Commonwealth of Massachusetts

Testimony of
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Commissioner, Department of Revenue
Consensus Revenue Hearing
January 22, 2015

Good morning Secretary Lepore, Chairman Spilka, Chairman Dempsey, and the respective members of both Chambers. My name is Amy Pitter, and I am the Commissioner of Revenue. 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 FY15 and our forecast for FY16. 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/).

As Massachusetts' economy continued to grow at a moderate pace and improved significantly during the last several years. State tax revenues have also improved in FY14 and the first 6 months of FY15. Increased investment/capital gains activity and the improvement of the economic fundamentals, such as the housing market, in 2014 have been affecting revenues positively. Federal fiscal policy challenges, the slow recovery of the Eurozone economy, and slowdown of growth in Chinese and emerging market economies, as well as the unrest in the Middle East and in Ukraine still 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 FY15 and FY16 revenue forecasts are based on actual collections through December 2014 and the economic projections of our vendors: *Moody's*

Analytics/Economy.com, *IHS Global Insight* and the *New England Economic Partnership*.

Moody's Analytics/Economy.com provides comprehensive and extensive historical and forecast data at the national and subnational/regional levels. They indicate that their services and areas of expertise cover more than 180 countries, over 150 global metro areas, all U.S. states, metro areas and counties. Their databases contain economic, financial, demographic and consumer credit time-series, most of which are updated regularly and made available to their clients. They are well known and respected across the country and other state agencies for their comprehensive and professional macro and state economic forecast modeling, as well as their quality real time technical services.

IHS Global Insight also provides very extensive historical and forecast data at the national, state and industry levels. They indicate that they cover almost all the countries around the world and 170 industries. They are also well known for their credible and reliable services across the country, and many state agencies subscribe to their data.

The New England Economic Partnership (NEEP) is a member-supported, non-profit organization. They provide objective economic analyses and forecasts to their members, businesses, governmental and non-governmental institutions. The organization is well known for its research of economic issues relevant to New England. NEEP meets twice a year: once in the spring and the other in the fall. NEEP also publishes macroeconomic forecasts of the New England region and its six individual states, including Massachusetts.

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 forecast efforts.

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 FY15 and FY16 are as follows:

FY15.

- After taking actual tax receipts through December into account, DOR is projecting that revenues will probably end the fiscal year 2015 at **$24.218 billion to $24.331 billion**. This range implies that we would be **$94 million below to $19 million above** the current FY15 revenue estimate of $24.312 billion.
- As you may know, through the end of December 2014, the Commonwealth had collected $18 million less than the year-to-date benchmark estimate that is assumed in the adjusted FY15 tax revenue estimate of $24.312 billion, reflecting a year-to-date actual tax revenue growth of 3.9%, and a baseline tax revenue growth of 3.3%. These figures exclude $24 million one-time settlement related payments received year-to-date.
- The updated FY15 revenue estimates that we are presenting today represent an increase of 3.7% to 4.2% from FY14. Our current FY15 revenue estimate of $24.312 billion represents an increase of 4.0%.
- Effective January 1, 2015, the part B income tax rate decreased from 5.20% to 5.15%. The impact of this rate reduction on FY15 revenue collections is about $70 million, which is reflected in our forecasts.

- Please note that December and January are important months for the Commonwealth's revenues, because personal quarterly estimated taxes are due.

FY16. Based on these updated FY15 revenue estimates and economic projections, DOR projects FY16 tax revenue collections will be in the range of **$25.239 billion to $25.723 billion**, reflecting an actual growth of 4.2% to 5.7% from projected FY15 revenues, and baseline growth of 4.9% to 6.4% from FY15.

- This represents growth of **$1.021 billion to $1.392 billion** over projected FY15 revenues.
- As I just mentioned, effective January 1, 2015, the part B income tax rate decreased from 5.20% to 5.15%. The impact of this rate reduction on FY16 revenue collections is about $145 million, which is also reflected in our FY16 forecast. However, a further rate reduction was not assumed.

Economic conditions underlying FY15 and FY16 revenue estimates.

- The national economy is expected to grow moderately in 2015 and 2016, with real GDP expected to grow by 3.5% to 3.8% in the last two quarters of FY15, and 3.1% to 3.2% in FY15. Uncertainties related to the global economy (particularly in the Eurozone, Chinese, emerging market economies, as well as unrests in the Middle East, Ukraine, and other part of the world) and U.S. fiscal 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 56% of FY14 revenues); sales tax (approximately 24%); corporate and business tax (approximately 11%), and other taxes (approximately 9%).

- 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, the baseline withholding collections are up 5.7%, and the baseline income tax cash estimated payments are up 14%, likely reflecting both strong non-wage income and strong stock market performance in 2014.

Personal income taxes generally: The labor market has shown significant improvement since the end of the recession.

  - The U.S. unemployment rate fell to 5.6% in December as US payroll employment rose by 252,000 jobs in the month. Unemployment rates are expected to gradually fall to 5.1% to 5.4% in FY2016.

  - Massachusetts employment bottomed out in October 2009. Projections for Massachusetts employment range from an increase of 1.6% to 2.0% over the remainder of FY15, compared to an increase of 1.6% to 2.1% in FY16.
  - Wage and salary disbursements are projected to increase by 4.0% to 4.3% over the remainder of FY15, and increase by 5.2% to 7.1% in FY16.
  - Massachusetts personal income is expected to rise by 4.2% to 4.8% over the remainder of FY15, and 4.5% to 6.2% in FY16.
  - Based on economic projections from the three vendors we use, the increase in total income taxes in FY15 is expected to range from 5.5% to 6.0%. The current FY15 revenue estimate anticipated an increase of 5.7% growth from FY14.

    Income tax growth in FY16 is expected to range from 5.1% to 6.7%.

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

- Tax year 2013 capital gains realizations were estimated to be $22.5 billion, an 11.9% decline from tax year 2012 realizations of $25.5 billion.
- After taking into account such a decline 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 FY14 decreased by 12.1% or $170 million from FY13, to approximately $1.237 billion.
- DOR projects that Massachusetts capital gains realizations will increase by 11.3% to 11.6% in tax year 2014 compared to tax year 2013, increase by 6.0% 6.4% in tax year 2015 compared to tax year 2014, and then decrease by 4.6% to 6.1% in tax year 2016. DOR capital gains forecast implies tax year 2014 capital gains taxes of $1.444 billion to $1.447 billion, and tax year 2015 capital gains taxes of $1.531 billion to $1.539 billion. On a fiscal year basis, capital gains taxes would be about $1.369 billion to $1.388 billion in FY15, an increase of $132 million to $150 million compared to FY14. FY16 capital gains taxes would probably be about $1.465 billion to $1.504 billion, an increase of $96 million to $116 million from FY15

Sales tax receipts through the first six months of FY15 have increased by 4.7% actual and 3.4% baseline,

- Massachusetts retail sales are projected to grow by 2.5% to 6.3% over the remainder of FY15 and by 3.7% to 5.7% in FY16.
- Baseline sales tax receipts in MA are projected to increase over the remainder of FY15 in a range of 4.2% to 5.2%, and 3.6% to 5.0% range in FY16.

Corporate and Business Taxes: Including the $24 million tax related Settlements & Judgments exceeding $10 million each, year-to-date corporate and business tax collections are down 3.7% actual and 7.1% baseline. This decline is mostly because we received more one-time tax settlement and judgment payments year-to-date last year than the same period this year. Year-to-date corporate and business cash estimated payments, which reflect current economic activity, are up only 12.6% actual and baseline. Corporate & business refunds are also up, 33%, which could be a reflection of incremental use of refundable and transferable credits this year.

- Nationally, corporate profits are expected to grow by 3.2% to 9.9% in FY16, compared to growth of 8.1% to 11.3% in FY15.
- Excluding large one-time tax settlement and judgment payments*, baseline growth in corporate and business tax receipts is projected to range from 8.7% to 9.5% over the remainder of FY15 and 5.5% to 7.8% in FY16.

* DOR does not make assumptions about one-timers for the remainder of this fiscal year and FY16.

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