

Tax Expenditure Review Commission Meeting
Wednesday, June 26, 2024
1:00 PM
Via Zoom

Commission Members in Attendance:

- Chairperson Rebecca Forter, MA Department of Revenue
- Chris Carlozzi, Designee, Senate Minority Leader
- Eli Roerden, Designee, House Minority Leader
- Lindsay Janeczek, Designee, MA Auditor
- Stephen Maher, Designee, Joint Revenue Committee, Senate Co-Chair
- Professor Natasha Varyani, Governor's Appointee
- Professor Thomas Downes, Governor's Appointee

Commission Members Absent:

- Amar Patel, Designee, Senate Ways and Means Committee
- Tim Sheridan, Designee, House Ways and Means Committee
- Ryan Sterling, Designee, Joint Revenue Committee, House Co-Chair
- Sue Perez, Designee, MA Treasurer

List of Documents:

- Meeting Agenda
- Draft Minutes
 - April 24, 2024 Meeting
- Presentation of June tax expenditure evaluation ratings, discuss and vote on ratings
 - 1.026 Exemption of Military Disability Pensions
 - 1.027 Exemption of Compensation to Massachusetts-Based Nonresident Military Personnel
 - 1.419 Business Exp of National Guard and Reserve Members
 - 1.033 Employer-Provided Education Assistance
 - 1.407 Personal Exemption for Students Aged 19 or Over
 - 3.002 Exemption for Sales to the Commonwealth
 - 3.107 Exemption for the American Flag

Meeting Minutes:

Chairperson Forter welcomed Commission members, and a quorum was recognized. The meeting via teleconference was called to order at 1:05 PM. Chairperson Forter put the Commission and public on notice that the meeting is recorded for the purpose of minutes. The recording of the meeting will be kept for public record.

Chairperson Forter noted changes in membership. Two new members were appointed by the Governor's office, Professor Natasha Varyani and Professor Thomas Downes. Varyani is a professor of law at Roger Williams University School of Law and Downes is a professor of economics at Tufts University. Appointment letters are attached at the end of this document. Chairperson Forter asked all members to introduce themselves.

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

Chairperson Forter provided a brief overview of the Commission's review process for the benefit of its newest members. Chairperson Forter explained that the Commission's goal is to flag expenditures that are determined to be problematic for various reasons, whether administrative or based on relevancy or other considerations. Chairperson Forter noted that this year marks the fifth year of the Commission's first evaluation cycle.

Chairperson Forter led a discussion on the Exemption of Military Disability Pensions. This tax expenditure was adopted in 1971 and has an annual revenue impact of \$ 0.6 - 0.8 million during FY22 - FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, amounts received as military disability pensions are excluded from gross income. Massachusetts adopts federal gross income as the starting point for determining income subject to the personal income tax. Massachusetts uses the definition of federal gross income as determined under the Internal Revenue Code (Code) as it appeared on January 1, 2022. As a result, Massachusetts adopts the federal income exclusion for "amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces or as a result of certain terrorist attacks." See Code §§ 104(a)(4),(5) (b). To qualify for the exclusion under Code §§ 104(a)(4), a payment generally must be made because of a combat-related injury. This report refers to payments that are excludable from federal and Massachusetts income under Code § 104 as military disability pensions. The revenue foregone by not taxing these amounts constitutes a tax expenditure.

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

The Commission assumes the goal of the expenditure is to prevent amounts received as military disability pensions from being diminished by subjecting them to income tax.

The administration of the exclusion for military disability retirement income does not present special challenges for DOR. Conformity with the federal exclusion based on the 2022 Code simplifies tax

compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. The Commission assumes that this consistency of treatment also eases the compliance burden for taxpayers. Note, however, that changes to the federal rules in the future could complicate administration of the exclusion if Massachusetts law is not updated to conform to those changes.

Members voted to approve the evaluation template for the Exemption of Military Disability Pensions as presented.

Professor Thomas Downs led a discussion on the Exemption of Compensation to MA-Based Nonresident Military Personnel. This tax expenditure was adopted in 1973 and has an annual revenue impact of \$10.6 - \$12.8 million during FY22 - FY26 with no sunset date.

Nonresident servicemembers are not subject to personal income tax on compensation for active-duty military service, even if the service is performed in Massachusetts. In general, nonresidents are subject to personal income tax on income from Massachusetts sources, including employment in the Commonwealth. See M.G.L. c. 62, § 5A(a). However, Massachusetts provides an exception to the general rule with regard to compensation received by nonresidents for active-duty military service. The exception is implemented by M.G.L. c. 62, § 5A(c), which deems such compensation “to be from sources other than sources within the Commonwealth.” Further, days spent in the Commonwealth while on active duty in the Armed Forces of the United States do not count toward the 183-day residency rule. See M.G.L. c. 62, § 1(f).

Note that federal law imposes the same rule as M.G.L. c. 62, § 5A(c) by providing that compensation for active-duty military service may not be sourced to a state in which a nonresident servicemember is serving in compliance with military orders. See 50 U.S.C.A. § 4001(b). The federal exemption also applies to certain income earned by spouses of nonresident servicemembers. See 50 U.S.C.A. § 4001(c). Massachusetts follows the federal exemption for military spouses even though spouses are not referenced in M.G.L. c. 62, § 5A(c). The federal exemption, including for military spouses, applies regardless of whether Massachusetts imposes its own exemption under M.G.L. c. 62, § 5A(c). Personal income tax revenue foregone as a result of exempting nonresident servicemembers’ military compensation constitutes a tax expenditure.

Most states exempt nonresident servicemembers’ military compensation from income tax. However, even if a state does not explicitly do so by statute, federal law imposes such an exemption.

The Commission assumes the goal of the expenditure is to ensure that nonresident servicemembers do not become subject to personal income tax by reason of their assignments to military posts in Massachusetts.

The administration of the exemption for nonresident servicemembers' military compensation presents some challenge for the Department of Revenue (DOR). Such compensation is taxable if received by resident service members. Thus, to monitor eligibility for the exemption the DOR must distinguish between resident and nonresident servicemembers. Residency is a fact-intensive determination, which requires a case-by-case analysis.

Administration is relatively simple for nonresident servicemembers as they are not required to provide any documentation of their residency status to the DOR in order to claim the exemption and are not required to file returns reporting exempt income. Nonresident servicemembers are required to provide such information if they are subjected to an audit.

Of note in the discussion is the distinction that the exemption applies to the personnel and to their spouses in the Commonwealth, even where language does not explicitly state so. Additionally, discussion took place regarding whether this is, in fact, a tax expenditure. The Commission agreed that this may be an issue that merits revisiting. These notes were added to the comment section of the evaluation template.

Members voted to approve the evaluation template for the Exemption of Compensation to MA-Based Nonresident Military Personnel as presented.

Stephen Maher led a discussion on the Deduction for Business Expenses of National Guard and Reserve Members. This tax expenditure was adopted in 2003 and has an annual revenue impact of \$1.5 - \$1.6 million during the FY22 - FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for determining employee business expense deductions, Massachusetts allows a personal income tax deduction for travel expenses incurred by National Guard and Armed Forces reserve members who must travel more than 100 miles from their homes to their assigned posts. The Massachusetts deduction is effectuated by M.G.L. c. 62, § 2(d)(1), which adopts the federal deductions allowable under Code § 62 that "consist of expenses of travel, meals and lodging while away from home, or expenses of transportation paid or incurred by the taxpayer in connection with the performance by him of services as an employee." Code § 62(a)(2)(E) allows members of the National Guard and Armed Forces reserve to deduct expenses that are incurred in connection with military services performed more than 100 miles away from home. The amount of the deduction is limited to (i) the regular federal per diem rate for lodging, meals, and incidental expenses and (ii) the standard federal mileage rate for car expenses, plus any parking fees, ferry fees, and tolls. The deduction is allowed only if (i) the taxpayer is not reimbursed for such expenses or (ii) the taxpayer is reimbursed and the reimbursement is reported as wages on the taxpayer's W-2. National Guard and Armed Forces reserve members are not required to itemize deductions in order to claim the federal or Massachusetts deduction. Revenue that is lost as a result of the deduction constitutes a tax expenditure.

States that conform to the Code for individual income tax purposes allow the federal deduction for business expenses of National Guard and Armed Forces reserve members, unless they decouple from the Code in that regard. The Commission is not aware of any state that has decoupled.

The Commission assumes the goal of the expenditure is to defray National Guard and Armed Forces reserve members' cost of travelling to their assigned posts.

The administration of the deduction for qualifying expenses incurred by National Guard and Armed Forces reserve members does not present any special challenges for the Department of Revenue (DOR). Adoption of the federal deduction simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. The Commission assumes that this consistency of treatment also eases the compliance burden for taxpayers.

Members voted to approve the evaluation template for the Deduction for Business Expenses of National Guard and Reserve Members as presented.

Christopher Carlozzi led a discussion on the Employer-Provided Education Assistance. This tax expenditure was conformed to since 1998 and has an annual revenue impact of \$13.7- \$14.8 million during the FY22 – FY26 with no sunset date.

Massachusetts adopts the Internal Revenue Code (Code) definition of gross income as it appears in the Code as of January 1, 2022 for personal income tax purposes. Under the 2022 Code, certain amounts paid by an employer for employee education or training are excluded from employee gross income.

Specifically, under Code § 127, employees can annually exclude up to \$5,250 of employer payments made pursuant to an "educational assistance program." Code § 127(a). An "educational assistance program" is a written plan created by an employer to provide employees with educational assistance. Code § 127(b)(1). The plan must meet various non-discrimination requirements. Code § 127(b)(2). Employer assistance may include payments for an employee's tuition, fees, textbooks, or other similar expenses. It may also include payments towards an employee's qualified student loan principal or interest after March 27, 2020 and before 2026. Employer assistance does not include payments for lodging, meals, transportation, tools, or supplies. An employee's education or training does not need to be related to their employment unless the education or training pertains to sports, games, or hobbies. Code § 127(c)(1).

Code § 132(j)(8) supplements Code § 127 by allowing employees to exclude employer-provided education assistance that is not covered by Code § 127 (e.g., assistance above \$5,250 or assistance unrelated to an educational assistance plan.). The § 132(j)(8) exclusion is only available if the education assistance benefit constitutes a "working condition fringe." In this context, the term "working condition fringe" means an employer-provided benefit that the employee would be allowed to deduct as a trade or business expense under Code § 162 if the employee had paid for the benefit directly. Note that employees cannot claim a tax deduction or credit for amounts excluded under Code §§ 127 or 132(j)(8).

Because of the Commonwealth's reliance on the Code for purposes of determining income, employer-provided education assistance is not included in employee gross income for Massachusetts tax purposes. The revenue lost by not taxing these amounts constitutes a tax expenditure.

All states that impose an income tax adopt the federal exclusion for employer-provided education and training assistance unless they decouple from the Code in that regard. States that adopt the federal exclusion include Connecticut, Maine, New York, Rhode Island, and Vermont. California has its own state-specific exclusion for education and training assistance.

The Commission assumes the goal of the expenditure is to encourage employees to take advantage of employer-provided education and training assistance programs. The Commission agreed to add comments to the form to ensure that the benefit incurred by employers is made clear alongside the benefit to the employees.

The administration of the exclusion for employer-provided education assistance does not present special challenges for DOR. Conformity with the federal exclusion based on the 2022 Code simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. The Commission assumes that this consistency of treatment also eases the compliance burden for taxpayers. Note, however, that changes to the federal rules in the future could complicate administration of the exclusion, if Massachusetts law does not conform to those changes.

Members voted to approve the evaluation template for the Employer-Provided Education Assistance as presented.

Christopher Carlozzi led a discussion on the Personal Exemption for Students Aged 19 - 23. This tax expenditure was adopted in 1986 and has an annual revenue impact of \$10 - \$10.6 million during FY22- FY26 with no sunset date.

Massachusetts provides a personal income tax exemption for each of a taxpayer's dependents, as determined under Internal Revenue Code (Code) § 151(c). See M.G.L. c. 62, § 3B(b)(3). The exemption allows taxpayers to reduce their taxable income by \$1,000 for each dependent. The Code's definition of a dependent includes qualifying children and qualifying relatives. See Code § 152(a). Qualifying children generally include a taxpayer's children (or certain specified close relatives) who are under the age of 19 and meet certain other requirements. However, qualifying children also include a taxpayer's children (including specified close relatives) that are full-time students under the age of 24, so long as they otherwise meet the definition of qualifying children. A qualifying relative is a relative (or non-relative that lives with the taxpayer) for whom the taxpayer provides more than half the support and who is not a qualifying child. See Code § 152(d).

The dependent exemption for qualifying children under 19 and qualifying relatives is not considered a tax expenditure for purposes of the Massachusetts Tax Expenditure Budget. This is because the tax expenditure analysis considers the family unit to be the basis of analysis. Taxpayers are assumed to have an obligation to support children and qualifying relatives under 19 and the exemption is not considered to be a special benefit for doing so. However, individuals aged 19 and over are assumed to be capable of supporting themselves, so the exemption applies to older children and qualifying relatives only if they are full-time students between the ages of 19 and 23. The exemption for such children and qualifying

relatives is considered a tax expenditure equal to the amount of personal income tax foregone as a result of allowing the exemption for such dependents

Most states that impose a personal income tax allow exemptions for dependent children who are full-time students between the ages of 19 and 23, including New York, Rhode Island, and Vermont. California and Maine allow credits for such dependents rather than exemptions. Connecticut does not allow an exemption for dependents of any age.

The Commission assumes the goal of the expenditure is to allow taxpayers to continue claiming dependent exemptions for children over 18 and under 24 who are pursuing higher education.

The administration of this exclusion does not present special challenges for the Department of Revenue (DOR). Conformity with federal age requirements for dependents simplifies tax compliance and administration by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. DOR assumes that this consistency of treatment also eases the compliance burden for taxpayers.

The Commission made note, with special attention from Professor Varyani, to keep in mind the changing demographics of the Commonwealth and the significant cost this may incur for the state. Members added this note to the comment section of the evaluation template

Members voted to approve the evaluation template of Personal Exemption for Students Aged 19 – 23 as presented.

Lindsay Janeczek led a discussion on the Exemption for Sales to the Commonwealth. This tax expenditure was adopted in 1967 and has an annual revenue impact of \$96.0-119.2 million during FY22-FY26 with no sunset date.

All retail sales of tangible personal property are subject to sales and use tax unless an exemption applies. M.G.L. c. 64H, § 6(d) provides an exemption for sales to the Commonwealth, its agencies and political subdivisions. The exemption does not apply to sales to other states.

The Massachusetts sales tax and complementary use tax is a transaction tax that applies to retail sales of tangible personal property, including prewritten computer software regardless of mode of transfer, and telecommunication services. A retail sale is any sale other than a sale for resale. A sale for resale occurs when a business purchases an item and sells it to a third party in substantially the same form in which it was purchased. All retail sales are taxable unless an exemption applies. These exemptions are tax expenditures because they prevent the imposition of tax on transactions that would otherwise be taxable.

Absent the exemption afforded by this tax expenditure, sales to the Commonwealth, its agencies and political subdivisions would be subject to sales and use tax, increasing the cost of government operations.

Most states that impose a sales and use tax provide an exemption for sales to the state and its agencies. Connecticut, Maine, New York, Rhode Island, and Vermont have such an exemption. California does not have such an exemption but allows government organizations to apply for refunds of sales tax paid on certain purchases.

The Commission assumes that the expenditure is intended to reduce the expenses of the Commonwealth, its agencies and political subdivisions, thereby increasing the resources such government organizations have available to devote to their missions.

Administration of the exemption for sales to the Commonwealth, its agencies and political subdivisions does not present any special challenge to taxpayers or the Department of Revenue (DOR). To claim the exemption government organizations must present exemption certificates to vendors. The DOR monitors the exemption when it audits vendors as part of its sales and use tax audit function.

Members voted to approve the evaluation template for the Exemption for Sales in the Commonwealth as presented.

Professor Varyani led a discussion on the Exemption for the American Flag. This tax expenditure was adopted in 1968 and has an annual revenue impact of \$1.0 - \$1.5 million during FY22- FY26 with no sunset date.

All retail sales of tangible personal property are subject to sales and use tax unless an exemption applies. M.G.L. c. 64H, § 6(w) exempts “[s]ales of the flag of the United States.” Sales of other flags, including state flags, are not exempt. Letter Ruling 92-3.

The Massachusetts sales tax and complementary use tax is a transaction tax that applies to retail sales of tangible personal property, including prewritten computer software regardless of mode of transfer, and telecommunication services. A retail sale is any sale other than a sale for resale. A sale for resale occurs when a business purchases an item and sells it to a third party in substantially the same form in which it was purchased. All retail sales are taxable unless an exemption applies. These exemptions are tax expenditures because they prevent the imposition of tax on transactions that would otherwise be taxable. One such exemption is the exemption for sales of U.S. flags.

Absent the exemption, all sales of the U.S. flag would be subject to sales and use tax. The revenue foregone as a result of the exemption constitutes a tax expenditure.

Several states provide a sales and use tax exemption for sales of U.S. flags. Connecticut, New York, and Rhode Island provide such an exemption. Vermont exempts sales of U.S. flags to and by non-profit veterans’ organizations. California exempts sales of U.S. flags by non-profit veterans’ organizations. Maine does not have a sales tax exemption for sales of U.S. flags. New Hampshire does not impose a sales and use tax.

The Commission assumes the goal of the expenditure is to promote patriotism by reducing the cost of the U.S. flag to consumers.

Administration of the exemption for the U.S. flag does not present any special challenge to taxpayers or the DOR. Vendors are generally aware of the exemption and do not charge sales tax on sales of U.S. flags. Exemption certificates are not required. The DOR reviews retailers’ sales as part of its sales and use tax audit program.

Professor Varyani made special note that compared to the year which this tax expenditure was enacted, patriotism may be different than that felt today. Additionally of note is commentary denoting that some states provide an exemption for those with nonprofit or veteran status.

Members voted to approve the evaluation template for the Exemption for the American Flag as presented.

Members agreed to reconvene in September. The purpose of the next meeting is to discuss the next batch of tax expenditures. Chairperson Forter thanked members for contributions to the Commission. Chairperson Forter concluded the meeting at 2:03 PM.



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MAURA T. HEALEY
GOVERNOR

KIMBERLEY DRISCOLL
LIEUTENANT GOVERNOR

April 17, 2024

Natasha N. Varyani, Esq.
Boston, MA 02111

Dear Attorney Varyani,

I am pleased to appoint you as a member of the Tax Expenditure Commission, pursuant to Chapter 207 of the Acts of 2018.

Before commencing your responsibilities, you must take an oath of office. The appointment will be void unless that oath is taken within three months of the date of this letter. Consistent with the statute under which you were appointed, your term will expire on July 1, 2026.

Lieutenant Governor Driscoll and I appreciate your willingness to serve the Commonwealth in this capacity.

Congratulations on your appointment.

Sincerely,

A handwritten signature in blue ink, reading "M. T. Healey".

Maura T. Healey

cc: Kimberley Driscoll, Lieutenant Governor
William Francis Galvin, Secretary of the Commonwealth
William J. McNamara, Comptroller of the Commonwealth
Matthew Gorkowicz, Secretary of the Executive Office of Administration and Finance



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MAURA T. HEALEY
GOVERNOR

KIMBERLEY DRISCOLL
LIEUTENANT GOVERNOR

May 24, 2024

Thomas A. Downes, Ph.D.
Brookline, MA 02446

Dear Dr. Downes,

I am pleased to appoint you as a member of the Tax Expenditure Commission, pursuant to Chapter 207 of the Acts of 2018.

Before commencing your responsibilities, you must take an oath of office. The appointment will be void unless that oath is taken within three months of the date of this letter. Consistent with the statute under which you were appointed, your term will expire on July 1, 2026.

Lieutenant Governor Driscoll and I appreciate your willingness to serve the Commonwealth in this capacity.

Congratulations on your appointment.

Sin

cerely,

A handwritten signature in blue ink, appearing to read "M. T. Healey", written over a large, stylized blue flourish.

Maura T. Healey

cc: Kimberley Driscoll, Lieutenant Governor
William Francis Galvin, Secretary of the Commonwealth
William J. McNamara, Comptroller of the Commonwealth
Matthew Gorkowicz, Secretary of the Executive Office of Administration and Finance