Tax Expenditure Review Commission Public Meeting Minutes
February 25, 2022
Via Teleconference
10:00AM

Commission Members in Attendance:

Chairman Kevin Brown, MA Department of Revenue
Professor Matthew Weinzierl, Governor's Appointee
Professor Michelle Hanlon, Governor's Appointee
Sue Perez, Designee, MA Treasurer
Steve Maher, Designee, Joint Revenue Committee, Senate Co-Chair
Greg Sullivan, Designee, Senate Minority Leader
Kerri-Ann Hanley, Designee, MA Auditor

Commission Members Absent:

William Burke, Designee, House Minority Leader
Jacob Blanton, Designee, Senate Ways and Means Committee
Chairman Aaron Michlewitz, House Ways and Means Committee
Chairman Mark Cusack, Joint Revenue Committee, House Co-Chair

List of Documents:

1. Meeting Agenda
2. Draft Minutes – January 14, 2022 Meeting
3. Draft Reports of Tax Expenditures:

1.018	Exemption of Meals and Lodging Provided at Work
1.022	Nontaxation of Capital Gains at Time of Death
1.106	Nontaxation of Capital Gains at Time of Gift
3.108	Exemption for Certain Precious Metals
3.301	Exemption for Items Used in Making Clothing
1.306 & 2.304	Election to Deduct and Amortize Business Startup Costs
1.308 & 2.309	Expensing of Exploration and Development Costs
1.309 & 2.308	Expensing of Research and Development Expenditures in One Year

Members were asked to announce themselves and a quorum was recognized by Chairman Brown. The meeting via teleconference was called to order at 10:02AM.

Chairman Brown put the Commission and public on notice that the meeting is recorded for purposes of minutes. The recording of the meeting will be kept for public record.

Chairman Brown requested that Commission members provide any changes to the January 14, 2022 draft meeting minutes. Hearing none, members voted unanimously to approve the January 14, 2022 meeting minutes.

Professor Weinzierl led a discussion on the Exemption of Meals and Lodging Provided at Work. This tax expenditure was adopted in 1973 and has a current annual revenue impact of $20.7 - $50.3 million per year during FY19-FY23 with no sunset date. This tax expenditure provides employees with an income exclusion for the value of meals and lodging provided by their employers for the employers' business purposes. Massachusetts conforms to the exclusion set out in the Internal Revenue Code (the "Code"), which results in a state tax expenditure. M.G.L. c. 62, § 2 was enacted in 1973 but the exclusion stems from Code § 119 (1954). States that adopt the definition of income under the Code follow the federal exclusion rules for meals and lodging provided to employees for the convenience of the employer unless they specifically decouple. DOR is not aware of any states that have decoupled from the federal exclusion. DOR assumes that the tax expenditure is intended to promote business efficiency by allowing employees to eat or sleep at or near their work locations without incurring a tax liability for the value of employer-provided meals or lodging. Members voted to approve the Exemption of Meals and Lodging Provided at Work evaluation template as presented.

Professor Hanlon led a discussion on the Nontaxation of Capital Gains at Time of Death. This tax expenditure was adopted in 1915 and has an annual revenue impact of $511.5 - $796.4 million per year during FY19-FY23 with no sunset date. Ordinarily, for federal income tax purposes, capital gains are taxed at the time appreciated property is transferred to a new owner. However, tax is not imposed on capital assets transferred by reason of the owner's death. Further, the new owner receives the assets with a new basis (i.e. the fair market value of assets at the time of decedent's death) rather than the same "carryover" basis of the decedent. Thus, the amount of appreciation that occurred while the decedent held the asset is never taxed. Massachusetts generally follows the federal rules for purposes of determining taxable capital gains. This conformity allows capital assets to escape the personal income tax to the extent of appreciation occurring prior to the decedent's death, resulting in a state tax expenditure. Every state that imposes a personal income tax generally follows the federal income recognition and basis rules applicable to transfers of capital assets. The nontaxation of capital gains on inherited property was intended to prevent the imposition of income tax on transfers that are potentially subject to the federal estate tax. Massachusetts also imposes an estate tax. Approximately 21,200 - 42,500 households benefit from this tax expenditure annually with an average benefit of $16,000 - $33,000 per household. Members discussed how the expenditure eases compliance burdens and if Massachusetts did not conform to federal rules, then taxpayers would have to track two separate basis amounts for the same asset for federal (stepped-up) and state (carryover) purposes. In addition, members discussed how this expenditure likely prevents double taxation in many cases because if the gain were taxed immediately upon death, the decedent's estate would owe income tax in addition to estate tax on the capital gain. Members also discussed that the elimination of this expenditure may lead to greater incentives for taxpayers to leave the state prior to death. Members voted to approve the Nontaxation of Capital Gains at Time of Death evaluation template as presented with the addition of a comment identifying the problematic nature of this tax expenditure. Professor Hanlon agreed to provide this comment.

Professor Weinzierl led a discussion on the Nontaxation of Capital Gains at Time of Gift. This tax expenditure was adopted in 1921 and has a current annual revenue impact of $23.9 - $37.2 million per year during FY19-FY23 with no sunset date. Ordinarily, for federal income tax purposes, capital gains are taxed at the time appreciated property is transferred to a new owner. However, the tax on capital gains on property transferred by gift is deferred until the new owner sells the property. If the new owner dies holding the gifted property, the tax is never imposed. Massachusetts generally follows the federal rules for purposes of determining taxable capital gains. This conformity results in a deferral and potential exclusion of tax on capital gains and therefore constitutes a state tax expenditure. Every state that imposes a personal income tax generally follows the federal income recognition and basis rules applicable to transfers of capital assets. These federal rules were originally intended to coordinate the federal income tax with the federal estate and gift taxes. The deferral and potential exclusion of capital gains was intended to prevent the imposition of income tax on transfers that are potentially subject to gift and estate taxes. Massachusetts does not impose a gift tax but does impose an estate tax. Members discussed that Massachusetts, unlike the federal government, does not assess a gift tax on transfers. This asymmetry is important because the absence of a state gift tax makes gifts relatively more attractive under Massachusetts law than under the federal code. To the extent that the federal gift tax is designed to complement the federal estate tax, namely to discourage potential bequestors from avoiding the estate tax through gifting, the state's choice not to assess a gift tax both lowers state revenue and encourages gifting. Members discussed that this tax expenditure benefits those making and receiving gifts, but legislators may wish to assess whether the state's divergence from the federal strategy is merited. Members agreed to approve the Nontaxation of Capital Gains at Time of Gift evaluation template with a change from somewhat disagree to somewhat agree for Easily Administered and the addition of a comment discussing the absence of gift tax. Professor Weinzierl agreed to provide this comment.

Sue Perez and Kerri-Ann Hanley led a discussion on the Exemption for Certain Precious Metals. This tax expenditure was adopted in 1987 and has a current annual revenue impact of $7.9 - $10.3 million per year during FY19-FY23 with no sunset date. This tax expenditure provides for a sales tax exemption for transactions with a sale amount of $1,000 or more of certain precious metals. The exempt items include rare coins of numismatic value; gold or silver bullion or coins; and gold or silver tender of any nation which is traded and sold according to its value as precious metal. Fabricated precious metals that have been processed or manufactured for industrial, professional, or artistic use do not qualify for the exemption. Of the 45 states that impose a sales tax, 36 have complete or partial sales tax exemptions on the retail sale of coins and precious metals bullion. States with partial exemptions typically require purchases to equal or exceed a stated minimum amount in order to qualify. Across states, the minimum amount ranges from a low of $500 (Florida) to a high of $1,500 (California). One state, Louisiana, imposes an upper limit pursuant to which the sales price must be below $500 for a purchase to qualify for the exemption. DOR assumes that the policy goal of the Massachusetts tax expenditure is to treat the specified precious metals in the same manner as investments or financial assets, rather than as taxable sales of tangible personal property. Members voted to approve the Exemption for Certain Precious Metals evaluation template as presented with an additional comment on the partial exemption of other states.

Chairman Brown led a discussion on the Exemption for Items Used in Making Clothing. This tax expenditure was adopted in 1967; the current revenue impact is negligible and there is no sunset date. Sales of materials used in making clothes, such as thread and fabric, are exempt from sales and use tax. Most neighboring states tax fabric, yarn, and other component parts of clothing. However, New York provides a similar exemption for sales of fabric and other components that are incorporated into clothing. New Jersey exempts from tax the sales of yarn, fabric, and other items to noncommercial purchasers if the items are incorporated into clothing. DOR assumes that the goal of the expenditure is to reduce the burden of the tax on clothing by exempting materials that households use to make their own clothes. It complements the Massachusetts exemption that applies to each item of finished clothing sold for $175 or less. Members voted to approve the Exemption for Items Used in Making Clothing evaluation template as presented.

Kerri-Ann Hanley and Greg Sullivan led a discussion on the Election to Deduct and Amortize Business Startup Costs. This tax expenditure was adopted in 2004 and has an estimated revenue impact of $1.3-$1.7 million per year during FY19-FY23 with no sunset date. For federal tax purposes, taxpayers can immediately deduct startup costs that would otherwise have to be capitalized over a period of 15 years. Massachusetts conforms to the federal deduction, resulting in a state tax expenditure. Every state that imposes a corporate or individual tax on income conforms to Internal Revenue Code (the "Code") § 195. DOR assumes that the tax expenditure is intended to encourage taxpayers to start new businesses. Members discussed the competitiveness of this tax expenditure and its relatively small revenue impact. If Massachusetts were to decouple from this federal tax expenditure the state could be less attractive for startups. Members voted to approve the Election to Deduct and Amortize Business Startup Costs evaluation template with the addition of adding "conformity to the Code" under business and individual goals.

Professor Hanlon led a discussion on the Expensing of Exploration and Development Costs. This tax expenditure was adopted in 1976 and has a current annual revenue impact of $0.145-$0.151 million per year during FY19-FY23 with no sunset date. For federal tax purposes taxpayers can immediately deduct certain costs incurred in developing specified mineral deposits. Such costs would otherwise have to be capitalized and deducted over a period of years. The recovery period for capitalized items varies based on the nature of the costs and the type of mineral deposit. Massachusetts conforms to the federal deduction, resulting in a state tax expenditure. Most states that impose a corporate or individual tax on income conform to the federal deduction for costs incurred in developing mineral deposits. States that conform to the federal deduction include California, Connecticut, Maine, New Hampshire, New York, Rhode Island, and Vermont. DOR assumes that the federal tax expenditure on which the Massachusetts tax expenditure is based is intended to encourage investment in the development of oil, natural gas, and geothermal resources. Because Massachusetts has few oil, natural gas, or geothermal resources, DOR further assumes that an additional purpose of the Massachusetts tax expenditure is the simplification of conforming to federal expensing rules. Members discussed the limited data on Massachusetts beneficiaries and the level of uncertainty of the size of impacted businesses since the estimated state revenue impacts are based on post-apportioned national estimates. Members shared concerns regarding the negative environmental implications of this tax expenditure since it is promoting the mining of fossil fuels. Members voted to approve the Expensing of Exploration and Development Costs evaluation template with a change from strongly agree to somewhat agree for Benefits Justify Costs and a change from strongly agree to somewhat agree for Intended Beneficiaries.

Chairman Brown and Sue Perez led a discussion on the Expensing of Research and Development Expenditures in One Year. This tax expenditure was adopted in 1986 and has an annual revenue impact of $46-$3.4 million per year from FY19-FY23 with a sunset date of 2022. Prior to tax year 2022, for federal purposes taxpayers could elect to immediately deduct research and experimental expenditures that they would otherwise have had to capitalize and deduct over a period of five years. Starting with tax year 2022, all expenditures for research conducted in the U.S must be capitalized and deducted over five years. Expenditures incurred outside the U.S. must be capitalized and deducted over 15 years. Massachusetts generally conforms to the federal rules for deducting research and experimental expenditures. This conformity resulted in a Massachusetts tax expenditure for tax years prior to 2022. Most states adopt the federal deduction for research and experimental expenditures. States that follow earlier versions of the Code may continue to allow the immediate deduction of research and experimental expenditures. States that require capitalization include Connecticut, Maine, New York, Rhode Island, and Vermont. California continues to allow the immediate deduction because it has its own state-specific cost recovery rules. DOR assumes that the tax expenditure was intended to encourage research and development. Members discussed the difficulty of measuring the overall benefit of this tax expenditure considering its 2022 sunset date. Members voted to approve the Expensing of Research and Development Expenditures in One Year evaluation template with a change from somewhat agree to somewhat disagree for Claimed by a Broad Group of Taxpayers.

Members continued the discussion on tax expenditures that are a result of Massachusetts' conformity to the Code. Members agreed it would be beneficial to re-evaluate the review schedule of these tax expenditures. Starting next year, DOR will present brief summaries of these tax expenditures to Commission members prior to providing finalized analyses. These summaries will include analyses on revenue impacts, other states' conformity, and level of difficulty associated with decoupling. DOR proposed providing lesser economic analysis for those tax expenditures with a lesser likelihood of legislative change based on the aforementioned criteria. Members agreed with this strategy.

Members discussed the next batch of tax expenditures to be reviewed at the next Commission meeting. Members agreed to schedule a meeting prior to late-April 2022. Chairman Brown concluded the meeting at 11:42AM.