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IV TAX REFORM

The state and local tax system in Massachusetts needs to be changed. It is biased against those of little income and wealth. Shifting the tax burden from lower- to higher-income groups—making taxation more progressive—would mean that the tax burden would be placed on those with the most ability to pay. A progressive tax system would help to make after-tax incomes more equal by easing the heavy tax burdens on poorer families.

Achieving such reform will not be easy because most fundamental changes imply a change in the state constitution. Such reforms have recently been defeated because popular support was lacking. We feel that this lack of popular support reflects, in part, a lack of understanding of the tax system by citizens.²⁰

This chapter introduces reforms which, if enacted, would make the Massachusetts tax system progressive. We believe that the following proposals should be given serious consideration by all citizens.

REFORMS OF THE PROPERTY TAX SYSTEM

Because the property tax is so regressive and full of inequities, some argue that it should be abolished altogether. They hold that reforming the system will not rectify its objectionable nature. Since a fundamental restructuring or abandonment of

20. It also reflects, in part, a healthy distrust of politicians. See (43).

this old institution does not seem likely in the near future, reform of the property tax system can at least minimize the more adverse effects of the property tax. The general reforms discussed here are viable, we feel, and move in the direction of less regressivity.

State-wide property tax. The present property tax system is based upon local assessment and collection of real property taxes. The result is that poorer communities tend to have higher tax rates than richer ones. If the property tax were placed on a state-wide basis, every city and town would have the same tax rate. Poorer families would still spend a larger part of their income on housing and property tax than would rich families. But poorer communities would not have higher tax rates than wealthier ones, as is often the case now.

Property tax classification. In 1970, referendum question 1 on the Massachusetts state election ballot asked the voter to approve or disapprove a proposed constitutional amendment granting the legislature unlimited authority to classify real estate for taxation purposes at different rates according to its use. This amendment refers to a scheme where, for example, commercial and industrial property would be taxed at different rates reflecting different usage.

In order to have a property tax classification system in Massachusetts, the constitution must be amended. The constitution now states that taxes on persons and estates must be "proportional and reasonable." Since this implies that all property regardless of use must be taxed at the same rate, the property tax classification method is excluded.

Arguments in favor of property classification for tax purposes are:

1. As mentioned previously in this book, de facto classification of property already exists. In many cities and towns assessment practices are such that industrial and commercial property tends to be assessed at higher rates than residential property.

2. Classification would make it easier for tax administrators to implement and enforce tax laws.
3. A classification system could allow residential property to be taxed at lower rates than commercial and industrial properties. Since the regressivity of the property tax is significantly related to the fact that it is a tax on shelter, such classification could help to mitigate this factor.
4. In discussing the pros and cons of such property tax reform, the Massachusetts Taxpayers Foundation notes, "To tax all kinds of personal and real property alike, according to its full value and at uniform rates, is to ignore wide differences in the ability of various classes of property owners to pay taxes." Property tax classification would obligate owners of certain properties to contribute greater responsibility in the support of government commensurate—at least more so—with their greater ability to do so. (22:2)

Tax classification of real property by assessors is already a reality throughout most of Massachusetts.²¹ The passage of an appropriate amendment would give the sanction of law and hence provide the framework for a more progressive method of classifying, assessing, and taxing property.

The circuit breaker. Property tax relief programs, or "circuit breakers," are designed to relieve the burden of property tax on low- and middle-income families. The basic purpose of the circuit-breaker concept is that no one should pay more than a certain percentage of their income for property taxes. If a property tax payment, for example, is considered to be exces-

21. As demonstrated in Chapter II, the de facto classification of property which already exists in most Massachusetts cities will be effectively wiped out by revaluation. This eradication—through revaluation—of de facto classification of property threatens to shift the property tax burden from a business community to the residential community.

sive in relationship to a family's total income, it is then rebatable by the state and is usually refunded as a credit on the income tax.

Many circuit-breaker bills are introduced into the legislature each session, some good and some not so good. One example of a good proposal is House Bill No. 4949 introduced into the legislature in 1973 and supported by the Massachusetts Law Reform Institute. This property tax relief bill provides for a graduated ceiling of income percentages that could be paid in property taxes: 5 percent of income for low- and low-middle-income families; 6 or 7 percent for middle-income groups. Under this provision, a low-income family will receive, as a credit toward their income tax, the difference between what they pay in property tax and 5 percent of their family income.

Assume, for example, that a Chelsea family with an annual income of \$10,000 owns a home assessed at \$10,000. With a 1972 full-value tax rate of \$119.00, that family would owe \$1,190 in property tax. A circuit breaker, as the one described above, providing a 5 percent-of-income ceiling for low-income families, would provide a credit of \$690 on this family's state income tax.²²

House Bill 4949 proposes that the state finance the cost of this system by a 2 percent increase in the taxes on earned income (from 5% to 7%) and unearned income (from 9% to 11%). The property tax credit would cost the state about \$100-150 million in decreased income taxes, although with the 2 percent increase, \$220-230 million could be raised. In order to protect families with incomes under \$10,000 from paying a higher tax, H4949 would raise personal exemptions considerably—from \$2,000 to \$3,000 for a married couple and from \$600 to \$800 for each dependent. The loss in revenues from these credits and exemptions should balance the added income from the increased rate so that the circuit breaker could come close to paying for itself.

This proposal and others similar to it would help low- and middle-income families by reducing their tax burden. Many

22. This figure is arrived at by taking the difference between the property tax they actually paid (\$1,190) and 5 percent of their family income ($0.5 \times \$10,000 = \500 ; $\$1190 - \$500 = \$690$).

high-income families already pay less than 5 percent of their income in property tax. At best, then, this proposal would make the property tax slightly less regressive.

At this writing, Massachusetts has not enacted a circuit-breaker bill per se. It does, however, provide relief to low-income elderly households. In 1963 the state adopted provisions for the relief of homeowners seventy years and over, establishing an exemption on property of \$4,000 assessed value or the sum of \$350, whichever would result in an abatement of the greater amount of taxes due.

Reforms of property tax administration. The manner in which the property tax is administered invites corruption, capriciousness, and inefficiency. An important remedy to these areas of vulnerability would be increased public disclosures of all assessment practices and records.

Abatement applications should be made public and disclosures of exempt properties should also be made. Disclosure of accurate assessment ratio studies, establishment of simple procedures for prompt appeals, and computer updating of property assessments are all important goals for reform and should contribute to increased efficiency and equity of property tax administration.

Use of other local taxes to relieve the property tax. Local sales, payroll, or income taxes have been suggested as ways to lower the property tax. Each of these taxes has its problems. A local sales tax is almost—though not quite—as regressive as a local property tax. It would also discriminate in favor of communities with a large number of retail outlets and against those with few stores. A local payroll or income tax can be avoided by those firms and workers with the most ability to move from the city, leaving the more marginal workers and firms to absorb the tax in the city.

State taxes, while they pose interstate competition, can at least avoid the problem of intercommunity competition.

THE GRADUATED INCOME TAX: AN ALTERNATIVE TO THE PROPERTY-TAX-LOADED MASSACHUSETTS TAX SYSTEM

In Massachusetts the property tax accounts for 54 percent of all state and local revenues. Reliance on this regressive tax must be reduced in order to relieve the excessive burden placed on low- and middle-income people.

Since state and local spending has increased in recent years, obtaining additional revenues from a tax other than the property tax is most desirable. The income tax is the only existing, broad-based tax that could possibly replace the property tax and at the same time reduce the overall regressivity of state and local taxation. The sales tax, which has often been suggested as an alternative to the property tax, just does not hold that promise.

For genuinely substantial tax reform, an income tax with graduated marginal rates for different levels of income would be necessary. This graduated income tax (GIT) would cause taxpayers with higher incomes to pay higher tax rates. At the present time the Massachusetts income tax is based on a flat rate percentage of income and consequently does little to alleviate the impact of the regressive taxes citizens must pay.

The adoption of a GIT could provide an ideal, two-pronged reform effort aimed at substantial property tax relief and actual reform of the state income tax structure. Substantially increased revenue from a progressive GIT would be collected by the state and then distributed back to cities and towns to equalize and ease their local tax burdens.

A graduated income tax would be far more desirable than the present flat-rate income tax for the following reasons:

1. It is based on a taxpayer's ability to pay, measured by total income. A GIT is more equitable because people with higher incomes can better afford to pay higher tax rates since the loss of income to taxes is more easily absorbed at higher incomes than at lower incomes.
2. Property tax relief is desperately needed, and the GIT is the most feasible and fairest way to raise the necessary

money. Because a GIT is sensitive to income, any change in the size of the tax base (total income) will be reflected in the magnitude of the tax collection. Property values are more static and not as sensitive to the changing fortunes of the economy.

3. The GIT is fairer than sales and consumption taxes, which are also flat-rate taxes and regressive. A progressive tax should be used to bring in the largest percentage of state revenue and simultaneously reduce reliance on the unfair taxes.
4. Because state income taxes are deductible when figuring federal tax liability, shifting the income tax burden to people in higher federal income tax brackets would result in a form of automatic revenue sharing.
5. Adoption of a GIT amendment to the state constitution would create a flexibility in its income tax structure which is lacking. In the future, this flexibility would allow such taxing methods as diminishing tax credits or other similarly progressive schemes.

In order to allow the state to set different tax rates on similar types of income, it is necessary to amend the state constitution. This process involves overcoming a number of legal and political battles. Since 1959, the legislature has repeatedly approved a constitutional amendment on the GIT. However, each time the amendment was submitted to the voters—1962, 1968, and 1972—it was defeated. In all three cases vigorous, well-financed, and well-organized campaigns were launched against the GIT amendment by corporate and financial interests.

Types of graduated income tax possible. Had the voters in previous referendum elections voted the passage of a GIT—or should they in the future—the legislature then decides which type will be adopted. There are three possibilities:

1. apply a uniform rate or percentage to an individual's federal income tax liability;
2. apply graduated rates to an individual's federal taxable income;

3. apply graduated rates to income determined to be taxable under Massachusetts law.

In addition to determining the type of tax, the legislature would also set the rate schedule, the allowable exemptions, deductions, and tax credits; and define taxable income, thereby determining the amount of revenue to be raised by the tax.

The type of graduated income tax that is potentially the fairest is option no. 3, an independent income tax. Basing the Massachusetts income tax on the federal income tax (option no. 1) or the federal tax base (option no. 2) would include all the unfair loopholes of the federal tax. Under option no. 3, the tax can be defined so that it is more income-inclusive, which should help to insure that everyone pays in accordance with their ability.

TABLE 4.1 Modified Graduated Income Tax Rate Schedule

| Amount income | Current Mass. tax ²³ | Scheme 1 | Scheme 2 | Scheme 3 |
|---------------|---------------------------------|--------------------------------------|--|--|
| | | Percent of federal tax ²⁴ | Modified N. Y. rates applied to federal taxable income ²⁴ | Modified N. Y. rates applied to Mass. taxable income |
| \$ 5,000 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| 6,000 | 95 | 68 | 17 | 19 |
| 8,000 | 190 | 149 | 54 | 56 |
| 10,000 | 290 | 239 | 105 | 114 |
| 15,000 | 540 | 476 | 300 | 348 |
| 20,000 | 790 | 789 | 640 | 703 |
| 25,000 | 1,040 | 1,148 | 1,100 | 1,187 |
| 50,000 | 2,290 | 3,814 | 3,814 | 3,569 |

Source: See reference (43:9)

23. For each \$100 of income which is from dividends or capital gains, the current Massachusetts tax would be \$4 higher.

24. Taxes based on the federal taxes or taxable income assumes that the taxpayer took standard deductions. If he itemized his deductions, the taxes he paid based on the federal tax or taxable income would be lower, depending on the amount of deductions claimed.

A recent study by Edward Moscovitch (40) shows a GIT based on the rate structure now used in New York State would, if applied to Massachusetts taxable income as currently defined, reduce taxes for 95 percent of all Massachusetts taxpayers. Under this scheme, all taxpayers with incomes of less than \$20,000 would pay less income tax; those above, more taxes. Over \$100 million of the tax burden would be shifted to the federal government via deduction on the federal tax form. These figures assume no increase in total revenue collections from the income tax.

A comparison of the three schemes outlined in the referendum to the current tax structure is made in Table 4.1. GIT Scheme 1 applies a uniform rate or percentage to an individual's federal income tax, Scheme 2 applies graduated rates to a person's federal taxable income, and Scheme 3 applies graduated rates to income determined to be taxable under Massachusetts law.

Graduated rate schedule. The amount of money people would pay with a graduated income tax would depend on the type of structure adopted by the legislature. The Coalition for Tax Reform, a liberal-moderate coalition of citizen and labor groups who fought for passage of the GIT in 1972, has suggested the income tax rate shown in Table 4.2, which illustrates the primary definition and central purpose of an income tax that has

TABLE 4.2 Suggested Graduated Income Tax Rate Schedule

| <u>Taxable income after personal exemption and allowable deductions</u> | <u>Tax rate (percent)</u> |
|---|---------------------------|
| First \$2,000 | 1 |
| \$ 4,001-\$ 6,000 | 3 |
| \$ 8,001-\$10,000 | 5 |
| \$12,001-\$14,000 | 7 |
| \$16,001-\$18,000 | 9 |
| \$20,001-\$24,000 | 11 |
| \$28,001-\$32,000 | 13 |
| \$36,001-\$50,000 | 15 |

graduated marginal rates. As income increases, the rate of tax paid on that income also increases. This rate schedule is also patterned on the one now used in New York State.

PROSPECTS FOR REFORM

This section dealing with tax reform—like the rest of this book—has been neither exhaustive nor all-comprehensive. We have dealt with only a few reforms that can make the overall tax system progressive. We have focused upon the two areas that present the biggest challenge and on which Massachusetts revenue requirements are most dependent.

Many obstacles to substantial reform exist. Considerable time may pass before the state will adopt a sufficiently satisfactory progressive system of taxation. Nevertheless, citizens must demand more tax equity and make the graduated income tax a primary goal toward equalizing the tax burden at state and local levels.

We have mentioned the failures to effect reform at the state level. In every case the wealthy and corporate interests have fought against progressive tax reform campaigns. They always win because they have the money and resources to mount effective media campaigns that influence public opinion.

Not until the people of Massachusetts educate themselves to more fully understand the issues involved in such reforms, and not until politicians and tax reformers begin to appreciate how, in fact, citizens perceive their economic reality, will the prospects of reform be good.

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