FY10 Consensus Revenue Hearing -- Talking Points

December 15, 2008

- Good Afternoon Madam Secretary, Ch. Panagiatakos and Ch. DeLeo and members of the Committees. My name is Navjeet Bal, and I am the Commissioner of Revenue. With me is Howard Merkowitz, the Director of the Department's Office of Tax Policy Analysis.

- As you have heard from previous speakers, the national economy entered a recession in December 2007, which is expected to last at least until mid-2009, when a slow recovery will begin. While the MA economy has held up somewhat better than the national economy, it too has entered a recession, probably in the summer of 2008.

- The national and state economic situation has deteriorated more rapidly than projected since the October 15, 2008 tax revenue revision, and economic forecasts for the remainder of FY09 and for FY10 have been reduced substantially over the past two months. Many forecasters now believe that the recession will be the most severe since WWII.

- The stock market and other asset markets have fallen over the period since the October revenue estimate was formulated, though the equity markets have recovered somewhat in the last few weeks. Forecasts for the stock market have also been cut substantially since October, leading to a reduction in estimates of capital gains taxes for FY09 and into FY10.

- Due to the uncertainty surrounding capital gains and bonus income, this year we are providing alternative scenarios, with the first set of forecasts deriving directly from the economic projections of our forecast vendors, and the second adjusted for risks which may not be fully reflected in those forecasts.

- As you may be aware, DOR does not generate economic forecasts itself, but uses forecasts from Economy.com, Global Insight, and the New England Economic Partnership (NEEP) as the basis for its revenue forecasts.

  - Using the economic forecasts from those groups, DOR converts the economic assumptions to revenue estimates based on historical relationships between the economy and tax revenues. Because only one of those groups – Economy.com – forecasts capital gains realizations, DOR uses the Economy.com capital gains model as the basis for its capital gains tax forecast.

- The briefing book that we have provided to you sets out the detailed the economic assumptions -- including, most importantly, projections for wages and salaries, personal income, retail sales and corporate profits, as well as the stock market -- so I won't go into detail now about those. I will say that those assumptions reflect the declining national and state economies and are consistent with what you have heard from previous speakers today. Based on those economic assumptions, the FY09 and FY10 tax revenue forecasts are as follows:

- FY09:

    - For FY09, DOR estimates that total tax revenues will be between $19.553 billion to $19.654 billion, which is $648 million to $749 million below the October 15, 2008 estimate. As I will describe in a few moments, there is further risk to these estimates from a more pronounced capital gains decline and from a substantial decline in year-end bonus income.

    - The October 15 estimate assumed a 28% decline in tax year 2008 capital gains *realizations*, which translated to a 30% decline in FY09 capital gains *taxes* from the then estimated FY08 capital gains tax collections.

    - The current estimate has been revised downwards to project a *41%* decline in tax year 2008 capital gains realizations, which translates to a *49%* drop in FY09 capital gains taxes from FY08 capital gains tax collections of approximately $2.1 billion.

- Due to the unprecedented speed of the stock market decline and record volatility of asset markets generally, the capital gains forecast is particularly uncertain this year, and DOR has created an alternative model to that used by Economy.com to provide a wider range of estimates.

    - The alternative model is consistent with the Massachusetts capital gains declines experienced during the previous stock market decline in 2001-2002.

    - This alternative model projects a steeper 59% capital gains decline in FY09, resulting in an additional risk of $492 million to the FY09 tax estimate.

- Further risk results from the possibility that the MA current wage and salary forecasts from the three vendors do not *fully* reflect the possible decline in bonus income (which would result in lower-than-expected withholding taxes) that could occur over the next four months. Based on an analysis of MA wage data and economic forecasts, DOR estimates that this poses an additional risk of $95 million in each of FY09 and FY10.

- FY10:

    - Based on the vendor economic forecasts, the FY10 tax revenue estimate is $19.992 billion to $20.311 billion, reflecting a projected economic recovery beginning in the second half of calendar 2009 and the Economy.com projection that there will be only a 1% decline in capital gains realizations in tax year 2009.

    - However, the alternative capital gains model we have created indicates a further risk that capital gains realizations could decline by an additional 35% in tax year 2009 -- on top of the potential

59% possible decline in tax year 2008. Combined with the $95 million risk due to declining bonuses I mentioned earlier, this creates a downward risk of $825 million to the $19.992 to $20.311 FY10 estimate.

- The wide range of estimates we have given reflects the extreme uncertainty that characterizes the current economic and forecasting environment, particularly, but not exclusively, as it relates to capital gains. On the capital gains front, we should have a much better sense as to FY09 capital gains by the end of January when the final income tax estimated payments of tax year 2008 have been received. At that point we should be able to narrow our estimate ranges, at least for FY09. Over the remainder of FY09, we will continue to monitor revenue collections and economic forecasts and update our revenue projections as necessary.