

Tax Expenditure Review Commission Meeting
Tuesday, October 1, 2024
1:00 PM
Via Zoom

Commission Members in Attendance:

- Chairperson Rebecca Forter, MA Department of Revenue
- Lindsay Janeczek, Designee, MA Auditor
- Sue Perez, Designee, MA Treasurer
- Stephen Maher, Designee, Joint Revenue Committee, Senate Co-Chair
- Amar Patel, Designee, Senate Ways and Means Committee
- Chris Carlozzi, Designee, Senate Minority Leader
- John Keeler, Designee, House Minority Leader

Commission Members Absent:

- Tim Sheridan, Designee, House Ways and Means Committee
- Ryan Sterling, Designee, Joint Revenue Committee, House Co-Chair
- Professor Natasha Varyani, Governor's Appointee
- Professor Thomas Downes, Governor's Appointee

List of Documents:

- Meeting Agenda
- Draft Minutes
 - June 26, 2024 Meeting
- Presentation of October tax expenditure evaluation ratings, discuss and vote on ratings
 - 1.024 Exemption of Benefits and Allowances to Armed Forces Personnel
 - 1.025 Exemption of Veterans' Pensions, Disability Compensation and G.I. Benefits
 - 1.017 Exclusion of Payments Received Under Government Conservation, Reclamation and Restoration Programs (previously Exemption of Cost-Sharing Payments)
 - 1.015 Exemption of Scholarships, Fellowships, and Tuition Reductions
 - 1.016 Exclusion of Certain Prizes and Awards
 - 3.001 Exemption for Sales to the Federal Government

Meeting Minutes:

Chairperson Forter welcomed Commission members, and a quorum was recognized. The meeting via teleconference was called to order at 1:03 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 asked for any comments or changes on the June 26, 2024 draft meeting minutes. Members did not provide any comment. Members voted to approve the June '24 meeting minutes as drafted. The meeting minutes will be posted to the TERC website.

Chairperson Forter led a discussion on the Exemption of Benefits and Allowances to Armed Forces Personnel. This tax expenditure was adopted in 1954 and has a revenue impact of \$14.2 - \$17.4 million per year during FY22 – FY26 with no sunset date.

Due to its reliance on the Internal Revenue Code (Code) for purposes of determining income, Massachusetts excludes from gross income several benefits to members of the armed services, including, under Code § 112, (i) compensation earned by members of the Armed Forces serving in a combat zone and (ii) income received by such individuals who were hospitalized as a result of injury incurred while serving in a combat zone, and under Code § 134, certain qualified military benefits, such as certain medical and disability benefits, moving allowances, dependent care assistance, and certain travel benefits.

All states that impose an income tax adopt the federal exclusion for income received for serving in a combat zone or during hospitalization as a result of injuries incurred during such service, as well as the exclusion for certain benefits to the members of the armed forces, unless those states 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 exclusion is to provide tax relief to members of the Armed Forces for their services generally, and also to those who (i) serve in a combat zone, or (ii) were hospitalized as a result of injury incurred while serving in a combat zone.

The administration of the exclusion for qualifying benefits and for income received by Armed Forces members for serving in a combat zone or during hospitalization as a result of injuries incurred during such service does not present special challenges for DOR. Payors of such income will identify it as excludable on Form W-2. Conformity with the federal exclusion based on the 2024 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.

Members voted to approve the evaluation template for the Exemption of Benefits and Allowances to Armed Forces Personnel as presented. Members agreed that this tax expenditure should not be flagged for legislative review.

Lindsay Janeczek led a discussion on the Exemption of Veterans' Pensions, Disability Compensation and G.I. Benefits. This tax expenditure was adopted in 1958 and has a revenue impact of \$49.7 - \$69.5 million per year during FY22 – FY26 with no sunset date.

Federal law provides that “[p]ayments of benefits due or to become due under any law administered by the Secretary [of Veterans Affairs] . . . made to, or on account of, a beneficiary shall be exempt from taxation.” 38 U.S.C. 5301(a)(1). The preemption applies for both federal and state tax purposes. As a result of this preemption, Massachusetts is not permitted to impose income tax on veterans’ disability pensions, disability compensation, and G.I. benefits. Note that the exemption does not apply to ordinary pensions received for serving in the military. There is no provision in the Internal Revenue Code (Code) or the Massachusetts General Laws specifically adopting the federal preemption.

Federal law prevents the federal government or any state from imposing an income tax on veterans’ disability pensions, disability compensation, and G.I. benefits.

The Commission assumes the goal of the federal law exempting veterans’ disability pensions, disability compensation and G.I. benefits from taxation is to prevent such benefits from being diminished by subjecting them to income tax.

The administration of the exclusion for military disability income does not present special challenges for DOR. Such income is not reported as taxable on Forms W-2 or 1099 for either federal or state purposes and is therefore distinguishable from other income. Conformity with the federal preemption 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 Exemption of Veterans’ Pensions, Disability Compensation and G.I. Benefits as presented. Members agreed that this tax expenditure should not be flagged for legislative review.

Stephen Maher led a discussion on the Exclusion of Payments Received Under Government Conservation, Reclamation and Restoration Programs (previously Exemption of Cost-Sharing Payments). This tax expenditure was adopted in 1978 and has a revenue impact of \$0.4 million per year during FY22 – FY26 with no sunset date.

Due to Massachusetts’ reliance on the Internal Revenue Code (Code) for purposes of determining income, property owners may exclude from income certain payments they receive for participating in designated conservation, reclamation, and restoration programs.

All states that conform to the Code for income tax purposes provide an exclusion for payments received under government conservation, reclamation, and restoration programs, unless they specifically decouple from the Code in that regard. The Commission is not aware of any states that have decoupled.

The Commission assumes that the goal of the expenditure is to encourage taxpayers to participate in conservation, reclamation and restoration programs.

The administration of the exclusion for payments from government conservation, reclamation and restoration programs does not present any special challenges for the Department of Revenue (DOR). Conformity with the federal exclusion 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 employers and employees.

Members voted to approve the evaluation template for the Exclusion of Payments Received Under Government Conservation, Reclamation and Restoration Programs with a change to Somewhat Agree on the question of whether the tax expenditure is primarily beneficial to small businesses. Members agreed that this tax expenditure should not be flagged for legislative review.

Chairperson Forter led a discussion on the Exemption of Scholarships, Fellowships, and Tuition Reductions. This tax expenditure was adopted in 1954 and has a revenue impact of \$43 - \$55 million per year during FY22 – FY26 with no sunset date.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, qualifying scholarships, fellowship grants, and tuition reductions are excluded from Massachusetts gross income.

All states that adopt the Code for individual income tax purposes allow an exclusion for qualifying scholarships, fellowship grants, and tuition reductions unless they have specifically decoupled 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 incentivize formal education by helping students defray its costs.

The administration of this exclusion does not present any special challenges for the Department of Revenue (DOR). Educational institutions must provide most students with IRS Form 1098-T (tuition statement), which includes a box for scholarships or fellowship grants. Taxpayers are instructed to include taxable portions of scholarships, fellowship grants, and tuition reductions in federal gross income. The Internal Revenue Service (IRS) uses this information to monitor compliance with Code § 117(a) and (d) and shares the results with the DOR. The Commission assumes that the consistency of treatment of qualifying scholarships, fellowship grants, and tuition reductions for federal and Massachusetts purposes also eases the compliance burden for taxpayers

Members voted to approve the evaluation template for the Exemption of Scholarships, Fellowships, and Tuition Reductions as presented. Members agreed that this tax expenditure should not be flagged for legislative review.

Amar Patel led a discussion on the Exclusion of Certain Prizes and Awards. This tax expenditure was adopted in 1954 and has a revenue impact of \$3- \$4 million per year during FY22 – FY26.

Due to Massachusetts' reliance on the Internal Revenue Code (Code) for purposes of determining income, prizes for achievements in specified fields and certain cash payments received for participating in the Olympics or Paralympics are excluded from Massachusetts gross income.

All states that adopt the Code for individual income tax purposes allow the federal exclusion for achievement prizes, unless they have specifically decoupled 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 avoid having taxes diminish the value of certain prizes and awards.

The administration of this exclusion presents some challenges for the Department of Revenue (DOR). Olympic and Paralympic medals and prizes are required to be reported by the payor on Form 1099-Misc, but it is not necessarily the case that the value of other prizes will be reported on 1099s or W-2s. Individual audits may be required to monitor the exclusion. However, conformity with the federal exclusion simplifies tax compliance and administration of the exclusion by allowing the same general rules and definitions to be used for Massachusetts and federal purposes. Further, such conformity allows the DOR to use audit results shared by the Internal Revenue Service (IRS) to monitor the exclusion.

Members agreed to approve the evaluation template for the Exclusion of Certain Prizes and Awards with an additional comment noting that this tax expenditure is complicated to administer and monitor because many of the prizes and awards are not reported. Members agreed that this tax expenditure should not be flagged for legislative review.

Chairperson Forter led a discussion on the Exemption for Sales to the Federal Government. This tax expenditure was adopted in 1968 and has a revenue impact of \$50.9 – \$62.4 million per year during FY22 – FY26 with no sunset date.

Sales to the federal government and its agencies are not subject to the sales and use tax because the US Constitution prohibits states from taxing such sales. The prohibition is effectuated by an exemption set out in the Massachusetts sales and use tax statutes.

The US Constitution prohibits any state from imposing a sales and use tax on sales to the federal government or its agencies.

There is no policy goal of the tax expenditure. The statute merely prevents Massachusetts from purporting to impose an unconstitutional tax on sales to the federal government and its agencies.

The sales and use tax rules for sales to the federal government and its agencies are administered through the Department of Revenue (DOR) audit function. The DOR has issued exemption certificates (Form ST-5), that the federal government and its agencies may present to vendors to claim the Massachusetts statutory exemption. The federal government and its agencies generally decline to present such certificates. Thus, the DOR must audit vendors to ensure that they are properly excluding sales to the federal government from taxable receipts.

Members agreed to approve the evaluation template for Exemption for Sales to the Federal Government with an additional comment noting that this is not really an expenditure because the Commonwealth has no choice but to exempt these sales. Sales to the federal government and its agencies are not subject to the sales and use tax because the US Constitution prohibits states from taxing such sales. The prohibition is effectuated by an exemption set out in the Massachusetts sales and use tax statutes. Administration of the expenditure is challenging because the federal government and its agencies generally decline to present exemption certificates, meaning that DOR must audit vendors to ensure that they are properly excluding sales to the federal government from taxable receipts. Members agreed that this tax expenditure should not be flagged for legislative review.

Members agreed to reconvene in November. 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 1:35 PM.