Tufts University | Jonathan M. Tisch College of Civic Life

THE CENTER FOR STATE POLICY ANALYSIS

THE $5.1 BILLION QUESTION FOR MASSACHUSETTS VOTERS

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EXECUTIVE SUMMARY

This November, Massachusetts voters could decide to cut the state income tax from 5 to 4 percent, as part of a proposed ballot question.

If this proposal passes, the effects will be substantial and enduring, straining the state budget by shifting billions of dollars out of public coffers and into people's pockets.

We at the Center for State Policy Analysis are committed to helping voters understand the likely impact of this and all state ballot questions.

Using the latest available data, and the same dynamic modeling techniques from our 2022 analysis of the millionaires tax, this report shows how an income tax cut would affect state spending, the state economy, and households at different rungs of the income ladder.

We find that:

- A tax cut would give households around the state more money to spend and save, with the average middle-class household's tax bill shrinking around $1,250 each year.
- Income tax collections would fall by nearly 20 percent and total state tax collections by roughly 10 percent, or $5.1 billion per year. A cut of this size would more than offset the revenue gains from the millionaires tax and imperil efforts to balance the state budget and sustain core government programs moving forward.
- Taxpayers across the income spectrum would see relatively similar benefits, with most households keeping an additional 1 percent of their income. This distribution looks quite different in dollar terms, with the highest-earning households receiving a tax cut roughly 30 times as large as a middle-class household.
- The tax cut would be phased in over three years, beginning January 1, 2027. This creates a serious planning problem for lawmakers, who are already building next year's budget and cannot know whether revenues will suddenly drop.
- Because the tax cut is relatively small compared to household incomes, it is unlikely to have a significant impact on private spending or the overall state economy.

In the sections that follow, we discuss each of these findings in greater depth, while also providing fuller background on the state income tax and the specific contours of the ballot question.

BASICS OF THE STATE INCOME TAX

The state income tax is the largest source of money for public programs in Massachusetts. It provides more than half of all state tax revenue, helping to fund everything from public schools to public transit, health care, early education, and economic development.

Unlike most states, Massachusetts has a relatively flat income tax, with a single 5 percent rate that applies to virtually all households. That rate has ratcheted down over time, from 5.95 percent to 5.3 percent around the turn of the millennium and then to 5 percent in the 2010s.

It is not possible to map income tax collections to specific state programs, as there is no formula saying: this dollar must support flood protections, or this must help with school renovation. But the money is central to all manner of state spending. Last year, our 5 percent income tax generated nearly $24 billion in revenue for the state, most of which went to the general fund and was then appropriated for specific uses based on lawmakers' sense of need and priority.

Of course, these billions in tax dollars come from millions of Massachusetts households, who contribute in amounts based on their incomes. A typical middle-class family earning around $120,000 per year contributes just under $6,000. Top earners contribute tens of thousands each year, and a small group of extremely high-earners — representing less than 1 percent of all households — pays an additional 4 percent tax on income over $1 million.

WHAT THE BALLOT QUESTION WOULD DO

If approved by voters, this proposed ballot question would gradually reduce the state income tax rate from 5 percent to 4 percent over a period of three years, such that the rate would be:

1. 4.67 percent starting on January 1, 2027
2. 4.33 percent for 2028
3. 4.00 percent for 2029 and thereafter

No other adjustments to the state's tax and budgeting system are included as part of this ballot question.

EFFECTS OF AN INCOME TAX CUT

An income tax cut is essentially a transfer of dollars — in this case from the state of Massachusetts to individual taxpayers.

Money that would have been collected by the state and used to support schools, health care, bureaucratic inefficiency, or other government efforts will instead remain in taxpayers' pockets, where it could help cover rent, pay for travel, or make prop bets on sporting events.

The real-world impact of moving money from state coffers to individual taxpayers depends on a variety of things, like the size of the transfer, the distribution of recipients, the possibility of positive (or damaging) spillover effects, and the amount of unproductive spending in both public and private budgets.

State revenue losses

Start with the simplest possible calculation, which misses some key dynamics but quickly establishes the rough scale.

Last year, the state collected nearly $24 billion in regular income taxes (after subtracting the $3 billion from the millionaires tax). Assuming that household incomes grow as they have in recent decades, we should collect around $27 billion in fiscal year 2030.

Dropping the income tax from 5 percent to 4 percent amounts to a 20 percent rate cut, meaning that all else being equal we should expect to lose about 20 percent of that $27 billion forecast — a $5.4 billion transfer from state collections to household budgets.

However, all else is not equal, and this estimate is likely too high.

The issue is that people's behavior changes along with tax rates. The effects aren't always large, but ample research suggests that higher tax rates reduce overall earnings, partly by making it less appealing to work, partly by encouraging various kinds of tax avoidance. Lower tax rates have the opposite effect, slightly increasing incentives to work and also reducing the need to hide income from tax authorities.

These behavior-changing effects were central to our earlier analysis of the millionaires tax, and we're applying the same approach here.

Cutting the income tax rate from 5 percent to 4 percent, however, doesn't induce as large a behavioral change. That's because the impact on behavior is proportional to the change in your tax bill *after accounting for both state and federal taxes*. A 1 percentage point state in-

come tax cut looks quite small as part of that overall bill.

As a result, we find that cutting the state income tax to 4 percent would increase household earnings by a real but relatively small amount, offsetting some but not much of the state's expected lost taxes. Instead of a 20 percent, $5.4 billion loss — which is what we estimate without behavioral effects — we expect income tax revenues to fall 18.9 percent, or $5.1 billion (nominal).

One further adjustment is needed before we can estimate the year-by-year impacts.

It matters that the state writes budgets for fiscal years — starting in July and ending in June — while tax rates apply to calendar years, January to December.

Consider an investor or a business-owning household weighing options in a world where the ballot question passes in November 2026. They'll know that the state tax rate is going to decline from 5 percent to 4.67 percent in two months. So if there's any way to hold off on collecting income for a bit, they might consider it — maybe by delaying invoices to clients, maybe by putting off stock sales.

Revenue loss from income tax cut

Accounting for behavioral changes and year-end deferral

Fiscal year	Revenue decline
FY 2027	-$0.82b
FY 2028	-$2.42b
FY 2029	-$4.16b
FY 2030	-$5.09b

Source: Massachusetts DOR, BEA, cSPA calculations.

This retiming strategy will cost the state money. We assume the amount of income deferred in this way will be real but small, about 1 percent of total earnings in any given year, which is reflected in the table showing revenue losses during the phase-in period.

Distribution of benefits

Reducing the state income tax from 5 percent to 4 percent will affect different households in different ways.

This may sound surprising, given that the tax has a flat rate. If everyone is now paying 5 percent, and everyone will instead pay 4 percent, shouldn't everyone's tax bill fall by exactly the same amount (20 percent)?

This is mostly true, but not entirely so. And the missing piece is that every household can exempt at least some of its income from the state tax, whether through the personal exemption or otherwise. These exempted pockets are especially valuable for lower-income folks, because they are able to safeguard a higher share of their income.

This system of exemptions is what makes our state income tax mildly progressive, meaning that middle- and higher-income folks contribute a slightly larger share of their income.

But the flip side is that any cuts to the income tax are mildly regressive, providing the greatest benefits to those middle- and higher-income households.

One way to see this is by comparing the amount of income households earn with the money they'll save if the ballot question passes.

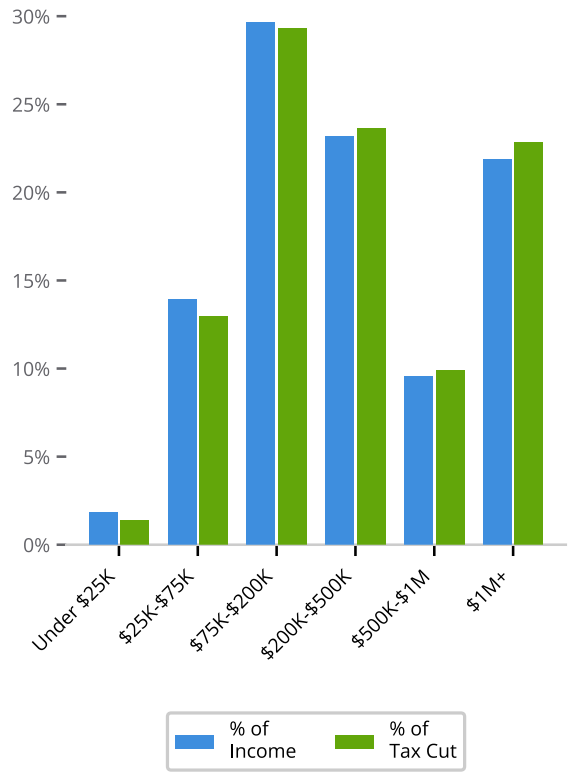
Extremely-low-income filers earn about 1.8 percent of all state income, but they will get just 1.4 percent of the money from this tax

cut. At the other end of the spectrum, filers who make over $1 million per year collectively earn 21.9 percent of state income but will keep 22.8 percent of the money from the tax cut. These distributional differences are small but nonetheless real.

Looking at dollars, rather than income shares, tells a very different story.

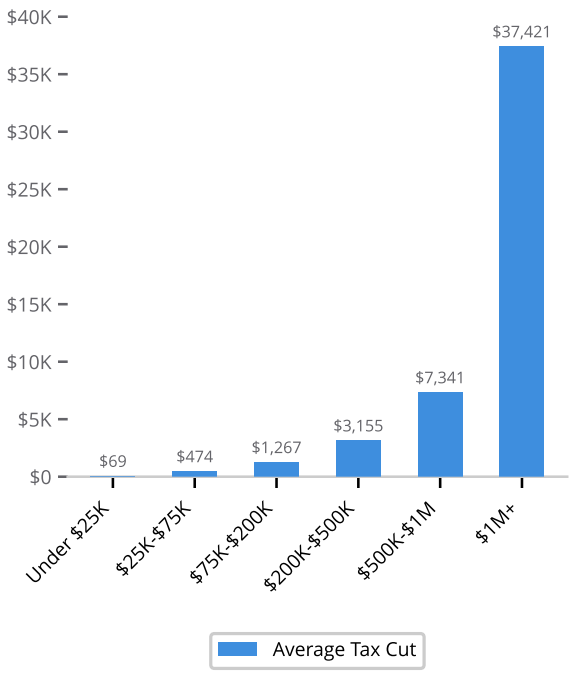
Since nearly all households get to hold on to an additional 1 percent of their income, having a higher income allows you to keep many more raw dollars. One percent of $5 million in income is $50,000 off your tax bill; one percent of $50,000 in income is just $500 in savings.

Distributional impact is relatively flat



Source: IRS Statistics of Income, cSPA analysis.

Higher-income households receive more dollars



Source: IRS Statistics of Income, cSPA analysis.

Public vs. private spending

The state, acting through the legislature, makes very different spending decisions than individual households, so when you shift money between these groups (as you do with a tax cut), it can fundamentally reorient statewide economic priorities.

Start from the perspective of state government. There are some things that the state is better positioned to fund, starting with public goods like schools, courts, clean energy projects, flood barriers, roadway repair, and police forces. The state is also able to provide community supports in a way that can be prohibitively expensive for individuals and families, whether that's subsidized health insurance, public defenders, nursing care for the aging poor, food for struggling families, or a foster care system for endangered children.

Cutting $5 billion from state tax revenues will imperil supportive programs like these. Which is not to say that state spending is maximally efficient, or that there isn't ample room to reduce waste. Doubtless there is, but you need to consider the math.

Total state tax collections will reach $50 billion by 2030, with net state spending of over $60 billion — so a $5 billion tax cut would require a budget cut of 7–10 percent, far larger than can plausibly be addressed by tackling inefficiencies.

Five billion is more than we spend on our entire court system or our whole child welfare infrastructure, more than we spend on transit and transportation, and more than we spend on public colleges and early education combined. On top of that, it's vastly more than we spend on environmental programs, legislative salaries, or elder services.

No doubt, if this tax cut passes, the state will find ways to adapt — but that adaptation will require a real narrowing of our public programs. And one challenge for voters is that it is impossible to know which programs will shrink and by how much. That answer depends on the unpredictable interactions between legislators, constituents, advocacy groups, and others unfolding over a period of years.

Adding to this uncertainty is the possibility that the state could also respond by raising other taxes, whether via a sales tax increase or a package of business taxes. Policy pendulums do sometimes swing in this way, as when the passage of the millionaires tax in 2022 was quickly followed by a roughly $1 billion package of unrelated tax cuts.

This is just half the story, though. Before deciding whether to support an income tax cut, voters also need to think about what households might do with the money they'll no longer contribute to the state.

Households have their own real advantages, when it comes to spending. Among other things, they:

- Have a better understanding of their own priorities
- Respond more quickly to changing economic conditions
- Are free to pursue more risk-taking opportunities
- Face cost pressures in a more direct and granular way than the state, which creates a kind of monthly spending discipline that can't be matched by state budget writers or procurement officers

If the income tax cut passes, the average middle-class household would have an additional $1,250 per year, money that would be used in millions of different ways around the Commonwealth, from covering rent to funding new ventures or splurging on a vacation.

But the whole theory behind market economies is that all this chaotic and distributed household spending supports the businesses and services that people care about. Moreover, it allows people to assess risks and take their own chances, possibly using this money to help fund breakthrough technologies or support urgent charitable causes.

The overall economy

If voters endorse this income tax cut, the impact on economic growth is likely to be small.

The fact that income tax cuts are fundamentally a transfer of money from public coffers to private pockets makes it hard for them to boost the overall state economy — especially when we're talking about shifting $5 billion in

a state where total economic activity amounts to roughly $700 billion.

It's true, as noted earlier, that tax cuts do slightly increase incentives to work, which would have some positive impact. Our modeling suggests that reported income would rise by roughly 1 percent under this ballot question. But *reported* is a key word here. Not all of this counts as new economic activity; some is the shrinking need for tax avoidance, given the lower tax burden. So the real economic gain from this channel is narrower.

Another way to spur growth is by attracting more workers to Massachusetts — or discouraging out-migration. But the research on migration suggests that even larger rate changes, like the millionaires tax, have a surprisingly small impact on interstate moves.

Other noteworthy impacts

- **Tricky implementation timing.** If this ballot question passes, it will take effect within two months, right in the middle of fiscal year 2027. That makes it extremely complicated for the state to plan its 2027 budget. If lawmakers expect the tax rate to stay at 5 percent, they may face a sudden and dramatic $820 million shortfall in the back half of the year. Yet if they plan for a potential tax cut, and budget conservatively, they may needlessly underfund valued programs.

- **Less flexible revenue system.** Money from the regular income tax is broadly available to support the evolving priorities of the state and fund areas with the greatest need. There are some exceptions to this, including the treatment of capital gains, but income tax dollars don't come with a lot of strings. When you cut the income tax, you increase the state's reliance on tax streams with more concrete spending rules; this includes the millionaires tax, which is meant for education and transportation, and the sales tax, a significant portion of which funds the MBTA.

- **Shifting importance of the SALT deduction.** When Massachusetts residents file federal tax forms, they're allowed to deduct some portion of their state tax payments. So when the state cuts taxes, it actually reduces this deduction, meaning that some households have to pay higher federal taxes. The details get complicated quickly, because the deductible amounts have whipsawed in recent years, but some of the very highest earners — especially owners of non-corporate businesses who maximize their deduction through a state workaround — will find themselves handing a substantial portion of any income tax cut directly to the federal government.

CONCLUSION

Among the ballot questions currently wending toward voters is a proposal to gradually cut the state income tax from 5 to 4 percent.

A yes vote would substantially limit the money available for state programs, reducing income tax revenue by 19 percent and total tax revenue by roughly 10 percent, or $5.1 billion, by 2030.

At the same time, taxpayers would be able to keep more of their earnings, with the average middle-class household receiving a benefit of roughly $1,250 per year.

In the coming months, cSPA will publish additional research on the proposed ballot questions, including comprehensive voter guides.

METHODOLOGICAL NOTES

The estimates in this analysis rely on public data and published economic research.

Information about Massachusetts income tax collections comes from the IRS Statistics of Income and monthly reports from the Massachusetts Department of Revenue.

We use the Bureau of Economic Analysis (BEA) measures of market income — wages, proprietors' income, and investment income — as our primary income measure, based on diagnostic tests showing it tracks the state's effective tax base more reliably than AGI over time. Revenue projections are based on the historical ratio between market income and the state's tax base. Income is projected forward from 2024 actuals using the compound annual growth rate from 1999–2019 (to avoid COVID-era distortions).

To account for behavioral responses to the rate cut, we apply an elasticity of taxable income (ETI) of 1.0, drawn from Mertens and Montiel Olea's 2018 study in the Quarterly Journal of Economics. The behavioral adjustment is applied to the combined marginal tax rate (state plus an assumed 22 percent average federal rate). A smaller ETI might better reflect the broad population affected by an income tax cut, but for consistency we used the same figure from our millionaires tax analysis (a lower ETI would have mildly increased our estimate of lost revenue).

Budgetary impacts are presented in nominal terms to match budget planning approaches. Distributional impacts, however, are adjusted for inflation.

Distributional estimates use IRS Statistics of Income data for Massachusetts tax year 2022, broken into six income groups. We approximate Massachusetts taxable income as federal AGI minus the state personal exemption, which varies by filing status.

We model a small retiming effect around the January 1 rate reductions, reflecting the incentive for some taxpayers to defer income when a lower rate takes effect. The magnitude of this shift is small — roughly 1 percent of total annual income or tens of millions of tax dollars for each January rate reduction.

Anyone interested in a fuller discussion of our methodology and data should reach out directly to cspa@tufts.edu.

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