

Commonwealth of Massachusetts

**Testimony of
Amy Pitter
Commissioner, Department of Revenue
Consensus Revenue Hearing
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Good morning Secretary Gonzalez, Chairman Brewer and Chairman Dempsey, my name is Amy Pitter, and I am the Commissioner of Revenue. With me today is Kazim Ozyurt, 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 FY12 and our forecast for FY13. We have distributed copies of our Briefing Book, which will also be available on our website, www.mass.gov/dor.

With the national economy still recovering and still growing slowly since the end of the recent Great Recession, the Massachusetts economy and its tax revenue collections continue to improve. But the uncertainty on economic growth and tax revenue growth has increased recently, mostly due to the uncertainty on U.S. fiscal policy and the Eurozone's sovereign debt/banking crisis. In this environment, tax revenue forecasting continues to be difficult and a challenging task all across the country and at the federal level.

Our FY12 and FY13 revenue forecasts are based on actual collections through November 2011 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 FY12 and FY13 are as follows:

FY12. Taking actual tax receipts through November into account, FY12 tax revenue is projected to exceed the revised A&F 10/17/11 FY12 revenue estimate by **\$36 million to \$70 million.**

- The revised A&F October 17, 2011 FY12 revenue estimate is 21.010 billion, and we are now projecting that revenues will end the fiscal year at **\$21.046 billion to \$21.080 billion.**
- As you may know, through the end of November, 2011, the Commonwealth collected \$40 million above the revised A&F October 17th estimate, reflecting a 4.7% growth rate.
- In order to understand our FY12 projections, it is important to note that while the national and state economies continued to grow, the growth has slowed down in 2011, and is expected to remain slow during the rest of the fiscal year. That slow down in growth is indicative of slow employment growth over the rest of the fiscal year.
- The updated FY12 revenue estimate that we are presenting today represents an increase of 2.6% to 2.7% from FY11. The revised A&F 10/17/11 estimate had represented an increase of 2.4%.
- December and January are important months for the Commonwealth's revenues as that is when the final corporate payments (for calendar year companies) and personal quarterly taxes are due.

FY13. Based on these slightly revised FY12 revenue estimates and the economic projections, DOR projects FY13 tax revenue collections to be in the range of **\$21.612 billion to \$21.763 billion**, reflecting an actual growth of 2.7% to 3.2% from the projected FY12 revenues, and baseline growth of 4.4% to 4.9% from our FY12 forecasting base.

- This represents growth of **\$560 million to \$683 million** over projected FY12 revenues.

Economic conditions underlying FY12 and FY13 revenue estimates.

- The growth of the national economy has slowed down significantly since the second half of 2010, and is expected to remain slow in 2012, with the growth in the second half of 2012 stronger than in the first half. Real GDP is expected to grow about 1.7% to 2.1% in the remainder of FY12 and 1.8% to 3.1% in FY13. U.S. fiscal policy and the Eurozone's sovereign debt/banking crisis remain major sources of uncertainty on economic growth.
- As you know, the main drivers of Massachusetts state tax revenues are income tax (approximately 56% of FY11 revenues); sales tax (approximately 24%); and corporate and business tax (approximately 11%).
- Massachusetts **income tax** is driven by employment, growth in wages and salaries, and capital gains realizations, as well as dividend and interest income. On a year-to-date basis, withholding is up 3.3% (baseline), but slowed down recently, and income tax cash estimated payments are up 21.5% (baseline), likely reflecting improvement in non-wage income and/or taxpayers' upward adjustment of estimated payments to match strong

capital gains taxes in tax year 2010 so as to qualify for a safe harbor rule in reporting estimated taxes.

Personal income taxes generally: The labor market has shown improvement since the end of the recession but recovery has been slow.

- The U.S. unemployment rate fell to 8.6% in November as US payroll employment rose by 120,000 jobs in the month. Unemployment rates are expected to increase slightly in 2012 as the recovery in the labor market is expected to be very slow.
- Massachusetts state employment bottomed out in the third quarter of 2009. Projections for Massachusetts employment range from an increase of 0.6% to 1.4% in FY12, compared to an increase of 0.2% to 0.9% in FY13.
- Wage and salary disbursements are projected to increase by 3.7% to 5.1% over the remainder of FY12, and increase by 3.4% to 6.4% in FY13.
- Massachusetts personal income is expected to rise by 3.7% to 4.2% in FY12, and 3.2% to 6.3% in FY13.
- Based on projections from the three vendors we use, the increase in total income taxes in FY12 is expected to range from 4.6% to 5.0%. The revised A&F 10/17/11 estimate anticipates an increase of 4.5%. Income tax growth in FY13 is expected to range from 5.1% to 6.5%.

Capital Gains: Over the past two fiscal years, Capital Gains taxes have continued to be a volatile revenue source in Massachusetts.

- For example, tax year 2010 capital gains realizations were estimated to be \$16.5 billion, a 107.3% increase from tax year 2009 realizations of \$8.0 billion.
- After taking into account such an increase in capital gains realizations and timing issues related to when in the FY taxpayers “true up” their taxes on capital gains for state income tax purposes, capital gains taxes received in FY11 increased by 73.0% or \$418 million from FY10, to approximately \$991 million.

DOR’s capital gains model, which takes into account such timing factors, is currently projecting an increase of \$105 million in capital gains tax receipts for the Commonwealth in FY12 as compared to FY11 (10.6% increase) for an estimated total of \$1.095 billion, compared with almost no increase in capital gains realizations in tax year 2011. The same model is projecting a 57.2% increase in tax year 2012 capital gains realizations and a 28.9% increase (\$317 million) in FY13 capital gains tax receipts for an estimated total of \$1.4 billion. Please note that our forecasts assume that the top federal capital gains rate will increase in CY13. (The current top federal rate of 15% was extended for two years in 2010.) A rate increase in CY13 would be expected to lead to increased capital gains realizations in CY12. If the federal capital gains rate does not increase in 2013 (e.g., if the current rate is extended indefinitely), and/or if the financial markets and housing market would NOT perform well, and then there is downside risk to our estimates.

Sales tax receipts through the first five months of FY12 have increased by 0.8% on an actual basis, reflecting the reinstatement of the sales tax exemption for alcohol sales in liquor stores. If you back out these tax law changes, sales tax receipts have increased 3.2% for the year-to-date.

- Massachusetts retail sales are projected to grow by 2.8% to 4.4% over the remainder of FY12 and by 3.0% to 4.1% in FY13.
- Baseline sales tax receipts in MA are projected to increase over the remainder of FY12 in a range of 2.8% to 3.6%, and 1.7% to 2.3% range in FY13.
- The voter repeal of the sales tax on alcohol sold in liquor stores will lead to an estimated decline of \$81 million in FY12 relative to FY11.

Corporate and Business Taxes: On a year-to-date basis, corporate and business tax receipts are up 4.3% actual but down 0.6% baseline, with estimated payments (an indicator of current business conditions) up 4.7%.

- Nationally, corporate profits are expected to grow by 1.0% to 7.4% in FY13, compared to growth of 6.2% to 9.1% in FY12.
- Baseline growth in corporate and business tax receipts is projected to range from 4.5% to 5.1% over the remainder of FY12, but increase only by 0.0% to 2.4% in FY12.

There are a few additional points that I would like make:

CY12 personal income tax rate reduction:

As you may know, under current state law, the state income tax rate will be reduced from 5.3% to 5.25% (effective January 1, 2012) if the growth in fiscal 2011 inflation adjusted baseline revenues (as defined in state law) over fiscal 2010 exceeds 2.5%, and if for each consecutive three-month period starting in August and ending in November, 2011 there is positive inflation-adjusted baseline revenue

growth as compared to the same consecutive three-month period in calendar 2010. So far we have passed “the 2.5% growth threshold test” for the FY11 inflation-adjusted baseline revenue growth. We have also passed three “0% growth threshold test” on September 15, 2011, October 17, 2011 and November 15, 2011, We will issue one last certification on December 15, 2011 for the three-month period ending November 30, 2011 to determine if the same 0% growth threshold test is met. On December 15th, we will also make a final statement on the status of the rate reduction. We estimate that revenue impact of this rate reduction for fiscal 2012 would be between \$52 million and \$56 million (with a mid-point of \$54 million). The revenue impact for fiscal 2013 (assuming no further rate reduction in calendar year 2013) would be between \$111 million and \$117 million (mid-point of \$114 million). Our current forecasts take into account such reductions.

\$10-plus Million Settlements and Judgments. As you know the FY12 budget amended state finance law to provide that any one-time settlement or judgment exceeding \$10 million is to be deposited in the Stabilization Fund. The statute requires that the Department of Revenue and the Attorney General jointly certifies such settlements and judgments, and the Comptroller transfers the proceeds from the General Fund to the Stabilization Fund. Thus far in fiscal 2012 (through the beginning of November 2011), about \$81.4 million has been certified. Such certifications are made on a bi-monthly basis.

Capital Gains Tax Certification:

As of July 1, 2010, the Mass. General Laws requires that the Department of Revenue issue a report by November 30th of each year indicating how much tax revenues is estimated to have been collected during the preceding fiscal year from capital gains income. As you may already know, the statute requires that any

amount in excess of \$1 billion would be transferred to Commonwealth's stabilization fund. As a part of this annual certification process, and per statute, DOR provided quarterly estimates of tax revenues estimated to have been collected from capital gains income after each quarter to the State Comptroller during FY11. On July 15, 2011, we certified that total tax revenues estimated to have been collected from capital gains income during fiscal year 2011 were \$985.3 million, and later on November 15th, we determined and certified that the final amount was \$990.6 million during FY2011 (the revision was based on the fact that we had more recent and complete data). We will repeat the same quarterly and annual certification process during the FY12.

Reporting requirements for Refundable/Transferable Credits:

In 2010, the Massachusetts Legislature enacted provisions requiring the public release of certain taxpayer-specific information related to Massachusetts refundable and transferable tax credit programs such as the brownfields credit, the historic rehabilitation credit, the low income housing credit, various life sciences credits, the film credit, etc). The tax credit transparency provisions require administering agency heads of the refundable and transferable tax credit programs to submit an annual report, by May 15th of each year, to the Department of Revenue for credits awarded or claimed during the previous calendar year. The report must contain the identity of each taxpayer and project (if applicable) that has either been awarded or issued a tax credit in the prior year and the date and amount of each such tax credit awarded or issued. We are in the process of contacting those administering agencies to collect such data for calendar year 2011, and setting up a database. Once we gather all the data that is required to be reported to DOR by May 15th 2012, we will make the data publicly available.

One-time revenues (settlements, other one-time revenues and refunds):

By nature one-time revenues are non-recurring (not from the same source) and they are not easy to predict. Historically, we had large one-time payments (especially in the last few years), which improved the revenues and were partly responsible for some of the surpluses. However there is no way to predict accurately whether such one-timers will repeat next year. Our general practice has been NOT TO MAKE any specific assumptions about their size and/or their timing.

Thank you for listening to my testimony. I will be pleased to accept your questions now.