PIONEER OPPORTUNITY

The Case for Competitiveness:

A Menu of Pro-Growth Changes to Massachusetts Business Tax Policy

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PIONEER INSTITUTE

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Success for Pioneer is when the citizens of our state and nation prosper and our society thrives because we enjoy world-class options in education, healthcare, transportation and economic opportunity, and when our government is limited, accountable and transparent.

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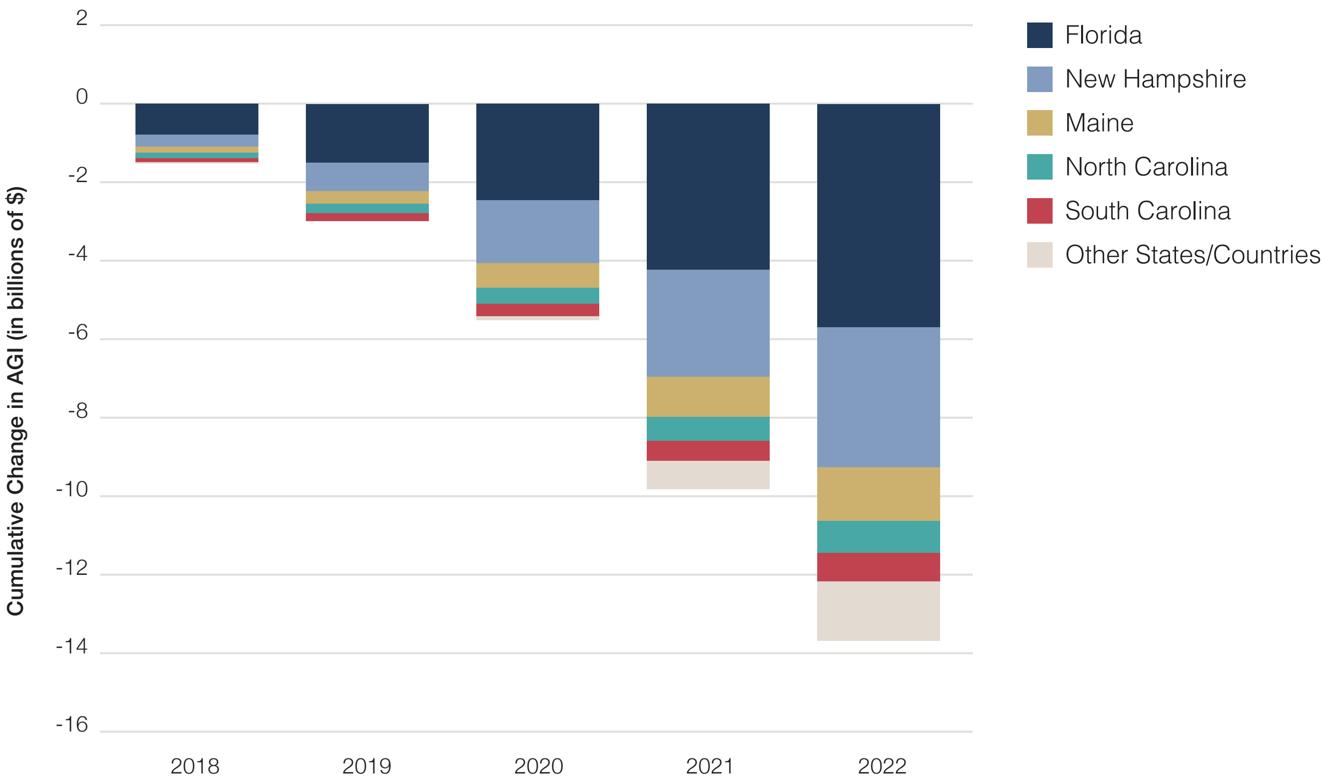
Introduction

Tax policy is commonly used not only to fund public budgets but also to influence behavior. It can incentivize certain actions by making them less expensive, such as the charitable giving deduction, or discourage other behaviors, like smoking, by increasing the cost of tobacco. The investment tax credit encourages business to invest in the overall economy and the apprentice tax credit promotes employment. Unfortunately, though, Massachusetts tax policy tends to promote behaviors detrimental to the long-term fiscal health of the state by encouraging the outmigration of wealth and talent.

In recent years, Massachusetts has lost billions of dollars in adjusted gross income (AGI) to states with business- and taxpayer-friendly policies. From 2018 to 2022, net migration from Massachusetts to Florida alone left the Bay State with nearly $5.7 billion less in taxable income.[1] For most states to which Massachusetts frequently sheds taxpayers, the rate of outmigration has only accelerated since COVID-19 (see Figure 1). These trends must be reversed.

Figure 1: Cumulative Change in Adjusted Gross Income Due to Net Migration Between Massachusetts and Other States, 2018–2022



Pro-business tax changes take many forms. The most basic way to reduce tax liability is to lower the tax rate. The 2024 reduction to the Massachusetts short-term capital gains rate is a recent example.[2] But there are several other types of reforms—exemptions, deductions, credits, changing the definition of terms, and/or changing the methodology used to determine liability.

For individuals, the policy goal is usually to reduce the cost of essential purchases. That is why Massachusetts has a sales tax exemption for food, clothing, and medicine and the federal government provides a mortgage interest deduction to defray the cost of purchasing a home.

For businesses, cost-saving tax changes often come in the form of tax credits because credits require a taxpayer to have tax liability to reap the benefits. In some instances, though, Massachusetts has eliminated the requirement that a taxpayer have a tax liability to benefit by making the credit refundable. The film tax credit is one such example.

Clearly, tax policy is a critical development lever Massachusetts can use to address affordability and competitiveness challenges. In contrast to the housing bond bill or capital investments in transportation, both of which are necessary but will take years to benefit taxpayers, the impacts of tax policy changes can be felt almost immediately—with one caveat. To change behavior, tax policy changes must be material and position Massachusetts more favorably than competitor states. While the $1 billion tax package adopted in 2023 provided relief to a wide swath of taxpayers, the changes were not sizeable enough to make a substantial difference. To illustrate, the renter's deduction was increased from $3,000 to $4,000.[3] The additional $1,000 exempt from the 5 percent income tax saves a renter $50 per year, hardly a notable amount for most households.

Thus, Pioneer Institute is supportive of impactful tax relief as the most immediate way to improve the state's business climate and grow the state's economy. Below are six tax policy changes that that could help reverse the outmigration trend.

Data Note:

Pioneer Institute recognizes the value of estimates that quantify the foregone revenue and gains in economic activity from enacting the tax policy changes proposed in this paper. However, communications from state officials have implied that obtaining the detailed microdata necessary to conduct such estimates would be infeasible at this time. Thus, this paper suggests tax policy changes with the caveat that they should be subject to a more thorough cost-benefit analysis prior to their enactment.

I. The Throwback Rule

Current Law: According to the Tax Foundation, corporations with business conducted in multiple states apportion income among those states for tax purposes.[4] Yet income earned in some states may not be subject to taxation there. This income is often referred to as "nowhere income." Massachusetts, 18 other states, and the District of Columbia employ a "throwback rule" designed to allow states to tax "nowhere income" if they are legally the company's primary place of business. [5] Massachusetts General Laws hold that the portion of a business' taxable net income that another state is prohibited from taxing under the U.S. Constitution shall be allocated in full to the Commonwealth if the business is domiciled here.[6]

A related "throw-out rule" (currently only enforced in Maine) holds that instead of the out-of-state sale being added to the numerator, it is subtracted from the denominator, effectively disregarding the sale for apportionment purposes.

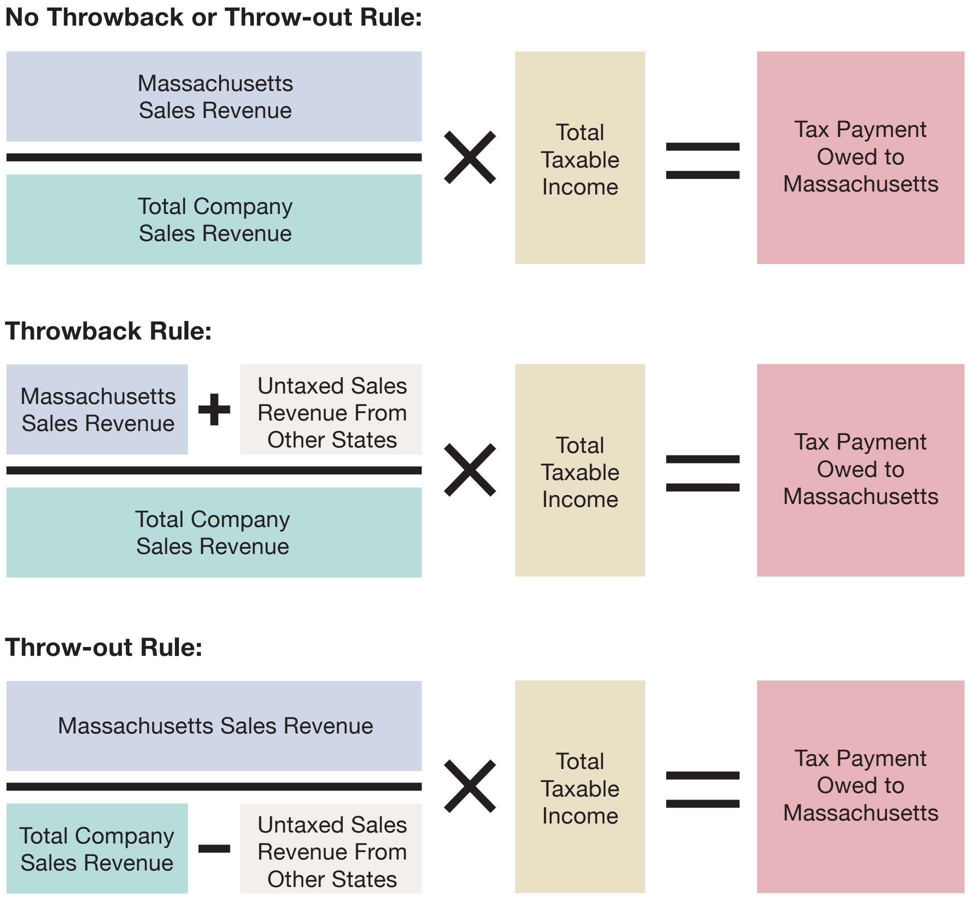
Massachusetts is among 19 states taxing 'nowhere income' via throwback rules, even as others repeal them.

Since 2020, the following states have repealed their throwback or throw-out rules, thus creating a more competitive and business-friendly tax environment: Alabama, Louisiana, Missouri, Vermont, and West Virginia.[7] Meanwhile, Arkansas has begun a full phase-out of its throwback rule that will conclude in 2030.

Massachusetts regulations (830 CMR 63.38.1 (5)) provide a good illustration of how the throwback rule works.

In Year 1, Company X, incorporated in Massachusetts, has a de minimis sales presence in New York, such that it is not subject to New York's corporate income tax. Thus, although Company X is engaged in business activity in both Massachusetts and New York, *all* of Company X's income from business activity is allocated to Massachusetts. If Company X also had taxable business activities in Connecticut and apportioned its income accordingly, sales from business activity in New York would still be thrown back to Massachusetts only and included in the numerator when determining the sales factor (see Figure 2).

Figure 2: Calculation of Corporate Tax Revenue With Throwback Rule, Throw-out Rule, and Neither



Proposed Change: Rather than maintain the "throwback" rule that maximizes the amount of tax a corporation will be subject to in Massachusetts, the Commonwealth should adopt the "throw-out" rule, thus limiting the sales factor to transactions made within the Bay State. While this would still result in a greater tax liability than if Massachusetts had no throwback rule at all, it would do so by solely considering *taxable* sales revenue in the sales factor, not by incorporating all untaxed revenue from other states. This is a fairer approach because it avoids taxing Massachusetts-based companies differently based on the other states in which they operate.

Impact: Besides Massachusetts, 18 states that have corporate income taxes impose a throwback rule, including competitor states such as California, Illinois, Vermont, and New Hampshire.[8] Adopting the throw-out rule instead would make it more appealing for companies to do business in the Commonwealth than in these other 18 states and put it on par with Maine.

II. Sting Tax

Current Law: When the surtax was first imposed, it was intended to subject large S corporations to the same tax rate as their C corporation counterparts in Massachusetts. S corporations provide many of the legal protections of a C corporation, but they can elect to be taxed as a non-corporate entity under MGL Chapter 62, the personal income tax statute.[9] Chapter 62 taxes income at the rate of 5 percent,[10] whereas Chapter 63 taxes corporate income at the rate of 8 percent.[11] To address this tax rate discrepancy, Section 32D imposes a formulaic surtax of 3 percent on S corporations with at least $9 million in total receipts in the taxable year and a surtax of 2 percent on S corporations with between $6 million and $9 million in total receipts.[12]

Tax expert Michael Lucci has called out Massachusetts' S corporation surtax as "an extra liability for S corporations that is unique among other states." [13] While several other states, including California, New York, Illinois, Tennessee, Washington, and Ohio, impose various taxes on S corporations, none use a gross receipts-based surtax specifically targeting S corporations with high receipts, making Massachusetts a clear outlier in this regard.[14]

Massachusetts is unique among other states in imposing a gross receipt-based surtax ("sting tax") on top of standard corporate excise taxes.

A recent Massachusetts Society of CPAs survey of accountants found that eliminating the Sting Tax on small businesses is one of the tax policy changes most likely to deter relocation.[15]

Proposed Change: When the surtax was first imposed, it was intended to subject large S corporations that elected to be taxed under the personal income statute for federal purposes to the same tax rate as their corporate counterparts in Massachusetts. While Massachusetts would be more competitive if the state were to eliminate this tax altogether, an interim step would be to update the tax thresholds. The current income threshold has not been updated since 2008 and thus ensnares many small businesses that were not intended to be subject to the surtax. Increasing the income thresholds by 50 percent to account for inflation and then benchmarking them to inflation on an ongoing basis would be a good start.

Impact: Increasing the sting tax income thresholds will provide much needed tax relief to many small businesses that are facing a wide array of cost increases such as labor, energy, healthcare, and unemployment insurance.

III. Minimum Corporate Excise

Current Law: Massachusetts does not have a simple corporate income tax. Instead, corporations are subject to an excise tax for the privilege of doing business here. Thus, the continuing operation of a business corporation's charter or other means of legal authority within the Commonwealth subjects a corporate entity, including subchapter S corporations, to a tax of $456 annually even if the corporation has no taxable income.[16]

In New England, Rhode Island, Connecticut, and Vermont have a minimum tax. Key competitor states like New Hampshire, Florida, and Texas do not (see Table 1). North Carolina has a $200 minimum tax but is phasing out its corporate income tax by 2030 (from its current low rate of 2.25 percent).[17]

Table 1: Minimum Corporate Income Taxes Among Select Massachusetts Competitor States [18]

State	Minimum Tax	% of Apportioned Net Income	% of Capital Stock	Gross Receipts Trigger
RI	$400	7% (min $400)	N/A	N/A
CT	$250	7.50%	0.31% (max $1M)	N/A
NH	N/A	N/A	N/A	$281,000
ME	N/A	N/A	N/A	N/A
VT	$100 – $100,000	8.93% (top rate)	N/A	$500,000 – $300M+
FL	N/A	5.50%	N/A	$2.47M
NC	$200	2.25% (phasing out to 0%)	1.50%	N/A
TX	N/A	0.375% – 0.75%	N/A	$2.47M
TN	$100	6.5%	0.25%	N/A

Key competitor states do not have minimum corporate taxes. Massachusetts does.

Proposed Change: Massachusetts should eliminate the minimum corporate tax. Massachusetts has had this tax since at least 1969,[19] when businesses sought physical proximity to markets, workers, and customers, but that is no longer as important with technological advances and the ability to have employees work remotely. At a time when businesses have many options for where to set up shop, removing the minimum corporate tax is low-hanging fruit among pro-business reforms.

Impact: Eliminating the corporate minimum excise would be one less hurdle for current small businesses, as well at immigrant and domestic entrepreneurs, to overcome in the early stages of operating a business in Massachusetts.

IV. Non-Income Measure of the Corporate Tax

Current Law: Massachusetts has a two-part corporate excise tax. The first component is an 8 percent tax on a corporation's income. The second is a non-income measure that taxes a company's net worth if it is an intangible property corporation or its property if it is a tangible property corporation. The non-income portion of the corporate excise is taxed at a rate of $2.60 per thousand of the value of the tangible property located in Massachusetts if the corporation is a tangible property corporation, or the total assets of the corporation less its total liabilities if it is an intangible property corporation.[20]

Massachusetts is one of just eleven states that has taxes on both tangible and intangible corporate assets.[21] Moreover, once Louisiana phases out their capital stock tax in 2026, Massachusetts will tax intangible corporate assets at the highest rate of any state.[22]

Massachusetts is one of just eleven states that has taxes on both tangible and intangible corporate assets.

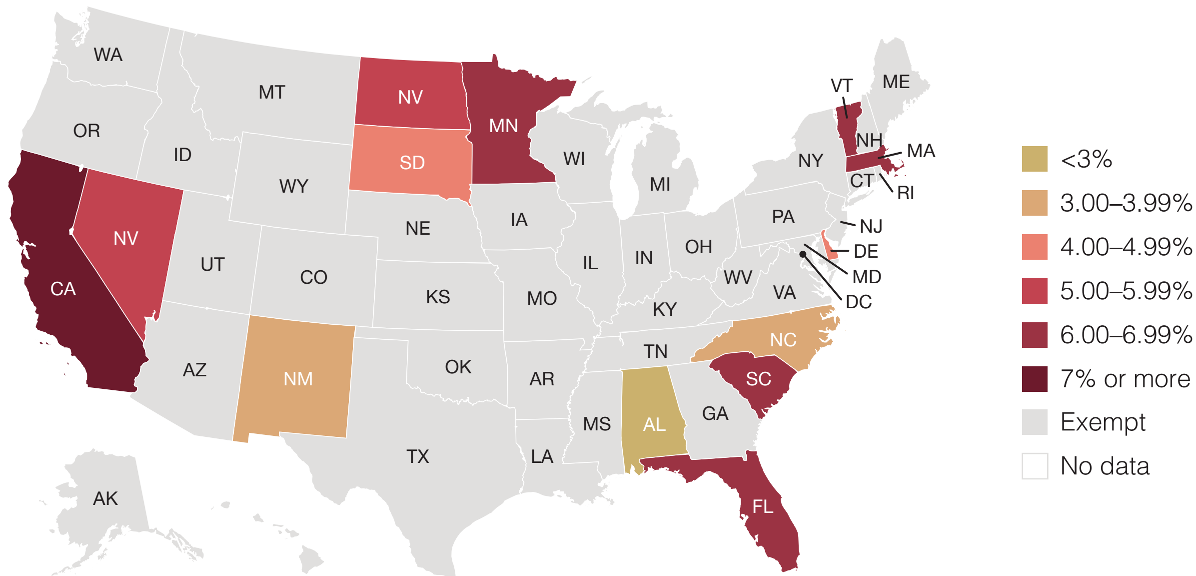
Proposed Change: The non-income measure of the corporate excise should be either eliminated or greatly simplified. Taxing assets and inventory discourages businesses from operating here.

Impact: This change would make Massachusetts more competitive given that the majority of states exempt at least some personal property from corporate excises and the vast majority exempt intangible assets.[23] It would also reduce the cost of compliance for companies because the law and regulations pertaining to the non-income measure are complicated and companies spend significant resources to comply with these provisions. Lastly, corporations that are not profitable still must pay intangible property taxes as applicable, a "tail risk" that acts as a strong deterrent to companies that might have otherwise moved to or expanded in Massachusetts.

V. Rolling Stock Tax

Current Law: Massachusetts' "use" tax, a companion to the sales tax, requires people who use—but do not purchase—tangible personal property in the Commonwealth to pay a 6.25 percent tax. The statute outlines several exemptions, but there is no exemption for trucks, trailers, or related equipment used in interstate commerce, known as "rolling stock." According to a 2018 report by the American Transportation Research Institute (ATRI), 36 states, including every other Northeastern state except Vermont, exempt such rolling stock from sales and use taxes, making Massachusetts one of 14 states without this exemption (see Figure 3).[24] By definition, rolling stock is a business purchase, a key distinction from most items subject to a retail sales tax.

Figure 3: Map of States by Rolling Stock Sales Tax Rate, 2018



Proposed Change: Massachusetts should adopt an exemption from the use tax for trucks, trailers, and other such rolling stock. This would help state businesses that transport goods to other states and get deliveries from suppliers.

Impact: By failing to exempt commercial rolling stock from the use tax, Massachusetts is essentially turning a consumption tax into a production tax. Adopting a rolling stock exemption would reduce the cost of transporting goods on our roads, making Massachusetts more welcoming for business operations.

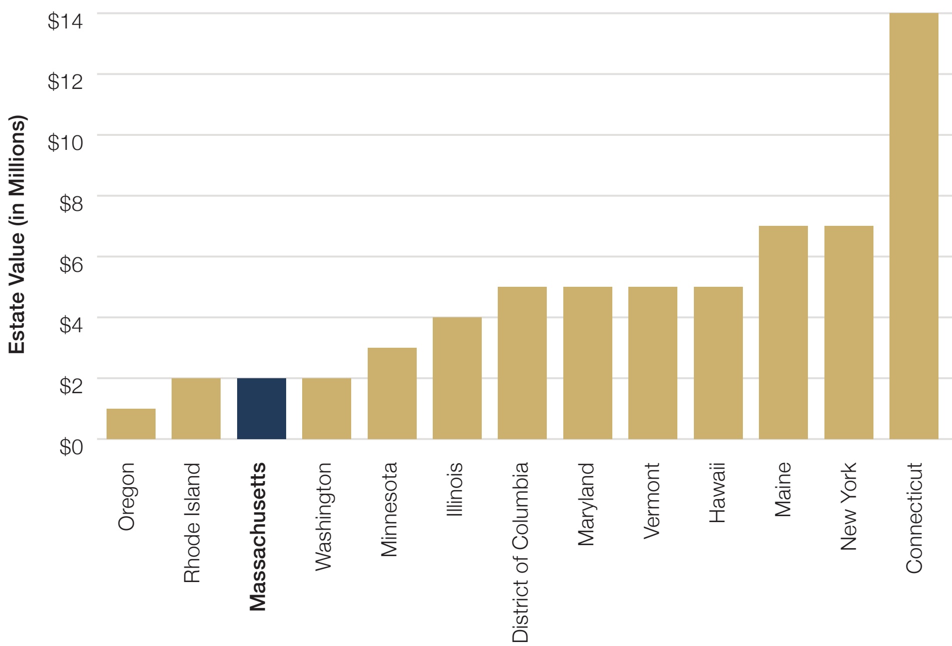
Massachusetts is one of 14 states imposing a use tax on rolling stock, diverging from the 36 states that offer exemptions.

VI. Estate Tax

Current Law: Massachusetts bases its estate tax law on the federal estate tax framework that was in effect until 2005, providing different credit amounts based on the size of the estate.[25] It is one of only 12 states that continues to impose an estate tax, creating a competitive disadvantage for high-net-worth residents compared to states without such taxes.[26] In 2023 and 2024, amendments to the Massachusetts estate tax law were enacted in response to this disadvantage. According to the Department of Revenue, one of these amendments provided a tax credit of up to $99,600, effectively eliminating the estate tax for estates valued at $2 million or less.[27] Additionally, the tax now applies only to the portion of an estate that exceeds the $2 million threshold, rather than taxing the full value once the threshold is crossed.[28]

Massachusetts' estate tax remains more burdensome than those in many other states for several reasons. Unlike the federal estate tax exemption, the Massachusetts exemption is not portable between spouses, meaning that the unused portion of the $2 million exemption cannot be transferred to a surviving spouse.[29] Additionally, the Massachusetts exemption is not indexed for inflation, causing it to erode in real value over time, effectively capturing more estates as asset values appreciate.[30] Compared to states like New Hampshire and Florida, which impose no estate tax, Massachusetts is a clear outlier. In every year from 1993–2022, Florida and New Hampshire accounted for at least fifty percent of adjusted gross income lost due to the net migration of tax filers from Massachusetts to other states and countries.[31] Massachusetts is also at a distinct disadvantage when it comes to states like New York and Illinois, which offer significantly higher exemptions (see Figure 4).[32]

Figure 4: Minimum Estate Value at which the State-Level Estate Tax Applies by State, 2024



Proposed Change: Massachusetts should avoid taxing estates entirely, as most states do. The tax serves as a trap for the unwary, hitting homeowners, small business owners, and others who may not have tax advisors. Alternatively, Massachusetts should adopt the federal minimum threshold for which the tax applies, currently $13.99 million for 2025.

Impact: Raising the estate tax income threshold could help stop the flow of outmigration Massachusetts is experiencing. A recent Massachusetts Society of CPAs survey indicated that 55 percent of accountants believed "that raising the estate tax threshold to $5 million and adjusting annually for inflation" would be likely to deter their clients' relocation.[33] The combination of the recently enacted 4 percent income surtax and the estate tax greatly impacts small business owners who are selling their businesses and wealthy taxpayers' decisions about where to domicile. Given Massachusetts' growing number of baby boomers and retirees, many taxpayers potentially subject to the estate tax will take action to avoid it. This means not only less estate tax revenue but also less revenue from a variety of taxes those estate owners would have otherwise paid for years to come.

Massachusetts is one of 12 states with an estate tax—and one of the most punitive.

Conclusion

Research indicates that tax policy plays a key role in outmigration from Massachusetts.[34] That exodus has been accelerating consistently over the last decade, and especially since the beginning of the COVID-19 pandemic in 2020. From 2011 to 2019, Massachusetts lost $10.3 billion in net adjusted gross income (AGI) from emigrating taxpayers.[35] In just three years from 2020 to 2022, the state lost even more—$10.7 billion in AGI, including $3.9 billion in 2022 alone.[36] Over the 2011 to 2022 period, annual AGI loss increased by a factor of seven.[37] Most of this AGI loss has been concentrated among tax filers with at least $200,000 in yearly income.[38]

A closer look reveals that those individuals sought out states that have lowered tax rates, implemented business-friendly policies, built substantial amounts of new housing, and greatly expanded job opportunities—effectively luring residents from less affordable states. If the state's competitive edge slips further and these trends continue, Massachusetts risks losing significant revenue in the near term and dampening its future economic potential. Pending a cost-benefit analysis that quantifies the economic benefits and foregone tax revenue, we offer these six tax policy changes as a starting point to reverse this alarming outmigration trend.

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Pioneer Institute develops and communicates dynamic ideas that advance prosperity and a vibrant civic life in Massachusetts and beyond.

Vision

Success for Pioneer is when the citizens of our state and nation prosper and our society thrives because we enjoy world-class options in education, healthcare, transportation and economic opportunity, and when our government is limited, accountable and transparent.

Values

Pioneer believes that America is at its best when our citizenry is well-educated, committed to liberty, personal responsibility, and free enterprise, and both willing and able to test their beliefs based on facts and the free exchange of ideas.

PIONEER INSTITUTE

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