

Commonwealth of Massachusetts

**Testimony of
Mark E. Nunnelly
Commissioner, Department of Revenue
Consensus Revenue Hearing
December 16, 2015**

Good morning Secretary Lepore, Chairman Spilka, Chairman Dempsey, and the respective members of both Chambers. My name is Mark Nunnelly, and I am the Commissioner of Revenue and Special Advisor to the Governor for Innovation Competitiveness. With me today is Kazim Ozyurt, Chief Economist and the Director of the Office of Tax Policy Analysis at the Department, and Kevin Brown, our General Counsel. We are pleased to present to you the Department's updated outlook on Massachusetts state tax revenues for FY16 and our forecast for FY17. We have distributed copies of our Briefing Book, which will also be available on our website (<http://www.mass.gov/dor/tax-professionals/news-and-reports/state-budget-documents/briefing-book/>).

Similar to previous years, the Massachusetts economy and state tax revenues have grown steadily in FY15 and the first five months of FY16. Increased investment and capital gains activity, improvements in labor market conditions, and increase in consumer confidence and spending, have all had a positive impact on revenues. The fluctuations in commodity prices, the U.S. monetary policy, the strong U.S. dollar, and the slowdown of economic growth (or even recession) in the rest of the world, such as the Eurozone, China, and other emerging markets, as well as unrest in the Middle East and global terrorism threat remain the major sources of uncertainty for economic growth and tax revenues in the near future. In this environment, there is still a great deal of uncertainty surrounding revenue forecasts.

Our FY16 and FY17 revenue forecasts are based on actual collections through November 2015 and the economic projections of our vendors: *Moody's Analytics/Economy.com*, *IHS Global Insight* and the *New England Economic Partnership*.

DOR has been subscribing to these vendors and benefiting from their economic data and technical services for quite some time. Their data and services have served us and the Commonwealth well in our state specific revenue modeling and forecasting efforts.

Just a note: Before I outline our forecasts, I would like to point out the difference between two revenue growth measures DOR uses often:

Actual revenue growth measure - growth in actual collections over two periods.

Baseline revenue growth measure- growth had there been no tax law or administrative changes that affected tax collections. Baseline growth also adjusts for fluctuations in the timing of tax collections. Baseline growth is a better measure of the change in the underlying tax base and the economy.

Based on the economic projections received from these vendors, DOR's capital gains projections, and revenue collections received year-to-date, DOR's revenue estimates for FY16 and FY17 are as follows:

FY16.

- After taking actual tax receipts through November into account, DOR is projecting that revenues will probably end the fiscal year 2016 in the **\$25.681 billion to \$25.843 billion range**. This range implies that we would be **\$69 million to \$231 million above** the current FY16 revenue estimate of

\$25.611 billion; a significant portion of this performance (above the current estimate) is probably attributable to investment-related income.

- Through the end of November 2015, the Commonwealth has collected \$73 million more than the year-to-date benchmark estimate that is assumed in the adjusted FY16 tax revenue estimate of \$25.611 billion, reflecting year-to-date actual tax revenue growth of 4.2%, and baseline tax revenue growth of 5.8%. These figures exclude \$14 million in one-time settlement-related payments received year-to-date.
- The updated FY16 revenue estimates that we are presenting today represent an increase of 3.0% to 3.7% from FY15. Our current FY16 revenue estimate of \$25.611 billion represents an increase of 2.7% from FY15.
- Effective January 1, 2016, the part B income tax rate has just been reduced from 5.15% to 5.10% by going through a certification process for the baseline revenue growth. The impact of this rate reduction on FY16 revenue collections is about \$74 million, which is reflected in our forecasts.
- Please note that December and January are important months for the Commonwealth's revenues because in December and January personal quarterly estimated taxes and in December corporate estimated taxes are remitted. DOR will monitor these revenues very closely during that period of time.

FY17. Based on these updated FY16 revenue estimates and vendors' economic projections, DOR projects FY17 tax revenue collections will be in the range of **\$26.657 billion to \$26.895 billion**, reflecting actual growth of 3.8% to 4.2% from projected FY16 revenues, and baseline growth of 5.2% to 5.7% from FY16.

- This represents growth of **\$0.976 billion to \$1.100 billion** over projected FY16 revenues.

- As I just mentioned, effective January 1, 2016, the part B income tax rate will decrease from 5.15% to 5.10%. The impact of this rate reduction on FY17 revenue collections is about \$152 million, which is also reflected in our FY17 forecasts. In addition, our FY17 forecasts reflect the assumption of a further part B income tax rate reduction from 5.10% to 5.05% effective January 1, 2017, which is estimated to reduce FY17 revenue collections by \$79 million.

Economic conditions underlying FY16 and FY17 revenue estimates.

- The national economy is expected to grow moderately in 2016 and 2017, with real GDP expected to grow by 2.5% to 2.6% in the last three quarters of FY16, and 2.4% to 2.5% in FY16. As I mentioned a few minutes ago, uncertainties related to the global economy (particularly in the Eurozone, Chinese, emerging market economies, as well as unrests in the Middle East, and other parts of the world) and U.S. monetary policies continue to be sources of risk to economic growth.
- As you know, the main drivers of Massachusetts state tax revenues are income tax (approximately 57.3% of FY15 revenues); sales tax (approximately 23.0%); corporate and business tax (approximately 10.4%), and other taxes (approximately 9.3%).
- Massachusetts **income tax** is driven by employment, wages and salaries, and capital gains realizations, as well as dividend and interest income. On a year-to-date basis, baseline withholding collections are up 4.9%, and baseline income tax cash estimated payments are up 11.6%.

Personal income taxes generally: The labor market has been strong recently.

- The U.S. unemployment rate fell to 5.0% in November as U.S. payroll employment rose by 211,000 jobs during the month. The unemployment rate is expected to stay at or near 5.0% in FY2017.
- Massachusetts employment bottomed out in October 2009 as a result of the Great Recession. Projections for Massachusetts employment range from an increase of 1.6% to 2.0% over the remainder of FY16, compared to an increase of 1.2% to 1.6% in FY17.
- Wage and salary disbursements are projected to increase by 3.5% to 4.8% over the remainder of FY16, and increase by 4.7% to 5.5% in FY17.
- Massachusetts personal income is expected to rise by 3.8% to 5.6% over the remainder of FY16, and 4.9% to 5.6% in FY17.
- Based on economic projections from the three vendors we use, the increase in total income taxes in FY16 is expected to range from 3.3% to 3.9%. The current FY16 revenue estimate anticipates an increase of 2.9% growth from FY15. Income tax growth in FY17 is expected to range from 4.0% to 4.6%.

Capital Gains: Capital gains taxes have always been a volatile revenue source and therefore the most difficult to predict:

- Tax year 2014 capital gains realizations were estimated to be \$30.5 billion, a 34.7% increase from tax year 2013 realizations of \$22.6 billion.
- After taking into account such an increase in capital gains realizations, and timing issues related to when in the fiscal year taxpayers “true up” their taxes on capital gains for state income tax purposes, we were able to determine that capital gains taxes received in FY15 increased

by 24.2% or \$328 million from FY14, to approximately \$1.680 billion.

- DOR projects that Massachusetts capital gains realizations will probably decrease by 7.7% to 9.7% in tax year 2015 compared to tax year 2014, increase by 0.5% to 2.7% in tax year 2016 compared to tax year 2015, and then decrease by 1.2% to 5.5% in tax year 2017. DOR's capital gains forecast predicts tax year 2015 capital gains taxes of \$1.516 billion to \$1.549 billion, and tax year 2016 capital gains taxes of \$1.556 billion to \$1.557 billion. **On a fiscal year basis,** capital gains taxes would be about \$1.531 billion to \$1.557 billion in FY16, a decrease of \$123 million to \$149 million compared to FY15. FY17 capital gains taxes would probably be about \$1.539 billion to \$1.554 billion, a decrease of \$3 million to an increase of \$8 million from FY16.

Sales tax receipts through the first five months of FY16 have increased by 5.9% actual and 6.6% baseline:

- Massachusetts retail sales are projected to grow by 3.3% to 6.1% over the remainder of FY16 and by 4.3% to 7.7% in FY17.
- Baseline sales tax receipts in MA are projected to increase over the remainder of FY16 in a range of 4.8% to 7.0%, and increase in a 5.0% to 7.0% range in FY17.

Corporate and Business Taxes: Including the \$14 million tax-related settlements & judgments exceeding \$10 million each, year-to-date corporate and business tax collections are down 0.3% actual and 0.1% baseline. Year-to-date corporate and business cash estimated payments, which reflect current economic activity, are down 9.5% actual and baseline.

- Nationally, corporate profits are expected to grow by 3.2% to 3.4% in FY17, compared to growth of 6.6% to 9.7% in FY16.
- Excluding large one-time tax settlement and judgment payments*, baseline growth in corporate and business tax receipts is projected to range from 2.7% to 3.7% over the remainder of FY16 and 3.7% to 4.7% in FY17.

* DOR does not make assumptions about one-time payments for the remainder of this fiscal year and FY17.

Thank you for your time. I'm happy to answer any questions you may have.