Tufts UNIVERSITY | Jonathan M. Tisch College of Civic Life

THE CENTER FOR STATE POLICY ANALYSIS

TESTIMONY

January 2023

cSPA Testimony, FY 2024 Consensus Revenue Hearing

I want to thank you for inviting me to testify today. It's always a privilege to be able to help the Commonwealth prepare for the future.

My name is Evan Horowitz and I'm the Executive Director of the Center for State Policy Analysis at Tufts University, abbreviated as cSPA.

cSPA provides timely, relevant research on live policy issues — in a strictly non-partisan way. We have done work on fiscal and economic policy, assessed the impact of ballot questions, and provided consulting services and technical support to state legislative committees.

Today, I want to talk about three things. First, I'll summarize our tax revenue projections for FY 2024. Second, I'll suggest ways to handle the first year of millionaires tax revenue. Third, I'll mention some mild concerns about the remainder of FY23 and assess future interactions with 62F.

For FY 2024, we estimate that state tax revenues will be roughly $40.2 billion, about 1.5 percent above the current FY 2023 benchmark.

Our estimate is based on a predictive model that uses US GDP to gauge likely state taxes. Historically, there's been a nearly 1:1 correlation between national GDP and Massachusetts tax revenues — because GDP reflects exactly the kinds of things that the state tends to tax, namely income and spending.

Building off this relationship, we can project state tax revenues using existing estimates of US GDP, which are produced by a range of reputable private and public organizations, including the Conference Board and the Wall Street Journal Economic Forecasting Survey.

Gathering these together, we find a general consensus for a “slowcession” through the middle of 2024, where the growth rate of the economy flags but doesn’t collapse. And this economic trajectory is expected to generate $40.2 billion in tax revenue.

This includes $1 billion in new millionaires tax collections, which is 80 percent of our $1.3 billion estimate for total millionaires tax liabilities for calendar year 2023. This 80 percent adjustment reflects our best estimate for the share of millionaires tax liabilities likely to be collected by the end of FY 2024.

So that's the first takeaway from our presentation: we expect $40.2 billion in total revenue for FY 2024, including $1 billion from the millionaires tax.

Now I want to say more about how to handle this millionaires tax revenue in the early stages of implementation, when uncertainty is particularly high.

First, I want to emphasize how important it is to distinguish between money from the 4 percent surtax and the net revenue accruing to the state.

We expect that, on its own, the 4 percent surtax will generate roughly $1.8 billion dollars in millionaires tax liabilities for calendar year 2023. This is the amount subject to the spending restrictions in the constitutional amendment.

However, this is not a good reflection of the amount of new revenue that the millionaires tax will generate for the state. And that's because implementation of the millionaires tax will actually reduce income tax collections — as taxpayers who leave the state or engage in tax avoidance will end up skirting both the millionaires tax and the state income tax.

So against this $1.8 billion in direct dollars from the 4 percent surtax is a loss of roughly $500 million in expected receipts from the state income tax.

This distinction is important for thinking about how much millionaires tax revenue to include in the FY 2024 budget. We recommend the following basic approach:

- There is a lot of uncertainty around millionaires tax revenue at this stage of its implementation, making it risky to spend all estimated dollars.

- At a minimum, enough millionaires tax revenue should be included in the FY 2024 budget to cover the expected $500 million reduction in the income tax. More broadly, we think it's safe and sensible to rely on $750 million to $1 billion in FY 2024.

- Given the extremely high volatility of millionaires tax revenue, the state should plan to create some kind of savings and stabilization plan as is done with capital gains.

Bringing these principles together, we think spending plans in the FY 2024 budget could include $750 million to $1 billion in millionaires tax revenue, with any overage diverted to a savings account to smooth future spending.

And given how important it is to track and understand the full economic impact of the millionaires tax in the years ahead, it would be extremely valuable for DOR to expand the information it provides on very high earners in Massachusetts — and to receive dedicated funding to make this happen.

The simplest approach is probably to mimic the statistics of income provided by the IRS, as those are carefully designed to protect taxpayer privacy.

Finally, I want to speak to the unusual fiscal conclusion to FY 2022, and what it portends for the future.

As everyone here is well aware, FY 2022 saw a dramatic clash of forces: unprecedented state tax revenue and a mostly-forgotten statute limiting tax collections, chapter 62F.

One question for the future is how frequently we might face similar circumstances — especially given the large potential size of the millionaires tax.

A few, extremely fluky events conspired to revive 62F after its long slumber: surging inflation, the rapid Covid collapse-and-recovery, and new payment options for pass-through entities.

According to our projections, it would take another set of inopportune events for the state to hit the 62F limit again in the coming years. And while adjusting the 62F formula to better reflect the impact of inflation, capital gains growth, and economic volatility still makes good policy sense, the urgency of addressing these issues is unclear.

For FY 2023, we anticipate final tax collections of $38-$38.5 billion, which is well below the current benchmark and even further below the expected 62F cap for this year.

In FY 2024, the 62F revenue cap is likely to rise to nearly $45 billion, out of reach of the revenue estimate we have offered today (even accounting for the fuller suite of revenues compassed by 62F.)

Note, however, that while avoiding 62F may help us sidestep some of the chaos of last season, it also means that the era of overflowing coffers is likely closing.

In particular, this year's revenue collection numbers are less cheering than they might seem from monthly reports. For one thing, they are inflated by...well, inflation.

When we set the FY 2023 benchmark a year ago, it was based on a set of inflation expectations that have proved overly-optimistic. In real, inflation-adjusted terms, we are meeting, but not exceeding, the current benchmark for FY 2023 tax revenues.

And these inflation-adjusted numbers are what really matter, because they reflect the reality that virtually all of the activities of state government have gotten more expensive, whether it's hiring people, procuring materials, providing housing support, or a great deal besides.

What is more, our modeling suggests that even ignoring the impact of inflation we are likely to end this fiscal year with a revenue shortfall of roughly $1 billion. The decisive factor will be

April collections, where we fear the monthly benchmark is overly optimistic given the collapse of financial assets in 2022.

I'd like to thank you for inviting me to participate today. I'm happy to answer any questions you may have. And more generally I'd like to say that cSPA is ready to provide additional research on any topic or issue that you think useful.