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## MTF Bulletin

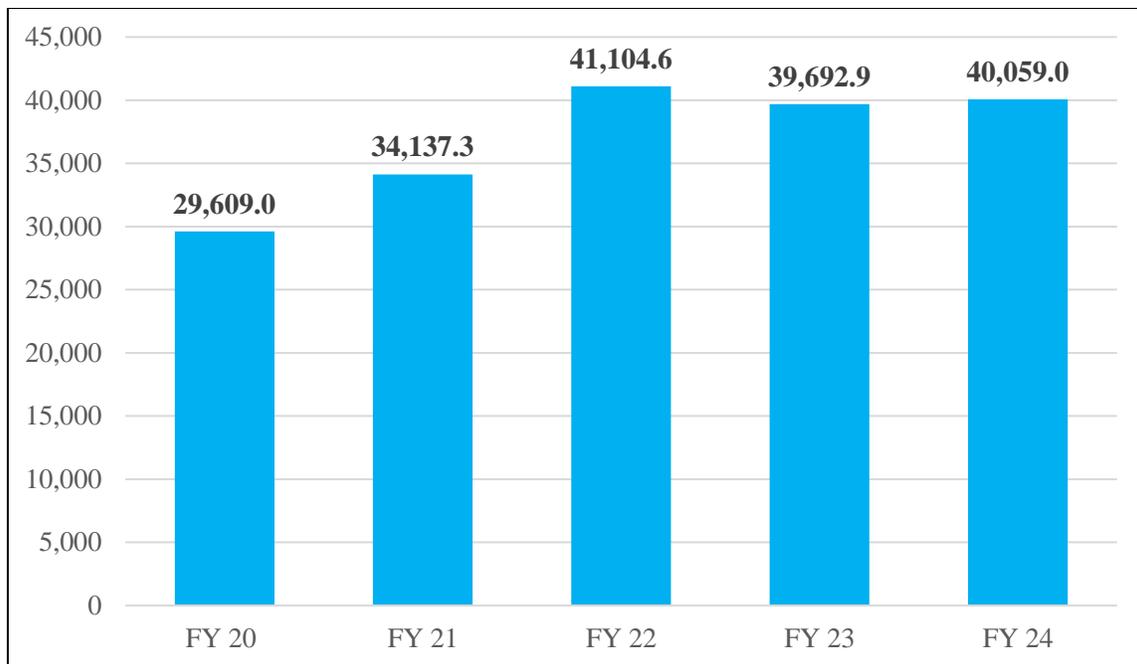
January 24, 2023

### FY 2023 and FY 2024 Tax Revenue Forecast – A Return to Normalcy?

Following a startling \$11.5 billion surge in FY 2021 and FY 2022, tax revenues for this year and next settle into a lower and slower growth pattern as global risks escalate. MTF projects that FY 2023 revenues will top the \$39.62 billion benchmark by \$75 million and grow to \$40.06 billion in FY 2024, an increase of \$366 million or approximately 1 percent over FY 2023 (Figure 1).

There are numerous cross-currents that affect the forecast, including healthy withholding and sales tax revenues offset by significant declines in non-withholding revenues due to reduced capital gains taxes and \$1.5 billion in state paybacks due to pass-through entities (PTE). It should not surprise that this forecast comes with several caveats.

**Figure 1 - State Tax Revenues, FY 2021 - FY 2024**



#### GAINS IN WITHHOLDING INCOME AND SALES TAX REVENUES TIED TO EXPANDING ECONOMY

Withholding income tax revenues are projected to increase by approximately \$700 million in FY

2023 and again in FY 2024, reaching \$17.3 billion (Table 1). The state’s economy has flourished over the past 12 months adding 145,000 jobs with an increase in average wages of 4.5 percent for the 3.3 million employees of private firms.

In addition, there were 260,000 job openings in October 2022 with just 130,000 people unemployed; leaving two jobs for every unemployed individual.<sup>1</sup> This ratio suggests that if there is an economic slowdown in 2023, eliminating open positions rather than turning to layoffs in a tight labor market may provide a buffer before the state experiences significant job losses.

Similarly, continued growth in consumer spending on durable goods and dining push sales tax revenues up 4.8 percent or \$440 million to \$9.66 billion in FY 2024. Taken together, withholding and sales tax revenues account for two-thirds of FY 2024 tax revenues and \$1.1 billion growth over the current fiscal year (Table 1).

These estimates are based on economic data from Moody’s Analytics that forecast continued growth in the U.S. economy in 2023 and 2024 rather than a forthcoming recession. It is important to note that withholding and sales tax revenues reflect the current economic state offering the first indicators of a potential slowdown. They should be monitored closely.

**Table 1 – Massachusetts Tax Revenues – FY 2022, FY 2023 vs. FY 2024**  
(\$ Millions)

	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>\$</b>	<b>%</b>
<b>Income</b>	<b>24,337</b>	<b>22,488</b>	<b>22,164</b>	<b>-324</b>	<b>-1.44%</b>
Withholding	15,915	16,601	17,297	696	4.19%
Non-withholding	8,422	5,887	4,867	-1,020	-17.32%
<i>Capital Gains</i>	4,328	3,008	2,298	-710	-23.60%
<i>Other non-withholding</i>	4,094	2,879	2,569	-310	-10.77%
<b>Sales</b>	<b>8,765</b>	<b>9,217</b>	<b>9,659</b>	<b>442</b>	<b>4.80%</b>
<b>Corp</b>	<b>5,069</b>	<b>5,001</b>	<b>5,139</b>	<b>138</b>	<b>2.76%</b>
<b>Other</b>	<b>2,934</b>	<b>2,987</b>	<b>3,097</b>	<b>110</b>	<b>3.68%</b>
<b>Total</b>	<b>41,104.6</b>	<b>39,692.9</b>	<b>40,059.0</b>	<b>366</b>	<b>0.92%</b>

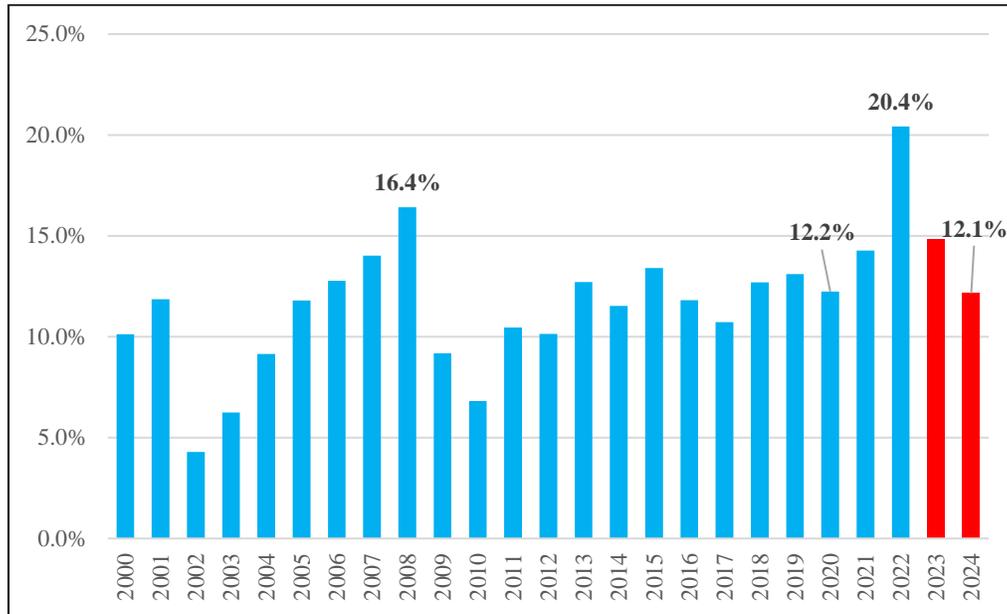
#### DECLINES IN NON-WITHHOLDING INCOME TAX REVENUES OFFSET GROWTH IN WITHHOLDING AND SALES TAXES

In FY 2024, other non-withholding income tax revenues will decline by \$1.02 billion, nearly offsetting the \$1.14 billion growth from withholding and sales tax revenues (Table 1).

This reduction follows a projected fall of \$2.5 billion in FY 2023. The decline in FY 2023 was expected coming off historic highs of \$4.3 billion in capital gains and \$4.1 billion in other non-withholding income (principally Schedule E and interest and dividends) in FY 2022. The \$8.4 billion total accounted for 20 percent of total tax revenues, the highest figure to date (Figure 2).

<sup>1</sup> See Appendix A for historic data on Massachusetts job openings per unemployed person.

**Figure 2 – Non-withholding Tax Revenues as a Percent of Total Tax Revenues;  
FY 2000 – FY 2024 (red bars are MTF projections)**



As happened in 2002 and 2009 – 2010, we are reminded that an overreliance on volatile revenue sources can pose significant budget challenges if not handled cautiously.

### Capital Gains Tax Revenues

The surge in capital gains in FY 2022 was fueled by strong growth in the markets in 2021 as the S&P 500 Index rose 25 percent, reaching its historic peak in December of that year. In 2022, the S&P 500 Index fell by 18 percent<sup>2</sup>, driving down projected capital gains tax revenues to \$3 billion in FY 2023. MTF projects that capital gains will continue to slide to \$2.3 billion in FY 2024, a decline of \$700 million. It’s worth noting that \$2.3 billion would represent the 4<sup>th</sup> highest total in the past 40 years.<sup>3</sup>

### Other Non-withholding Income Tax Revenues<sup>4</sup>

Following a surge to \$4.1 billion in FY 2022, which was \$1.8 billion higher than any previous year, other non-withholding income tax revenues are projected to decline by \$1.2 billion in FY 2023 and \$300 million in FY 2024.

Non-withholding tax revenues jumped in FY 2022 in large part from payments received from pass-through entity (PTE) excise taxes. The Legislature enacted the elective program in 2021 to help mitigate the \$10,000 cap on federal state and local tax (SALT) deductions passed by Congress in 2017. Participants<sup>5</sup> pay a 5 percent excise tax to the state and are eligible to claim 90 percent back in credits that can be deducted from federal returns. The state keeps the remaining 10 percent.

<sup>2</sup> See Appendix B for S&P 500 performance from January 2020 to December 2021.

<sup>3</sup> See Appendix C – Capital gains tax revenues, 1983 - 2024

<sup>4</sup> Principally Schedule E income, interest, and dividends

<sup>5</sup> PTEs include S-corporations, partnerships and LLCs

In FY 2022, the state collected \$2.26 billion in PTE excise taxes, keeping 10 percent or \$226 million. The state anticipated that the \$2 billion in credits would be claimed within the same tax year but that did not happen. Instead, DOR estimates that approximately \$600 million was claimed in FY 2022 leaving a state liability of approximately \$1.4 billion that will reduce other non-withholding tax revenues in FY 2023 and potentially FY 2024 when they are claimed. At some point new excise taxes should offset the state's outstanding liability, but the novelty of the program and the lack of data on the timing and amount of these payments create budgetary risks.

#### CORPORATE AND OTHER TAXES GROW MODESTLY

Corporate profits and taxes are projected to rebound in FY 2024, growing by \$140 million or 2.75 percent after a \$70 million decline in FY 2023. For many companies, higher demand and lower business costs from reduced travel and real estate holdings will offset a growth in wage costs and inflationary pressures.

#### OTHER TAXES KEEP PACE AS COVID IMPACTS RECEDE; DEMOGRAPHIC TRENDS

Other tax revenues<sup>6</sup> are projected to grow by \$50 million in FY 2023 and \$110 million in FY 2024 as motor fuel and room occupancy revenues climb back from pandemic-related lows. Separately, estate tax revenues have increased by \$265 million or 44 percent since 2019 as the state's population ages. Although the timing of estate tax payments is difficult to forecast, the trend from an aging population suggests that these taxes are likely to continue to experience positive growth.<sup>7</sup>

#### SURTAX REVENUES FROM THE FAIR SHARE AMENDMENT

The revenue estimates presented above do not include revenues from the income surtax. The timing of surtax collections over the next 18 months, questions regarding tax policy implementation, and uncertainty as to the surtax's effect on taxpayer behavior render any FY 2023 and FY 2024 surtax estimates unreliable. Given that uncertainty, MTF recommends the following approach to surtax revenues:

- Require the Comptroller to certify surtax revenues annually to be deposited into trust funds dedicated to education (50 percent) and transportation (50 percent);
- In FY 2023, use no surtax revenue for the remaining months of the fiscal year;
- In FY 2024, cap the use of surtax revenue at \$500 million;
- In FY 2025 and after, use the most recently certified surtax amount for the budget; and
- Require that the surtax trust funds maintain a minimum balance (adjusted for inflation) to protect against future downturns.

MTF will publish a more detailed set of fiscal recommendations on surtax revenues later in the week.

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<sup>6</sup> Other tax revenues include motor fuels, room occupancy, estates, cigarettes, alcohol, and deeds among others.

<sup>7</sup> See Appendix D – Massachusetts population aged 65+

## HEADWINDS ARE UNNERVING AND PLENTIFUL

- Will there be a global recession? The World Bank downgraded their global growth forecast to 1.7% from 3%; acknowledging that a global recession is possible given tighter financial conditions, heavy indebtedness, inflation, and rising geo-political tensions.
- Geo-political risks are the highest in decades, including:
  - Russia-Ukraine war escalates
  - China’s international ambitions collide with neighbors
  - Globally isolated, Iran & North Korea respond to threats with force
  - Authoritarian anti-democracy pressures expand in democratic countries
- Inflation spiral – a re-opened China leads to post-COVID economic expansion in 2024 driving up demand and prices for energy and other commodities<sup>8</sup>
- A functioning Congress? Failing to adjust the debt ceiling would have a catastrophic effect on US and Massachusetts economies
- Climate economic impacts surge, not priced into U.S. and global growth assumptions<sup>9</sup>
- COVID remains: XBB 1.5 is just the latest wave
- Demographics<sup>10</sup> – Massachusetts is running out of workers

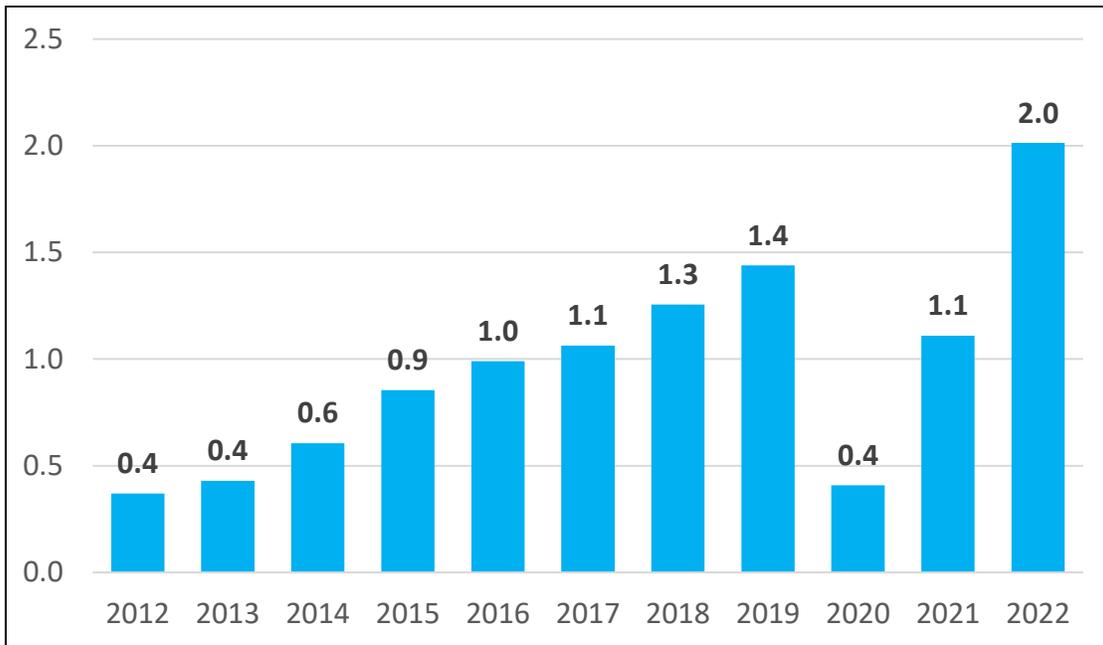
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<sup>8</sup> See for example Charles Schwab, [Top 10 Global Risks in 2023](#), Jeffery Kleintop, December 18, 2022: “It’s not unreasonable to expect a surge in pent-up spending from 1.4 billion consumers after a year of restrictions, aided by soaring excess cash deposits and falling mortgage rates.”

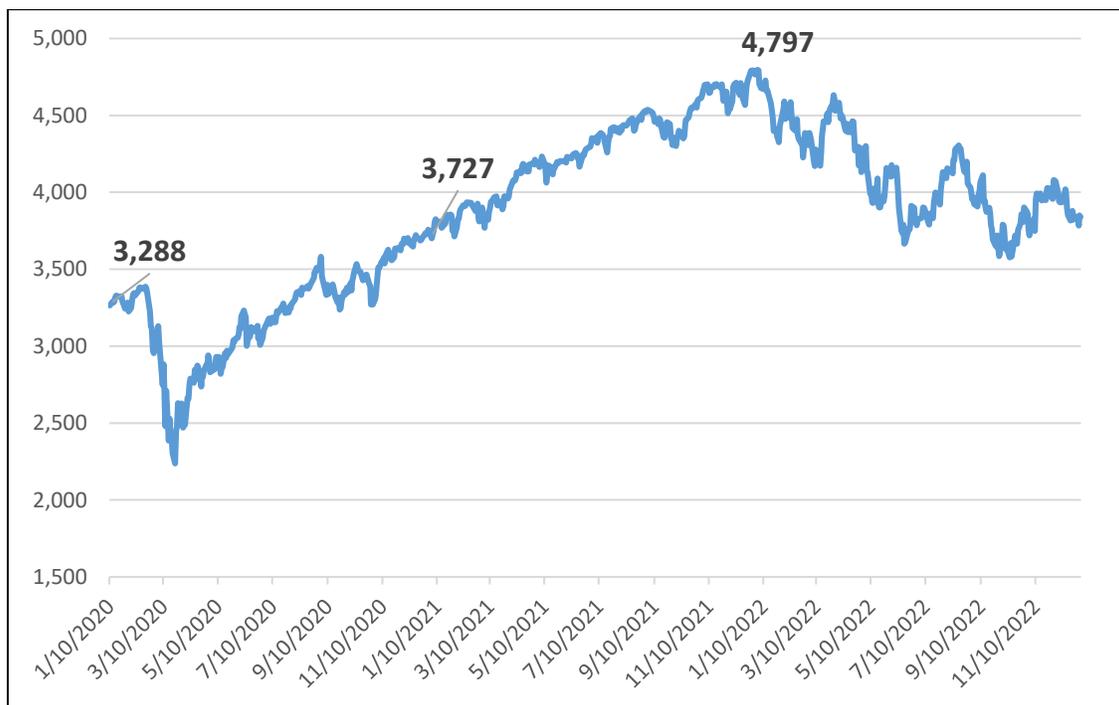
<sup>9</sup> See, Congressional Research Service, [How Climate Change May Affect the U.S. Economy](#), April 4, 2022.

<sup>10</sup> See Appendix E for key findings from MTF’s December 2022 report on demographics.

**Appendix A – Massachusetts Job Openings per Unemployed Person**

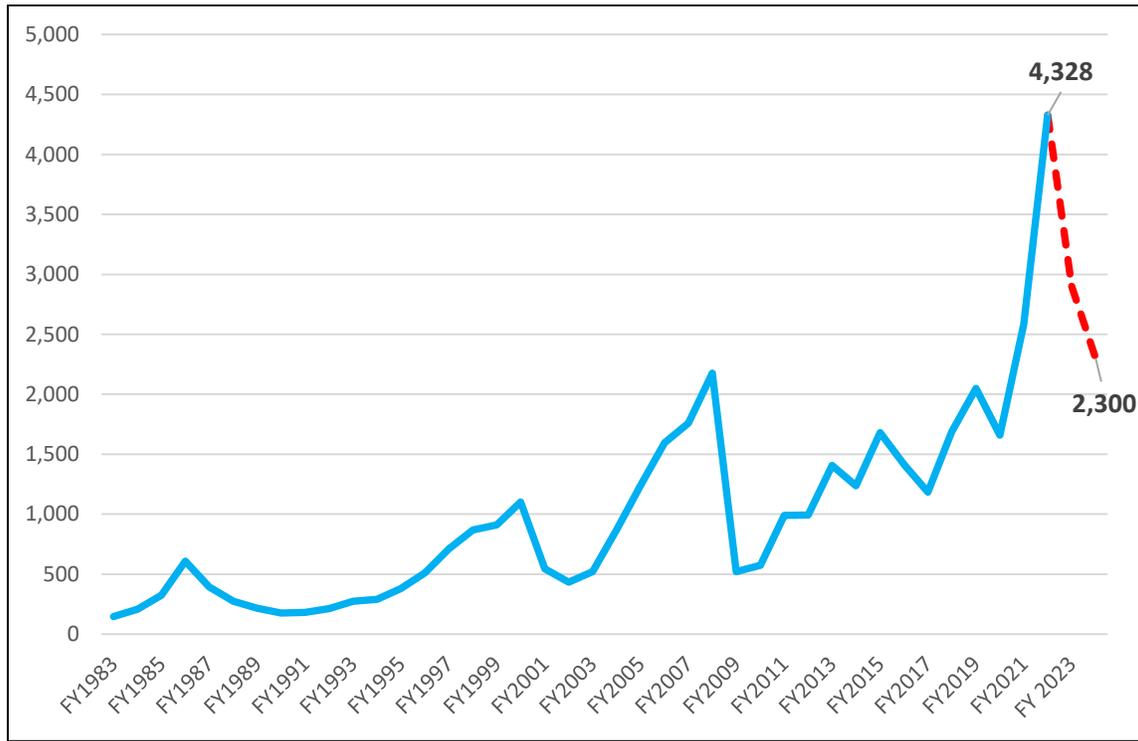


**Appendix B – S&P 500 Index, January 2020 – August 2021<sup>11</sup>**

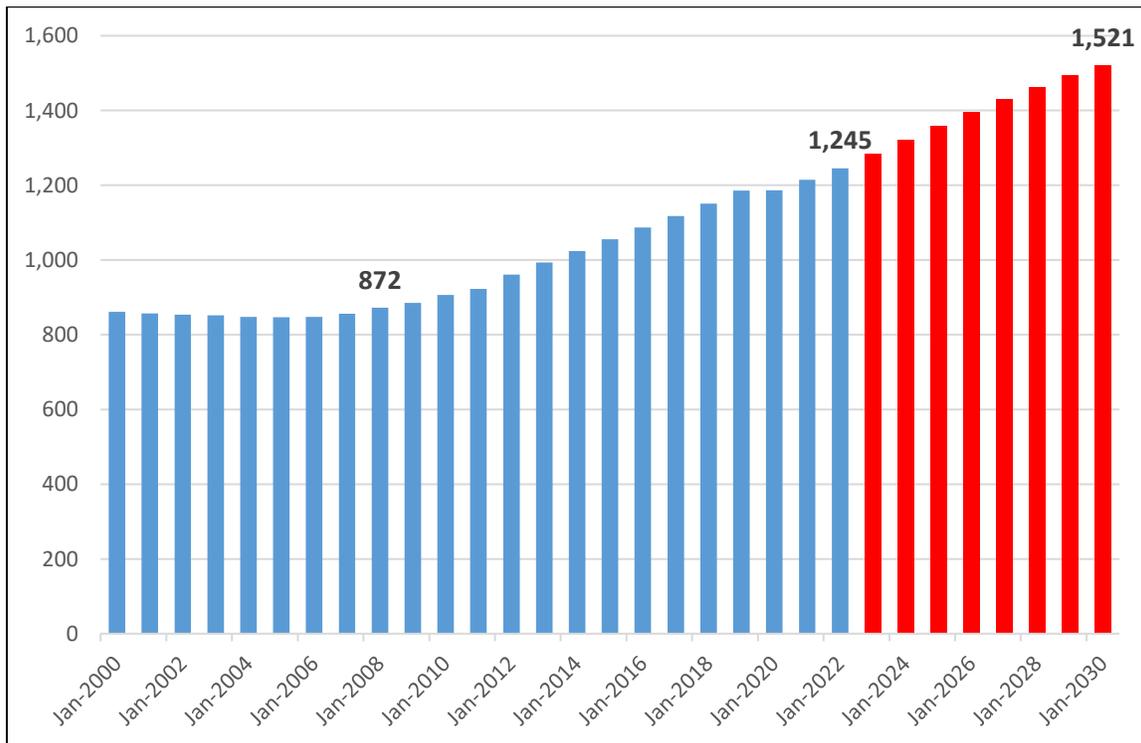


<sup>11</sup> [S&P 500 doubles from its pandemic bottom, marking the fastest bull market rally since WWII](#), Yuni Li and Nate Rattner, CNBC, August 26, 2021.

**Appendix C – Capital Gains Tax Revenues; FY 1983 – FY 2024 (Red line is a projection)**



**Appendix D – MA Population Aged 65+ (Red bars are a projection)**



## **Appendix E – Key Findings from MTF Report *Massachusetts’ Demographic Trends Threaten our Talent Pipeline and Economic Strength***

Some of the major findings from MTF’s [demographics report](#) include:

- The number of Massachusetts work-aged residents 20 – 64 peaked in 2018, has declined by 50,000, equivalent to the population of Everett, and is projected to fall by another 120,000 by 2030.
- In September, Massachusetts had 289,000 job openings and 129,000 people unemployed suggesting a labor shortage of 160,000. This means there are 2.2 jobs for every unemployed person, double the figure of just five years ago.
- The number of births in Massachusetts has steadily declined by almost 30 percent in the past 30 years to 66,200, the second lowest figure since 1940 when the state’s population was 2.7 million less than today.
- Due to an aging population, the number of deaths is climbing to the point where Massachusetts’ natural population growth (births minus deaths) is projected to turn negative before the end of the decade.
- Massachusetts has lost hundreds of thousands of residents over the past few decades who left for other states but that trend spiked to 46,000 in 2021 as people took advantage of remote work or labor shortages in other states to find a better quality of life than Massachusetts can offer.
- Put differently, the 46,000 residents in 2021 was the 4<sup>th</sup> most in the country, while the other New England states gained 40,000. Of the 67 New England counties, only 9 lost population in 2021 - 7 of them are in Massachusetts.
- At the same time, international immigration, which for decades more than offset residents leaving the state, plummeted to 12,700, a decline of 35,000 or 75 percent from 2017.
- An aging population, along with the impacts of COVID, have led to a jump in retirements further eroding the size of the workforce.