

Commonwealth of Massachusetts

**Testimony of
Navjeet K. Bal
Commissioner, Department of Revenue
Consensus Revenue Hearing
December 16, 2009**

Good morning Secretary Gonzalez, Chairman Panagiotakos and Chairman Murphy, my name is Navjeet Bal, and I am the Commissioner of Revenue. With me today is Howard Merkowitz, the Director of the Office of Tax Policy Analysis at the Department. We are pleased to present to you the Department's updated outlook on Massachusetts state tax revenues for FY10 and our forecast for FY11. We have distributed copies of our Briefing Book, which will also be available on our website, www.mass.gov/dor.

With the national economy emerging from the most severe recession since WWII, and unprecedented volatility in the stock and credit markets over the past 18 months, tax revenue forecasting is more difficult and uncertain than it has been in recent memory. Our FY10 and FY11 revenue forecasts are based on actual collections through November 2009 and the economic projections of our vendors: Moody's Economy.com, Global Insight and the New England Economic Partnership.

Based on these economic projections, DOR's capital gains projections and revenues received year-to-date, DOR's revenue estimates for FY10 and FY11 are as follows :

- **FY10.** Taking recent settlement payments into account, and actual tax receipts through November, FY10 tax revenue is projected at \$18.246 billion to \$18.653 billion
 - This is \$33 million below to \$373 million above the A&F October 15, 2009 FY10 revenue estimate of \$18.279 billion. The October 15 estimate did not include significant, one-time settlement payments received after that date, and it was based on revenues received through September.

- The FY10 revenue estimate represents a decline of 2.2% to 4.5% from FY09. The 10/15 estimate represented a decline of 4.3%.
- December and January are important months for the Commonwealth as that is when corporate and personal quarterly taxes are due. We will be releasing the December 15 report by the end of the week.
- Built on these FY10 revenue estimates, FY11 tax revenue is projected to be in the range of \$18.531 billion to \$19.342 billion, reflecting baseline growth over FY10 estimates of 1.7% to 3.9%.
 - This represents growth of \$285 million to \$689 million over projected FY10 revenues.

Economists agree that the national economy is beginning to emerge from the recession, and is expected to grow moderately in calendar year 2010 and then accelerate throughout calendar year 2011. Following declines in the first quarter (-6.4%) and second quarter (-0.7%) of calendar 2009, real GDP growth turned positive in the third quarter of 2009 at an annual rate of 2.8%, and is expected to remain positive in the fourth quarter and into 2010. FY11 real GDP forecasts range from increases of 2.4% to 2.7%, but with faster growth in the last two quarters of the fiscal year.

As you know, the main drivers of Massachusetts state tax revenues are income tax (approximately 58% of FY09 revenues); sales tax (approximately 21%) and corporate and business tax (approximately 12%).

Massachusetts **income tax** is driven by employment, growth (or declines) in wages and salaries, capital gains realizations as well as dividend and interest income. On a year-to-date basis, withholding is down 4.3% (baseline) and income tax estimated payments are down 32.9% (baseline) reflecting declines in non-wage income, especially capital gains.

The labor market has begun to stabilize as the pace of job losses has slowed.

- The U.S. unemployment rate edged down to 10.0% in November as US payroll employment fell by only 11,000 jobs in the month, far below the

job losses posted in the past 22 months. Unemployment rates, however, are expected to remain close to their current levels in 2010 as the recovery in the labor market is expected to be very slow.

- Massachusetts state employment is expected to bottom out between now and next summer. Projections for Massachusetts employment range from a decline of 0.6% to an increase of 0.5% in FY11, compared to declines of 1.8% to 3.2% in FY10.
- Wage and salary disbursements are projected to decline by 1.7% to 5.1% over the remainder of FY10, reflecting the ongoing softness in the labor market, but are expected to increase by 1.1% to 3.4% in FY11.
- Massachusetts personal income is expected to rise 2.6% to 3.5% in FY11, compared to a projected decline of 0.1% to 1.9% in FY10.

Based on projections from the three vendors we use, the decline in total income taxes in FY10 are expected to range from -2.2% to -5.0%. The A&F revenue estimate of 10/15/09 anticipates a decline of 3.8%. Income tax growth in FY11 is expected to range from 1% to 4%.

The Commonwealth's experience with capital gains taxes over the past two fiscal years underscores the volatility of this revenue source.

- To put this in perspective, tax year 2008 capital gains realizations were \$14.6 billion, a 60.4% decrease from tax year 2007 realizations of \$36.9 billion.
- Reflecting this dramatic drop in capital gains realizations and timing issues related to when in the FY taxpayers "true up" their capital gains for state income tax purposes, capital gains taxes received in FY09 declined by 75% or \$1.6 billion from FY08 to approximately \$541 million.
- DOR's capital gains model, which takes into account such timing factors, is currently projecting an increase of \$160 million in capital gains tax receipts for the state in FY10 as compared to FY09 (29.5% increase), despite a projected 13.5% decline in capital gains realizations in tax year 2009. The same model is projecting a 10.3% increase in tax year 2010

capital gains realizations and a 13% increase (\$91million) in FY11 capital gains tax receipts.

Sales tax receipts through the first five months of FY10 have increased by 9.2% on an actual basis, reflecting the sales tax rate increase and the lifting of the sales tax exemption for alcohol sales in liquor stores. If you back out these tax law changes, sales tax receipts have fallen 7.5% for the year-to-date. This decline is in line with other states that saw sales tax revenues decline an average of 8.2% in the third calendar quarter of this year.

- It should be noted that the pace of decline slowed in the last two months.
- Massachusetts retail sales are projected to grow by -0.6% to 1.0% over the remainder of FY10 and by 3.5% to 4.4% in FY11
- Baseline sales tax receipts in MA are projected to decline over the remainder of FY10 in a range of -1.4% to -3.2%, before picking up in the 2.7% to 3.2% range in FY11.

On a year-to-date basis, **Corporate** and business tax receipts are up 6.8% on an actual basis, but down 1.7% baseline, with estimated payments (an indicator of current business conditions) down 10.7%.

- Nationally, corporate profits are expected to grow by 2.9% to 6.4% in FY11, compared to growth of 3.8% to 22.6% in FY10. There is clearly a divergent view about how much corporate profits are expected to grow this fiscal year.
- Growth in corporate and business tax receipts is projected to range from -0.6% to 4.4% over the remainder of FY10 and to change a further -1.4% to 7.0% in FY11.