



June 27, 2019

## **FY19 Surplus: A \$500 Million Question**

### *Decision-Makers Likely to Face Big Choices; MTF Recommends Framework*

The Commonwealth of Massachusetts may be on track to end fiscal year 2019 with a surplus of approximately \$522 million according to new analysis by the Massachusetts Taxpayers Foundation (MTF). State decision-makers will choose whether to spend or save any potential surplus in the coming weeks and months.

MTF's analysis indicates fiscal 2019 budgeted tax revenue growth of nearly \$1.8 billion, a six percent increase over fiscal 2018's historically strong performance and \$1 billion or four percent above the fiscal 2019 tax estimate. MTF surmises some of this revenue growth, especially related to corporate income tax collections, is the result of federal tax law changes and is non-recurring.

Consistent with MTF's mission of fiscal stability and the long-term well-being of the Commonwealth, MTF outlined a framework for handling any fiscal 2019 surplus:

1. Add to the state's "rainy day" fund.
  - a. Deposit estimated non-recurring tax revenue from deemed repatriation of corporate dividends to the Stabilization Fund.
  - b. Deposit tax-related settlements and judgments exceeding \$10 million each to the Stabilization Fund.
2. Pay down unfunded pension and OPEB liabilities.
3. Make one-time investments in transportation and education initiatives.
  - a. Create and invest in the Transportation Technology Transformation Initiative (T3I), a public-private partnership to foster a new transportation technologies sector.
  - b. Make critical investments to enhance school safety and security, upgrade technology, and cover other school improvements.

## Estimating the FY19 Surplus

<b>Fiscal 2019 Changes Since 4/10/19</b>	
<i>Implied Balance as of April 10, 2019 Info Statement</i>	<u>\$ Change</u>
<b>Projected Balance as of 4/10/19</b>	<b><u>-9.5</u></b>
<i>Revenue</i>	
Tax Revenue over Benchmark	951.7
Tax Transfers to MBTA & MSBA	-23.8
Major Fund Gaming Penalties (Encore and MGM)	22.4
Encore Opening 6/23/19	3.4
<b>Subtotal, Revenue Changes</b>	<b><u>953.7</u></b>
<i>Spending</i>	
Stabilization Fund Transfer	
vs \$489.2 million	422.4
<b>Subtotal, Spending Changes</b>	<b><u>422.4</u></b>
<i>Net Impact on Balance</i>	531.3
<b>Balance after Changes</b>	<b>521.8</b>

*Figures in \$ millions.*

Figure 1: Estimation of Budget Surplus; Baseline data is from the Commonwealth Information Statement dated April 10, 2019

### Fiscal 2019 Taxes

Assuming June tax collections are equal to the benchmarks, fiscal 2019 tax collections will total \$29.6 billion, an increase of \$1.8 billion, or about six percent over the fiscal 2018 total and \$952 million over the fiscal 2019 tax benchmark as depicted in Figure 2.<sup>1</sup> After accounting for additional required transfers of \$24 million to the Massachusetts Bay Transportation Authority (MBTA) and the Massachusetts School Building Authority (MSBA), budgeted tax revenue growth is projected at \$27.6 billion, or about seven percent growth over fiscal 2018.

This performance comes on the heels of historically strong tax collections in fiscal 2018, which exceeded the previous year by nearly nine percent. Together, fiscal years 2018-2019 represent the strongest two-year period of tax revenue growth since fiscal years 1997-1998.

<sup>1</sup> The Department of Revenue (DOR) published the fiscal 2019 tax benchmark estimate of \$28.392 billion on August 1, 2018. On December 31, 2018, the Secretary of Administration and Finance announced the revised fiscal 2019 tax benchmark of \$28.592 billion.



A statutory provision known as “excess capital gains” mandates automatic transfers of capital gains tax revenue over a threshold to the state’s Stabilization Fund, also known as the “rainy day” fund. On June 18, 2019, the Massachusetts Comptroller made an initial transfer of approximately \$636 million to the Stabilization Fund as a result of this provision. MTF projects a further transfer of approximately \$275 million in July 2019 for a total FY19 transfer of \$912 million.

In fiscal 2018, state budget assumptions included only a modest excess capital gains transfer of \$52 million. The actual excess capital gains transfer to the Stabilization Fund totaled nearly \$514 million. As a result, though tax revenue estimates exceeded expectations by more than \$1 billion, more than half of this amount was automatically transferred to the Stabilization Fund. Moreover, after accounting for spending above expectations and other tax-related changes, only a relatively small surplus was available to executive and legislative decision-makers.<sup>2</sup>

In contrast, fiscal 2019 tax estimates *already assumed* a large capital gains transfer and as a result, a substantial portion of the estimated surplus is subject to decisions made by the Governor and the legislature.

Further, the calculations depicted in Figure 1 do not include changes to non-tax revenue sources other than those noted nor changes in estimated spending since April. Inclusive of these items, the actual fiscal 2019 surplus may be larger or smaller than calculated in this analysis. Additional information about non-tax revenue and spending will be available after June 30, 2019.

---

<sup>2</sup> For more information, see MTF publication [FY2018 Fiscal Update: Closing the Year](#) dated June 19, 2018.



DRAFT – NOT FOR PUBLICATION

Commonwealth Tax Revenue Estimates		2018		2019		vs FY18		vs FY19BM	
Tax Revenue Summary		Actual	Benchmark	Estimate	\$ Change	% Change	\$ Change	% Change	
Income									
Withholding		12,731.6	13,228.7	13,194.2	462.6	3.6%	-34.5	-0.3%	
Non-Withheld		3,507.9	3,503.7	3,814.7	306.8	8.7%	311.0	8.9%	
<u>Subtotal, Income</u>		<u>16,239.6</u>	<u>16,732.4</u>	<u>17,008.9</u>	<u>769.3</u>	<u>4.7%</u>	<u>276.5</u>	<u>1.7%</u>	
Sales & Use									
Regular		4,433.1	4,635.0	4,690.8	257.7	5.8%	55.8	1.2%	
Meals		1,154.4	1,207.0	1,215.8	61.4	5.3%	8.8	0.7%	
Motor Vehicles		866.3	878.0	896.6	30.3	3.5%	18.6	2.1%	
<u>Subtotal, Sales &amp; Use</u>		<u>6,453.8</u>	<u>6,720.0</u>	<u>6,803.3</u>	<u>349.4</u>	<u>5.4%</u>	<u>83.3</u>	<u>1.2%</u>	
Corporate		2,381.1	2,338.6	2,800.0	418.8	17.6%	461.4	19.7%	
All Other		2,701.7	2,801.3	2,931.9	230.2	8.5%	130.6	4.7%	
<b><u>Total, Tax Revenue</u></b>		<b><u>27,776.2</u></b>	<b><u>28,592.3</u></b>	<b><u>29,544.0</u></b>	<b><u>1,767.8</u></b>	<b><u>6.4%</u></b>	<b><u>951.7</u></b>	<b><u>3.3%</u></b>	
Tax Transfers									
MBTA Transfer		1,007.9	1,042.1	1,054.0	46.1	4.6%	11.9	1.1%	
MSBA Transfer		847.9	882.1	894.0	46.1	5.4%	11.9	1.3%	
Workforce Training Trust Fund		24.7	24.0	24.0	-0.7	-2.8%	0.0	0.0%	
<b><u>Subtotal, Tax Transfers</u></b>		<b><u>1,880.5</u></b>	<b><u>1,948.2</u></b>	<b><u>1,972.0</u></b>	<b><u>91.5</u></b>	<b><u>4.9%</u></b>	<b><u>23.8</u></b>	<b><u>1.2%</u></b>	
Other Tax Revenue									
Tax-Related Settlements & Judgments		11.0	48.8	48.8	37.8	342.8%	0.0	0.0%	
<b>Total Budgeted Operating Tax Revenues</b>		<b>25,906.7</b>	<b>26,692.9</b>	<b>27,620.9</b>	<b>1,714.1</b>	<b>6.6%</b>	<b>928.0</b>	<b>3.5%</b>	
Capital Gains Tax Revenue									
Capital Gains Collections		1,682.7	1,700.7	2,123.1	440.4	26.2%	422.4	24.8%	
Statutory Threshold		1,168.8	1,211.5	1,211.5	42.7	3.7%	0.0	0.0%	
<b><u>Transfer to Stabilization Fund</u></b>		<b><u>513.9</u></b>	<b><u>489.2</u></b>	<b><u>911.6</u></b>	<b><u>397.7</u></b>	<b><u>77.4%</u></b>	<b><u>422.4</u></b>	<b><u>86.3%</u></b>	
<b>Taxes Available to Budget</b>		<b><u>25,392.8</u></b>	<b><u>26,203.7</u></b>	<b><u>26,709.3</u></b>	<b><u>1,316.4</u></b>	<b><u>5.2%</u></b>	<b><u>505.6</u></b>	<b><u>1.9%</u></b>	

Figures in \$ millions.

## MTF Recommendations for FY19 Surplus

<b>MTF Framework for FY19 Surplus</b>	
Figures in \$ millions.	\$ Amount
<b>FY19 Estimated Surplus</b>	<b>521.8</b>
<i>Add to Rainy Day Fund</i>	
Repatriation of Corporate Dividends	240.4
Tax-Related Settlements & Judgments	48.8
<i>Subtotal, Add to Rainy Day Fund</i>	<u>289.2</u>
<i>Pay Down Unfunded Liabilities</i>	
Pension	65.0
OPEB	65.0
<i>Subtotal, Pay Down Unfunded Liabilities</i>	<u>130.0</u>
<i>One-Time Investments</i>	
Transportation Technology Transformation Initiative (T3I)	50.0
Education Investments	50.0
<i>Subtotal, One-Time Investments</i>	<u>100.0</u>
<b>Total, Recommended Deposits and Investment</b>	<b>519.2</b>
<b>Remaining Surplus</b>	<b>2.6</b>

Figure 3: MTF Framework for FY19 Surplus.

1. Add to the “Rainy Day” Fund*Non-Recurring Tax Revenue from Repatriation of Corporate Dividends*

Fiscal 2019 corporate income tax collections may total \$2.8 billion, an increase of \$418 million, or an incredible 18 percent over fiscal 2018 actuals. This is likely to be the largest year-over-year increase since the initial rebound from the Great Recession in fiscal 2011, as depicted in Figure 7.

Some of this growth is likely from provisions of the federal Tax Cut and Jobs Act of 2017 (TCJA) that expanded the corporate tax base. A further provision of TCJA deemed as repatriated certain foreign income held by corporations (hereafter, repatriation). The fiscal 2019 tax benchmark assumed repatriation would generate an additional \$65 million in tax revenue. The estimate of this one-time revenue surge may have been too conservative, though a full tabulation of this impact will likely not be complete until late 2019.



## Corporate Tax Growth vs Trend

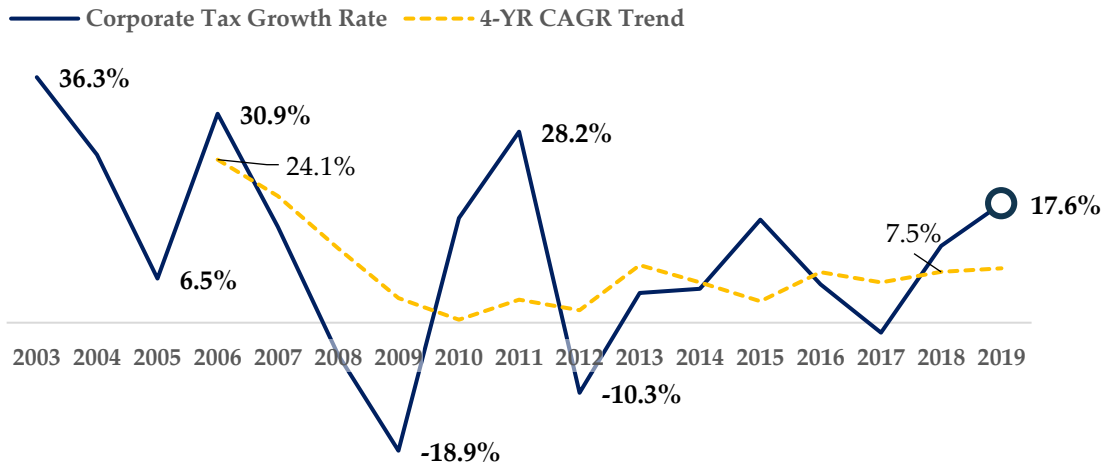


Figure 2: Corporate Income Tax Collection Growth Rates vs Trend FY03-FY19E.

Given its one-time nature, it is sensible to deposit this revenue into the “rainy day” fund to be used during the next economic downturn. Using a trend analysis to generate a rough estimate as illustrated in Figure 7, the variance to trend is approximately \$240 million in fiscal 2019.

### *Tax-Related Settlements and Judgments Exceeding \$10 M Each*

Large tax settlements represent an unpredictable revenue source. Rather than relying on this source for budgeted revenue as is current practice, policymakers should revive the policy implemented by Governor Patrick to credit these payments, worth approximately \$49 million in fiscal 2019, to the Stabilization Fund.

### 2. Pay Down Unfunded Pension and OPEB Liabilities

The Commonwealth’s unfunded pension and Other Post-Employment Benefits (OPEB) liabilities represent a growing long-term challenge to fiscal stability. Further, new accounting standards now require governments to include an estimate of OPEB liabilities on balance sheets, making the obligations more transparent to the public and to credit rating agencies. Progress toward paying down these liabilities is important for the state’s debt issuance to remain attractive to bondholders.

In its April 2019 rating, S&P Global Ratings identified “progress in terms of pension funding” as a key to upgrading the Commonwealth’s credit rating.<sup>3</sup> Setting aside \$130 million for these unfunded liabilities will advance efforts to reduce these obligations while also improving the Commonwealth’s credit rating.

### 3. One-Time Investments in Transportation and Education

The Commonwealth relies on a robust transportation network and a high-performing education system to grow the economy. One-time strategic investments in these policy areas will help spur future economic growth.

#### *Transportation Technology Transformation Initiative (T3I)*

The Commission on the Future of Transportation recommended a new public-private effort known as the Transportation Technology Transformation Initiative (T3I) to develop and integrate new transportation technologies into the state’s highways and public transit infrastructure.

An initial investment of \$50 million in a new Transportation Technology Transformation Fund will help foster a new transportation technology sector, while also harnessing available talent, resources and innovation to address some of the pressing transportation challenges confronting the Commonwealth.

#### *One-Time Education Investments*

The Massachusetts Business Alliance for Education (MBAE) has identified several education “gaps” facing students in the Commonwealth, such as the “Employability Gap” between the skills sought by employers and those developed through the education system and the “Achievement Gap” between Massachusetts students as a whole and those from economically disadvantaged and under-represented minorities. One-time education investments should be aimed at addressing these education gaps.

Strategic investments of up to \$50 million for upgrades at schools across the Commonwealth, for technological improvements, training programs and technical assistance, school security and safety upgrades, energy efficiency investments, and other related one-time costs will provide needed upgrades to the educational infrastructure of the Commonwealth.

---

<sup>3</sup> S&P Global Ratings Massachusetts; Appropriations; CP; General Obligation; General Obligation Equivalent Security; Sales Tax dated April 18, 2019. Available at [MassBondholder.com](http://MassBondholder.com).



**Conclusion**

Unexpected revenue is an opportunity for executive and legislative decision-makers to address long-term challenges and make one-time investments in the Commonwealth’s future. The decisions regarding how best to spend or save this windfall are pivotal.

MTF recommends a combination of measures that save for future economic downturns, address unfunded obligations, and prioritize non-recurring spending on education and transportation. This balanced approach will improve the state’s credit rating, build financial resiliency, and foster the long-term well-being of the Commonwealth.

