Commonwealth of Massachusetts

Testimony of
Geoffrey E. Snyder
Commissioner, Department of Revenue
Consensus Revenue Hearing
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Good morning, Secretary Gorzkowicz, Chair Rodrigues, Chair Michlewitz, and members of the House and Senate. My name is Geoffrey Snyder and I am the Commissioner of the Department of Revenue. With me today is Kazim Ozyurt, Chief Economist and Director of the Office of Tax Analysis; Tim Rooney, DOR's Chief Financial Officer; and Rebecca Forter, Deputy Commissioner for Tax Policy. Thank you for inviting us here today.

We are pleased to present the Department's outlook for Massachusetts state tax revenues for FY23 and FY24.

Our Focus today is on FY23 and FY24, but a recap of FY22 will provide helpful context.

Revenue collections for FY22 totaled $41.105 billion, $3.438 billion above the FY22 benchmark and $6.982 billion more than the amount collected in FY21. We saw positive results across the board, with each major revenue category exceeding both benchmark and prior year collections. The numbers reflect unprecedented capital gains tax revenue, positive labor market conditions, strength in retail sales, and a timing impact associated with pass-through-entity, or PTE, excise payments.

As you know, pass-through entities do not generally pay tax on their income. Instead, the income flows through to the PTE's members, who pay tax on their share of the entity's income. As part of the Tax Cuts and Jobs Act of 2017, a cap for individual taxpayers was put in place on the amount of state and local taxes that can be deducted at the federal level. However, the PTE excise allows members of a pass through entity to work around the federal limit on state and local tax deductions by electing to have the PTE pay state tax on the PTE's income at the entity level. Individual members can then claim a credit in an amount equal to 90% of their share of the PTE excise paid by the entity. Our experience to-date with PTE excise indicates that a significant amount of the member credits generated from excise collections received in the current fiscal year are not realized until the taxpayer files their return in the following fiscal year. Because the PTE excise was enacted during FY22, the result is an estimated one-time revenue increase of approximately $1.4 billion in FY22. We believe this is a one-time timing event because, going forward, a significant portion of PTE excise payments collected in the current fiscal year will be offset by member credits generated by the excise payments remitted in the prior fiscal year. As a result, our FY23 and FY24 forecasts assume PTE excise will impact revenue by only -$13 million and a positive $102 million, respectively.

FY22 also saw the 62F credit requirement triggered for only the second time since its enactment in 1986.

Chapter 62F of the Massachusetts General Laws requires credits to be issued to eligible taxpayers if total state tax revenue exceeds an annually calculated cap tied to wage and salary growth in the Commonwealth. On September 15th, 2022, the State Auditor certified that FY22 total state tax revenues exceeded the allowable amount by $2.941 billion, triggering the 62F credit requirement. As a result, DOR began the distribution of $2.941 billion in credits in November 2022, primarily in the form of refunds, to taxpayers in proportion to the Massachusetts income tax liability incurred by taxpayers in tax year 2021. At this time, taxpayers who have already filed a 2021 return and had a tax liability in that year should have received their refund. Eligible individuals who have not yet filed their 2021 tax return, but file by September 15, 2023, will receive a refund approximately one month after filing.

[DOR's FY23 and FY24 Forecasts.]

Now we would like to discuss our FY23 and FY24 forecasts.

We face a number of areas of uncertainty in FY23 and FY24. Tax collections will vary depending on many factors including:

- The U.S economic outlook and the impact of a potential recession during the forecast periods;
- The persistence of a high rate of inflation and its impact on consumer spending and economic growth;
- The duration of the Federal Reserve's aggressive monetary policy and its impact on inflation, financial and real estate markets, business investment, and consumer spending;
- The impacts of the Russia-Ukraine conflict and energy prices; and
- Other significant global and political factors.

The assumptions used to project the impact of these, and other factors will generate varying economic scenarios and tax revenue forecasts.

Our FY23 and FY24 forecasts are based in part on the projections provided by our economic vendors, Moody's Analytics and S&P Global (formerly IHS Markit). Both vendors have developed projections based upon various economic scenarios and we have incorporated these into our forecasts.

In addition to the vendors' economic projections, our FY23 and FY24 forecasts reflect FY23 year-to-date preliminary tax collections as of December 2022.

FY23 year-to-date collections through December 2022 totaled $17.789 billion, $1.087 billion above the year-to-date benchmark and $56 million less than collections in the same period in FY22. The positive results in comparison to the benchmark reflect lower than expected credits claimed by PTE members and stronger than expected retail sales. As mentioned, we expect the year-to-date impact of PTE member credits to reverse itself in the second half of FY23 as members utilize these credits.

On July 28, 2022, the Secretary of Administration and Finance established the FY23 tax revenue benchmark estimate of $39.618 billion.

Before including our estimate of the revenue associated with the recently approved 4% Surtax, DOR forecasts FY23 revenue to be in the in the range of $39.767 billion to $40.471 billion, an increase of $149 million to $853 million from the FY23 tax revenue benchmark.

For FY24, before including the Surtax, DOR forecasts revenue to be in the range of $39.838 billion to $41.017 billion, which is between 0.2% and 1.3% higher than our FY23 forecast.

We forecast the revenue impact of the 4% Surtax to be in the range of $229 million to $265 million in FY23 and $1.445 billion to $1.766 billion in FY24.

With the inclusion of the 4% Surtax, our FY23 forecast is between $378 million and $1.118 billion higher than the FY23 revenue benchmark and our FY24 revenue forecast is between 3.2% and 5.0% higher than our FY23 forecast.

Now we would like to provide some detail around our forecasts of each tax category.

Please note that Massachusetts state tax revenues consist of the following major tax types: income tax, which in FY22 accounted for 59.2% of state tax revenue, followed by sales tax at 21.3%, corporate and business tax at 12.3% and "all other" taxes at 7.2%.

Beginning with income tax:

- Income tax revenues are driven by employment, wages and salaries, capital gains, income from dividends and interest, and non-corporate business income.
- According to the U.S. Bureau of Labor Statistics, U.S. total non-farm payroll employment rose by about 4.5 million over the twelve months ending December 2022 and by 23.2 million since April 2020. It is now 1.2 million, or 0.8% more than its pre-pandemic level in February 2020. As of December 2022, the U.S. unemployment rate is 3.5%, a significant decline from its high of almost 15% at the end of the recession in April 2020, and consistent with its February 2020 pre-pandemic level of 3.5%.
- Massachusetts employment followed a similar pattern to that of US employment. According to the U.S. Bureau of Labor Statistics, Massachusetts total non-farm payroll employment increased by 144,200 over the twelve months ending in November 2022 and by 677,100 since April 2020. However, it is still down 0.3% from its pre-pandemic level in February 2020.

Total Income Taxes: Using the most current economic projections from our vendors and before including the 4% Surtax, FY23 income taxes are forecasted to be between $46 million lower and $216 million higher than the FY23 benchmark of $22.897 billion. In FY24, they are forecasted to range between a 1.5% decrease and no change from our FY23 income tax forecast.

Total income taxes will be impacted by the 4% Surtax, which we again forecast to be in the range of $229 million and $265 million in FY23 and $1.445 billion and $1.766 billion in FY24.

With the inclusion of the 4% Surtax, FY23 income taxes are forecasted to be between $183 million and $481 million higher than the FY23 benchmark. In FY24, they are forecasted to increase by between 3.7% and 6.4% from our FY23 income tax forecast.

Withholding: In FY23, withholding tax collections, before including the 4% Surtax, are forecasted to be between $230 million and $113 million lower than the FY23 benchmark of $16.858 billion. In FY24, they are forecasted to increase by between 4.8% and 5.5% from the FY23 forecast.

Capital Gains: Capital gains taxes are a volatile revenue source and collections hit an all-time high in FY22. However, with the risk of a potential economic recession, rising interest rates, and current equity market levels, the trend of capital markets has reversed, resulting in a significant decline in unrealized capital gains.

Based on these trends and our vendor's projection for the S&P 500, our FY23 capital gains forecast is between $2.933 billion and $3.045 billion, which compares to the FY23 capital gains benchmark of $2.959 billion. In FY24, we forecast capital gains to be between $1.926 billion and $2.205 billion.

Sales Tax: Total sales tax receipts through the first six months of FY23 are 6.0% above the year-to-date benchmark, with regular sales tax 5.1%, meals tax 9.4%, and motor vehicle sales tax 6.9% above their respective year-to-date benchmarks.

Total Sales tax receipts in FY23 are forecasted to be $424 million to $532 million higher than the FY23 benchmark of $8.844 billion. In FY24, they are forecasted to increase by 3.6% to 4.5% from our FY23 sales tax forecast.

Corporate and Business Taxes: FY23 year-to-date corporate and business tax collections, another of the more volatile revenue categories, is 3.4% above the year-to-date benchmark.

FY23 corporate and business tax revenue collections are forecasted to exceed the FY23 benchmark of $4.747 billion by between $98 million and $362 million. For FY24, corporate and business tax receipts are forecasted to increase by 1.3% to 1.6% from our FY23 forecasts. Please note that these forecasts exclude one-time tax settlement and judgment payments, which DOR does not attempt to forecast.

Other Taxes: Collections in the "all other" category through the first six months of FY23 are 8.2% below the year-to-date benchmark, reflecting mostly decreases in Motor Fuels, Deeds, Cigarettes, and Estate taxes.

In FY23, the "all other" tax category is forecasted to be below the FY23 benchmark of $3.129 billion by between $327 million and $257 million. In FY24, the All Other Tax category is forecasted to increase by 0.7% to 1.5% from our FY23 All Other tax forecast.

To recap:

- Excluding the impact of the 4% Surtax, the Department of Revenue forecasts FY23 tax revenue in the range of $39.767 billion to $40.471 billion. This range is 0.4% to 2.2% more than the FY23 total tax revenue benchmark of $39.618 billion.
- Excluding the impact of the 4% Surtax, we forecast FY24 tax revenue in the range of $39.838 billion to $41.017 billion, which is between 0.2% to 1.3% above DOR's FY23 tax revenue forecast excluding the 4% Surtax.
- Our forecast for the 4% Surtax is between $229 million and $265 million in FY23 and $1.445 billion and $1.766 billion in FY24.
- FY23 year-to-date tax revenues are $1.087 billion above the year-to-date benchmark and $56 million less than collections in the same period of FY22. However, a significant portion of the above benchmark performance is due to lower-than-expected credits claimed by PTE members, which we expect to reverse in the second half of FY23.
- Like the national economy, the growth of the Massachusetts economy slowed in 2022 compared with 2021, as the Fed raised interest rates aggressively to control high inflation. As measured by the year-over-year percentage change in the CPI before seasonal adjustment, inflation was still at 6.5% in December 2022. On the other hand, consumer spending was robust and labor markets were tight as evidenced by strong employment growth and declining unemployment. Looking ahead, our vendors' baseline forecasts assume a further economic slowdown and/or a mild recession in the first half of calendar 2023, followed by slow growth. Key risk factors to such forecasts include a deeper and longer economic recession, the duration and success of the Fed's monetary policies, persistently higher inflation and interest rates,

and an escalation of the Russia-Ukraine conflict.

- Due to these risk factors, there is a significant degree of uncertainty in both the economic projections and the tax revenue forecasts. We will continue to closely monitor these risk factors and the impact they may have on the state economy and tax revenue collections.

Please note that we have distributed copies of our supporting documents. We are available to respond to any questions.

Thank you for your time.