specified terrorist attacks would be required to pay Massachusetts personal income tax on all of their income. The revenue foregone as a result of the exemption constitutes a tax expenditure.

Many states provide a similar exemption from income taxes, including California, Connecticut, Maine, New York, Rhode Island, and Vermont. The Commission is not aware of any state without a similar exemption.

The Commission assumes the goal of the expenditure is to provide tax relief to the families of taxpayers that die as a result of injuries sustained in (i) military service in a combat zone, (ii) military or civilian service in a military action or terrorist attack, or (iii) specified terrorist attacks.

Members voted to approve the evaluation template for the Exemption of Income Received by Persons Killed in Military Action or Terrorist Activity as presented.

Chairperson Forter noted that Professor Michelle Hanlon's and Professor Matthew Weinzierl's terms are set to expire after this meeting. Chairperson Forter thanked Professor Michelle Hanlon and Professor Matthew Weinzierl for serving the Commission. Michelle and Matt helped lay the groundwork for how we evaluate tax expenditures have made significant contributions to the Commission over the past 4 years. The Commission is appreciative of the collaborative spirit and generosity displayed by Michelle and Matt. Michelle and Matt's support in this endeavor speaks volumes about the teamwork and collaboration that are at the core of our Commission's success. Michelle and Matt brought a wealth of knowledge, skills, and experience to the table. Their dedication and enthusiasm were evident. Chairperson Forter mentioned that the Governor's Office is working on appointing new members. Members agreed to schedule the next meeting for May/June. The purpose of the next meeting is to review the next batch of tax expenditures. Chairperson Forter concluded the meeting at 1:53 PM.