



The Fiscal State of Affairs: Budget and Tax Issues

Presentation to the Mass. Municipal
Auditors' & Accountants' Association

by Eileen McAnney

June 12, 2017

About MTF

Founded in 1932, the Massachusetts Taxpayers Foundation is widely recognized as the state's premier public policy organization dealing with state and local fiscal, tax, and economic policies.

The Foundation's record of **high quality research and non-partisan analysis** has earned the organization **broad credibility** on Beacon Hill and across the Commonwealth.

Our mission is to provide accurate, unbiased research with balanced, thoughtful recommendations that strengthen the state's finances and economy in order to foster the long-term well being of the Commonwealth.



Outline

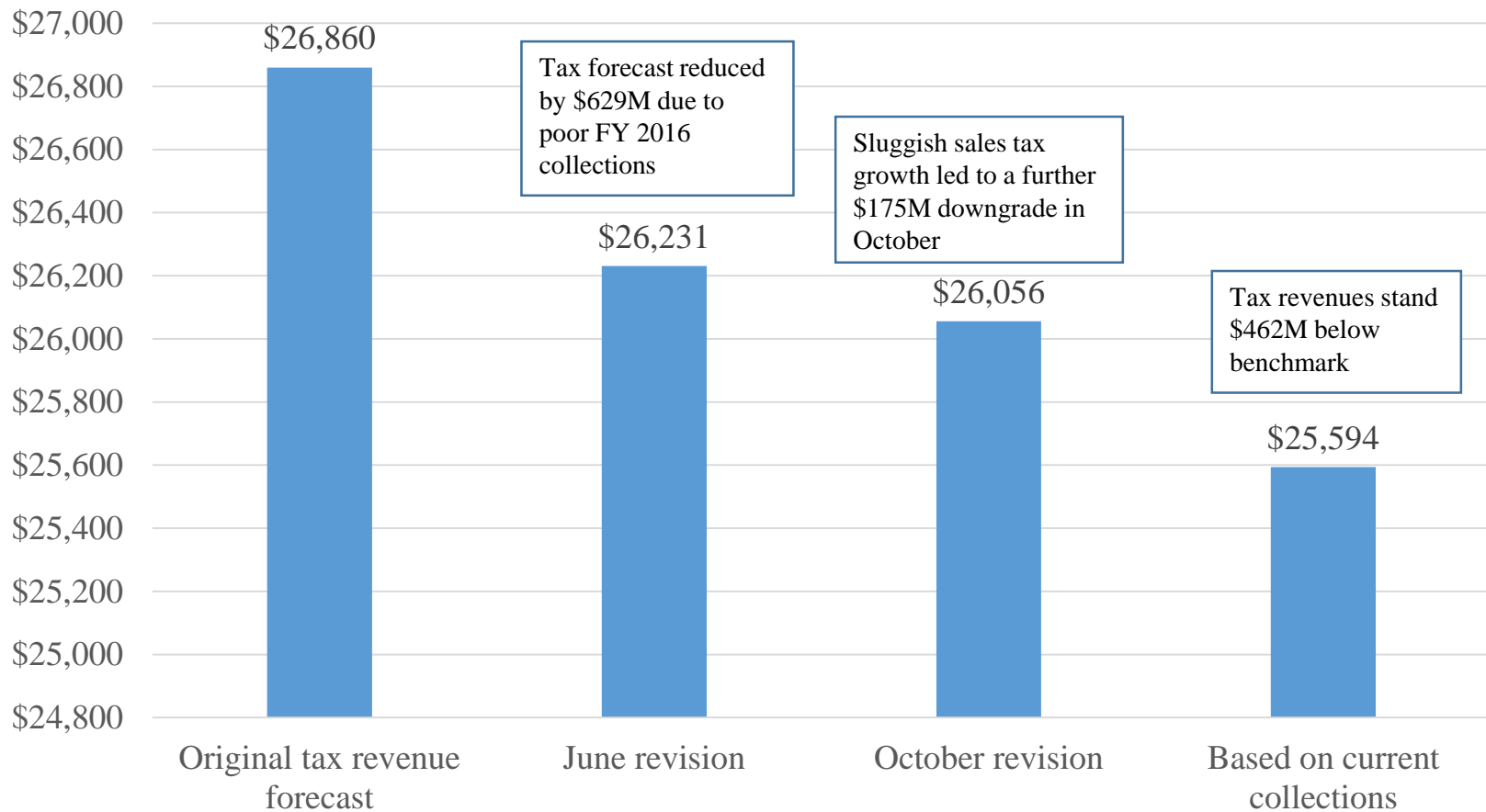
- I. Current Budget Picture
- II. FY 2018 Budget
- III. FY 2018 Tax Revenue Issues
- IV. Conference Committee Preview
- V. Long-term Fiscal Challenges



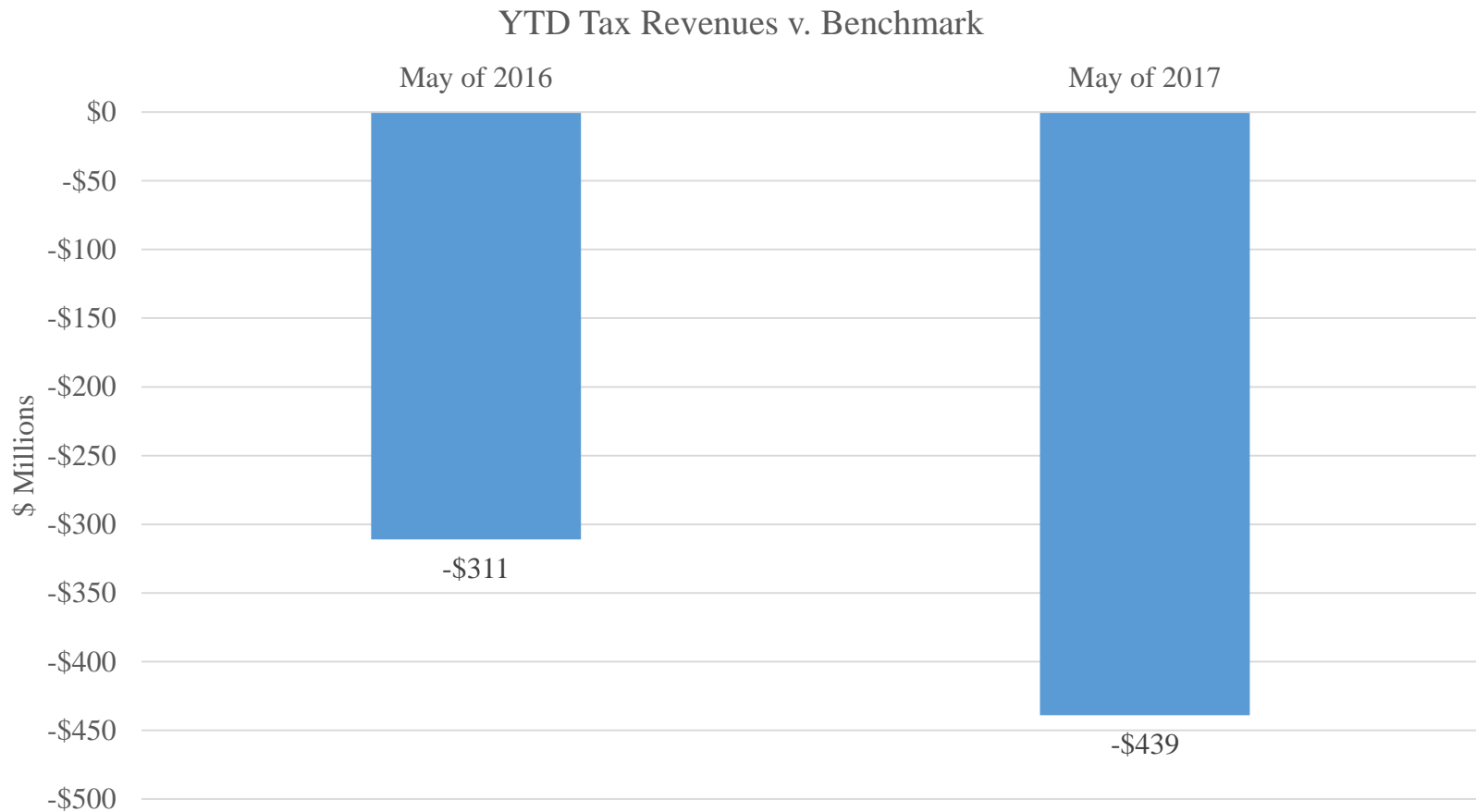
Current Budget Picture



FY 2017 Tax Revenues Continue to Disappoint



FY 2017 Revenue Picture is Worse than FY 2016

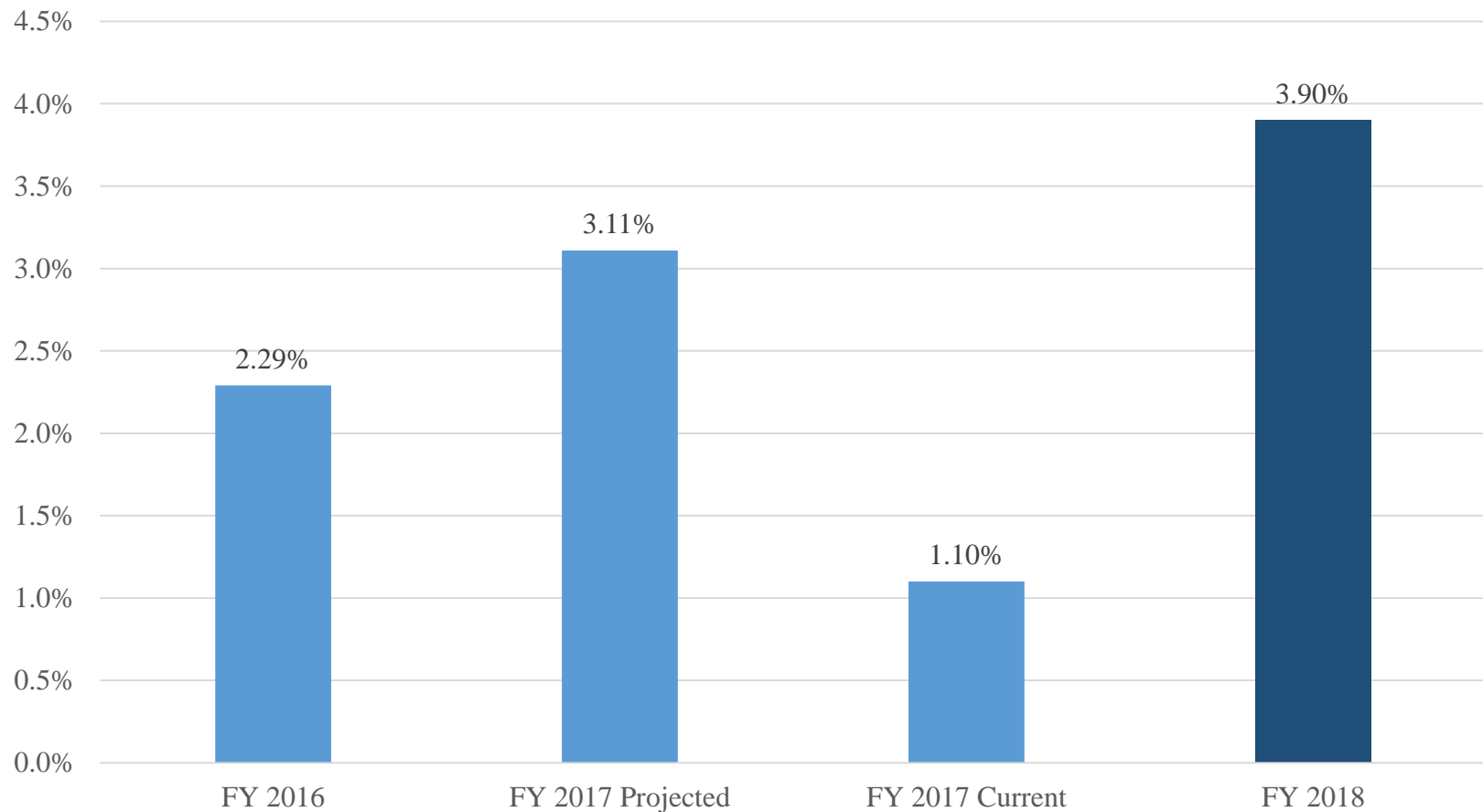


FY 2018 Budget



FY 2018 Projection is Increasingly Unrealistic

FY 2018 Consensus Revenue compared to recent collections



Five Major FY 2018 Budget Issues

1. Soundness of tax revenue projections
2. New revenue proposals put forward in Governor's Budget
3. MassHealth cost growth
4. First step in implementing school finance overhaul
5. Spending shortfalls built into House & Senate budgets



Closing the Budget Gap

Estimated Gap	\$832		
	<i>H1</i>	<i>House</i>	<i>SWM</i>
Employer assessment	\$300	\$180	\$180
Tobacco settlement/OPEB	\$129	\$129	\$129
Sales tax timing (one time)	\$95	\$95	\$95
New ongoing tax revenue	\$61	\$66	\$98
Capital gains	\$52	\$52	\$52
Reduced transportation transfers	\$48	\$68	\$78
Reversion assumption	\$0	\$0	\$50
GIC rate caps	\$40	\$0	\$0
Trust Sweeps	\$0	\$15	\$15
Life Science Cap	\$5	\$5	\$5
TAFDC Eligibility	\$13	\$0	\$0
TAFDC Caseload	\$30	\$30	\$24
MassHealth Savings (net)	\$0	\$40	\$60
Increased DOT revenues	\$20	\$20	\$20
Other cuts	\$39	\$132	\$26
Total solutions	\$832		



FY 2018 Spending Summary

	<i>Spending Comparison</i>				FY 2018 Senate
	FY 2018 House 1	Amendments	FY 2018 House	Amendments	
Line item spending	\$40,909.0	\$77.7	\$40,830.0	\$50.9	\$40,842.2
Off Budget	\$4,300.6	\$0.0	\$4,300.6	\$0.2	\$4,300.8
Total spending	\$45,209.6	\$77.7	\$45,130.6	\$51.1	\$45,143.0

- Both House and Senate budgets appropriate less than House 1, however:
 - Both budgets significantly underfund a number of accounts
- Budgets propose ~\$1.5 billion in spending growth over FY 2017
 - Tax revenues likely overinflated by \$700 million – \$1 billion



Spending – MassHealth

House 1 MassHealth spending	\$16,488.2	
	House	Senate
Adjustment for reduced caseload	-\$128.9	-\$107.8
Auditor report savings	\$0.0	-\$12.0
Optometrist scope of practice	\$0.0	-\$10.0
New Spending		
Nursing home supplemental rates	\$17.8	\$0.0
Pediatric speciality units	\$14.8	\$0.0
Acute care speciality rates	\$13.0	\$0.0
Adult day health rates & other	\$5.0	\$0.0
Total Spending	\$16,409.9	\$16,358.4
<i>Numbers in millions</i>		

- SWM takes advantage of decline in MH caseload at end of CY 2016
- SWM differs from House in:
 - Auditor & optometrist savings
 - Supplemental rates

Spending – Chapter 70

	FY 2018 H1	FY 2018 House	FY 2018 Senate
Funding	\$4,719,407,242	\$4,734,405,553	\$4,756,814,887
Increase over FY 2017	\$91,393,624	\$106,391,935	\$128,801,269
Per pupil aid	\$20	\$30	\$30
Foundation changes for employee benefits	Yes	Yes	Yes
Foundation changes for special education costs	No	No	Yes
Funds to mitigate impact for change in low-income student accounting	No	Yes (separate line item)	Yes (in Chapter 70)

- SWM goes further than House or H1 in Foundation Budget changes
 - Inserts sweeping Foundation Budget changes into MGLs
 - Includes funding of Foundation Budget changes as part of annual Consensus Revenue process

Spending – Other Local Aid

- Unrestricted General Government Aid (UGGA)
 - House and Senate budgets provide \$1.062 billion
 - 3.9% (\$39.9 million) growth over FY 2017
- Education reimbursements:

Program	FY 2017 Funding	FY 2017 Reimb. %	FY 2018 House 1	FY 2018 House	FY 2018 Senate
SPED Circuit Breaker	\$277,281,180	74.0%	\$277,281,180	\$281,281,181	\$294,390,396
Charter School Reimbursement	\$80,500,000	58.5%	\$80,500,000	\$80,500,000	\$83,500,000
Regional School Transportation	\$61,021,000	72.0%	\$61,021,000	\$62,021,000	\$62,271,000
Homeless Student Transportation	\$8,350,000	32.0%	\$8,350,000	\$8,350,000	\$8,350,000
Non-Resident Pupil Transport	\$250,000	7.8%	\$250,000	\$250,000	\$250,000

Local Policy Issues

- Community Preservation Act
 - Senate proposes increase to deeds excise fee which would more than double current state match
 - House directs \$10M of any FY 2017 surplus to CPA
- Community Benefit Districts
 - Both House and Senate include language allowing for the creation of Community Benefit Districts
 - CBDs allow property owners to vote to form a non-profit entity responsible for area betterments
 - Property owners would be assessed to support the CBD
- Local Aid Revenue Sharing Commission
 - Senate proposes study of how to improve local aid distribution



MassHealth Accounts for 60% of New Spending in FY 2018 Budget

New Spending in FY 2018 Budget		
	House	Senate
MassHealth	\$942	\$891
Pensions	\$196	\$196
Chapter 70 and Local Aid	\$159	\$169
Developmental Services	\$76	\$77
Higher & Early Education	\$29	\$63
Other	\$79	\$96
Total	\$1,481	\$1,493



FY 2018 Tax Issues



FY 2018 Tax Proposal Comparison

	House 1	House	SWM	Senate	Language Differences
Employer assessment	\$300	\$180	\$180	\$180	Yes
Economic activity/sales tax	\$30	\$30	\$30	\$30	No
Debit/credit income reporting	\$20	\$20	\$20	\$20	No
Temporary accomodations	\$12	\$0	\$18	\$18	Yes
EITC change	\$0	\$10	\$10	\$10	No
Tobacco enforcement compliance	\$0	\$7	\$0	\$0	No
Hotel reseller	\$0	\$0	\$7	\$7	Yes
Film tax credit change	\$0	\$0	\$0	\$14	Yes
Total new tax revenue (ongoing)	\$62	\$67	\$85	\$99	
New veterans tax credit	-\$1	-\$1	-\$1	-\$1	Minor
Net new revenue (ongoing)	\$361	\$246	\$264	\$278	
Sales tax timing	\$125	\$125	\$125	\$125	Yes
Flavored tobacco	\$0	\$0	\$0	\$7	Yes
<i>Numbers in millions</i>					



Employer Assessment Proposal

- Governor's budget proposed new assessment on employers who did not meet standards for employee coverage
 - Standards based on uptake and plan value
 - Proposal expected to generate \$300M in FY 2018 and \$700M+ when fully phased in
- House and Senate budgets have amended Governor's proposal
 - Direct Admin. to account for concerns with scope of initial proposal
 - Senate provides alternate option of Employer Medical Assistance Contribution increase



Employer Assessment

	House 1	House	Senate
Estimated revenue	\$300	\$180	\$180
Language specifying revenue	No	No	Yes
Two year sunset	No	Yes	Yes
Explicit EMAC option	No	No	Yes
Specific eligibility standards	Yes	No	No
Language related to common concerns	No	Yes	Yes
Hardship waiver	No	Yes	Yes
Ability to exempt classes of employer	No	No	Yes
Differential assessment based on firm size	No	No	Yes



Sales Tax Timing

- Both House and Senate assume \$125 million from sales tax timing initiative first proposed by Governor, but approach differs:
 - House:
 - Allows DOR to implement daily remittance or other method to improve collections
 - If DOR adopts daily remittance, must address concerns that have been raised
 - Senate:
 - Gives DOR option of daily remittance v. prepayment
 - Requires DOR to certify any policy is feasible/cost effective prior to implementation
 - ❖ If neither proposal is justifiable, one time resources transferred from FY 2019



Other Conference Tax Issues

- Temporary accommodations (Senate)
 - Senate more expansive than House 1 proposal
 - Senate also adds hotel resellers
- Film tax credit restrictions (Senate)
- Flavored tobacco (Senate)
- Tax Expenditure Review Commission (Senate)
- Economic activity definition (nexus) lawsuit



Conference Committee Preview



Conference Committee Issues

- For 2nd straight year, Conference will likely entail reducing tax revenue estimate
 - Low end of reduction: \$700 million
 - High end: \$1 billion
- Scope and mechanics of employer assessment & sales tax timing
- Other tax differences
 - Lodging/hotels
 - Film tax
 - Tobacco
- Approach on underfunded accounts



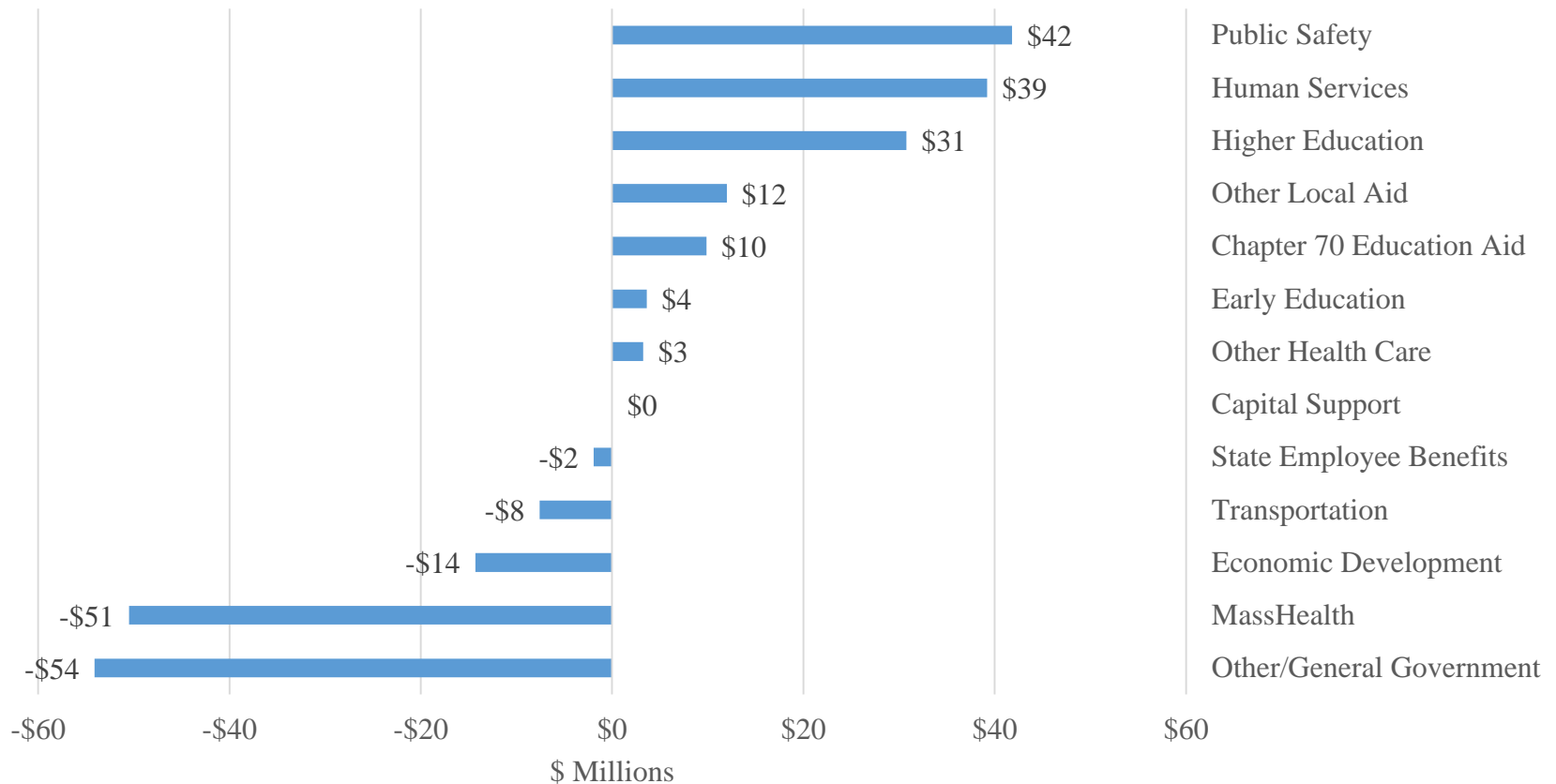
Different Approach to Policy in Budget Will Create Conference Challenges

Notable Budget Policy Sections Compared		
	House	Senate
Foundation Budget Changes in Law	No	Yes
Chapter 70 in Consensus Revenue	No	Yes
Tax Expenditure Commission	No	Yes
CPA Changes	No	Yes
MBTA Pacheco Restrictions	No	Yes
GIC Membership	No	Yes
Educator Evaluation Changes	No	Yes
Film Tax Restriction	No	Yes
Flavored Tobacco Tax	No	Yes
Casino Closing Time	Yes	No
Conservation Land Tax Credit	Yes	No



House and Senate Spending Compared by Policy Area

Spending Differences in House and Senate Budget
Positive Numbers Denote Senate is Higher

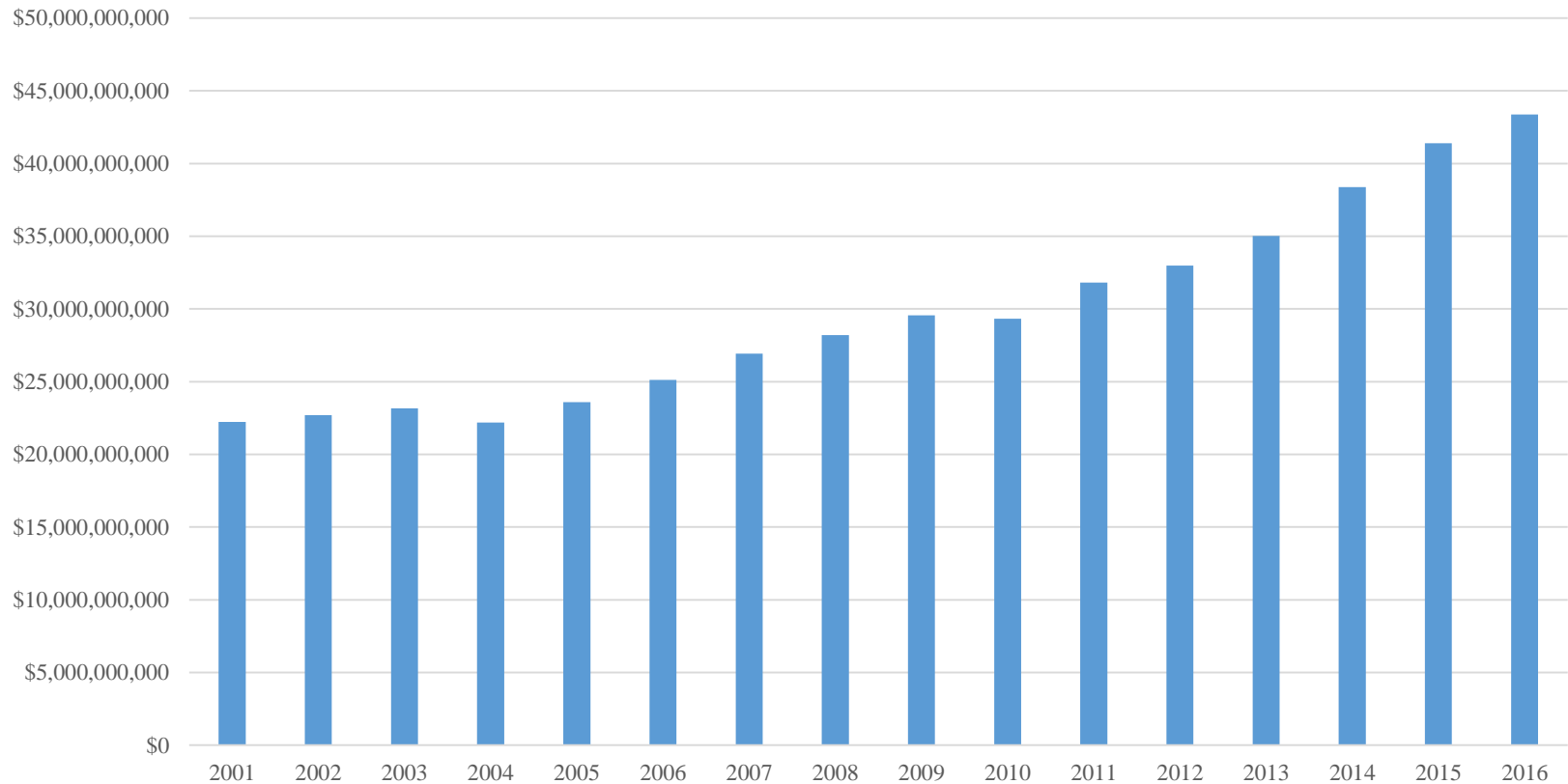


Long-term Fiscal Challenges



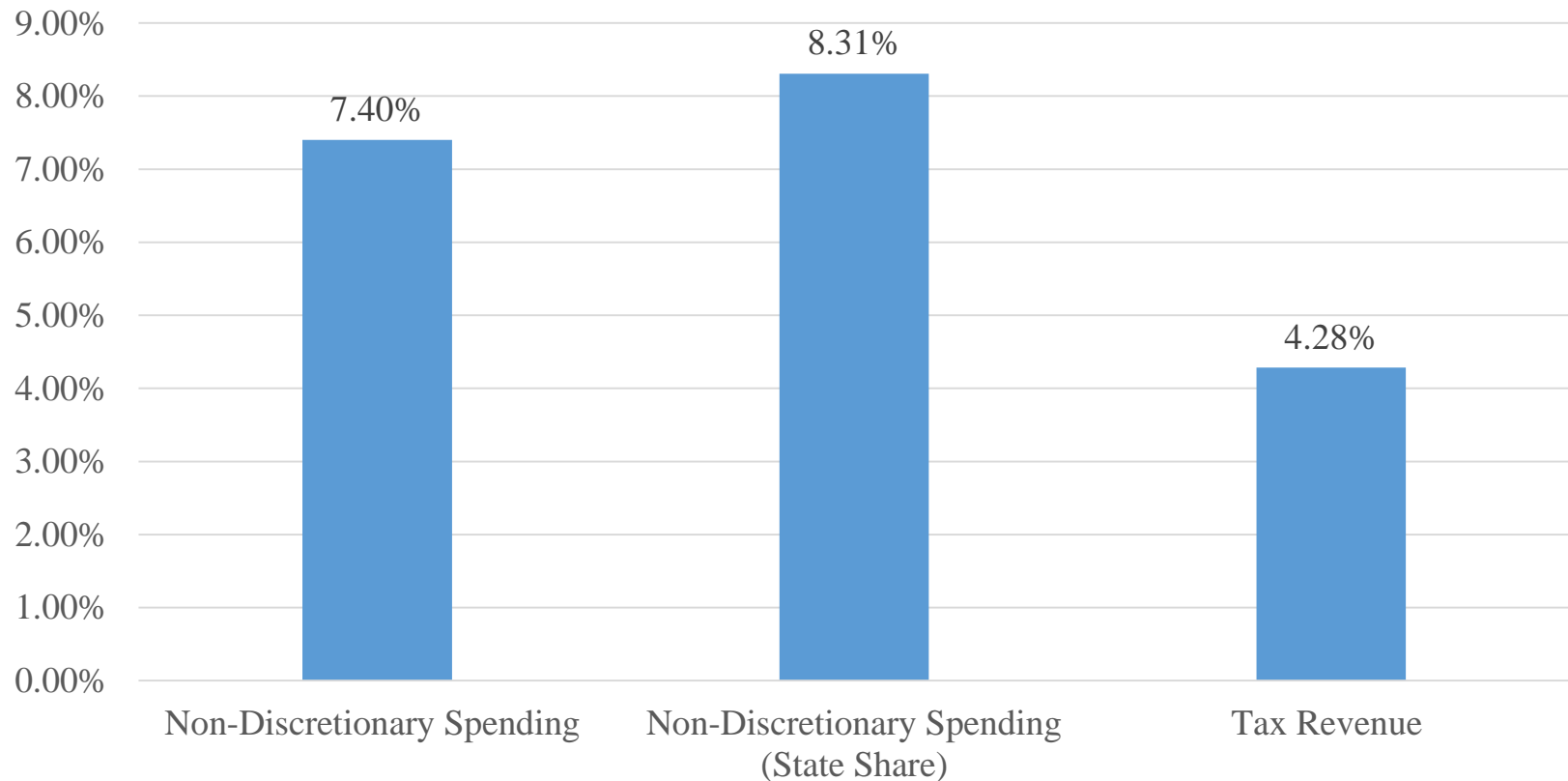
Massachusetts Spending Growth in Context

Appropriated Spending, FY 2001 - FY 2016



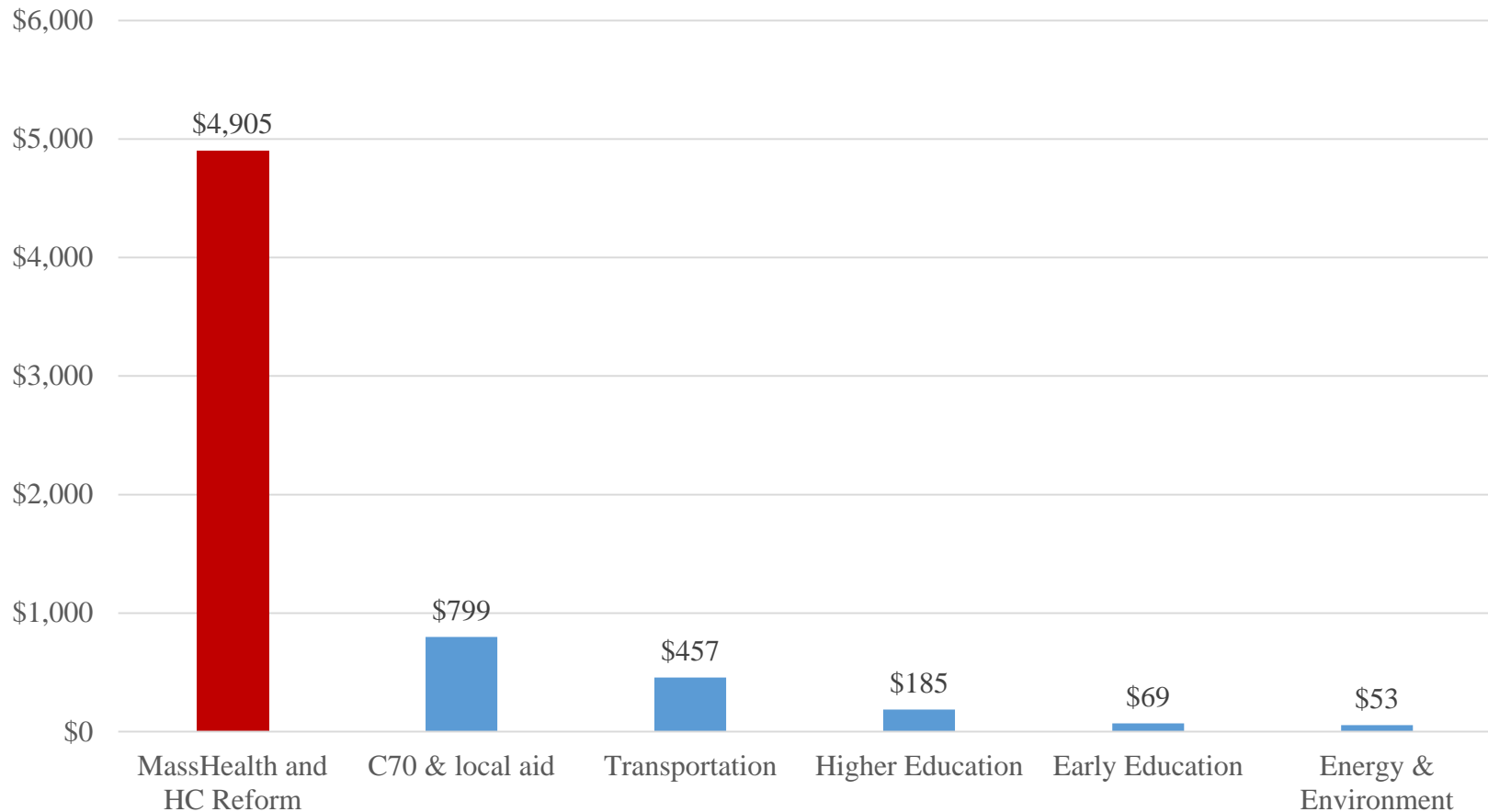
Non-Discretionary Spending Outpaces Revenue Growth

FY 2012 - FY 2016 Average Growth



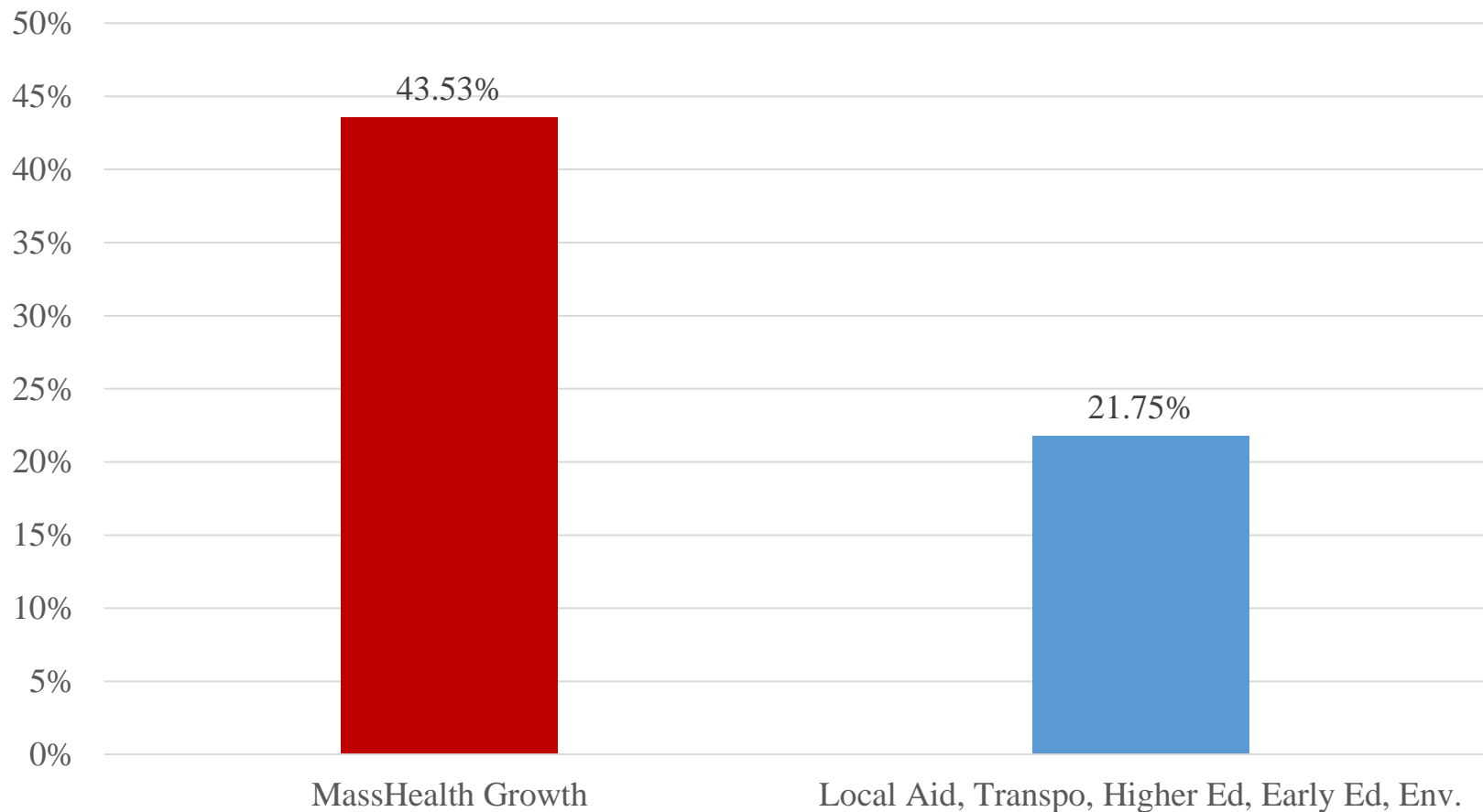
Each Year MassHealth Spending Growth Dwarfs Other Areas...

Spending Increase, FY 2012 – FY 2017
(in \$ millions)

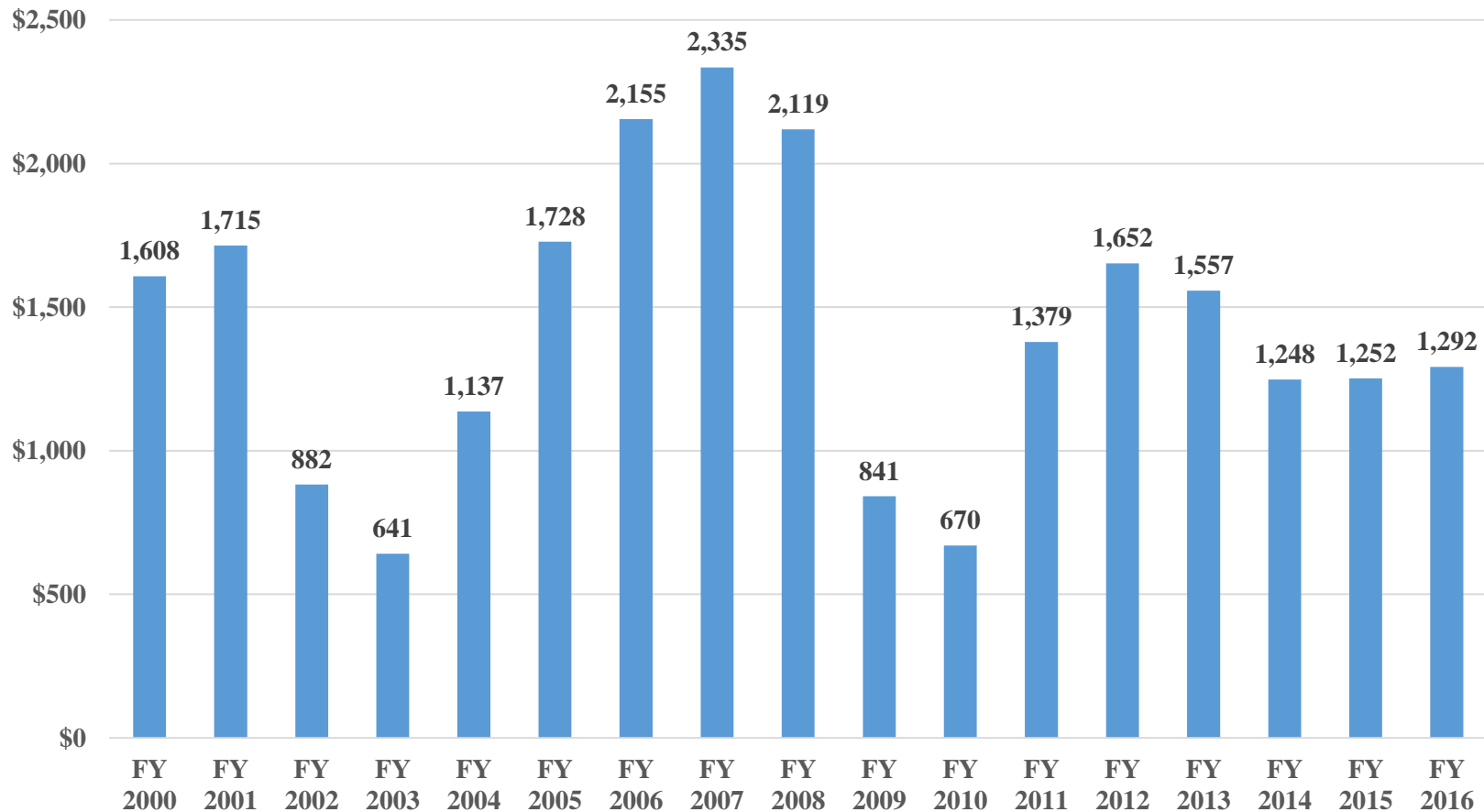


...And the Problem is Getting Worse.

Percent Spending Growth FY 2012 – FY 2017

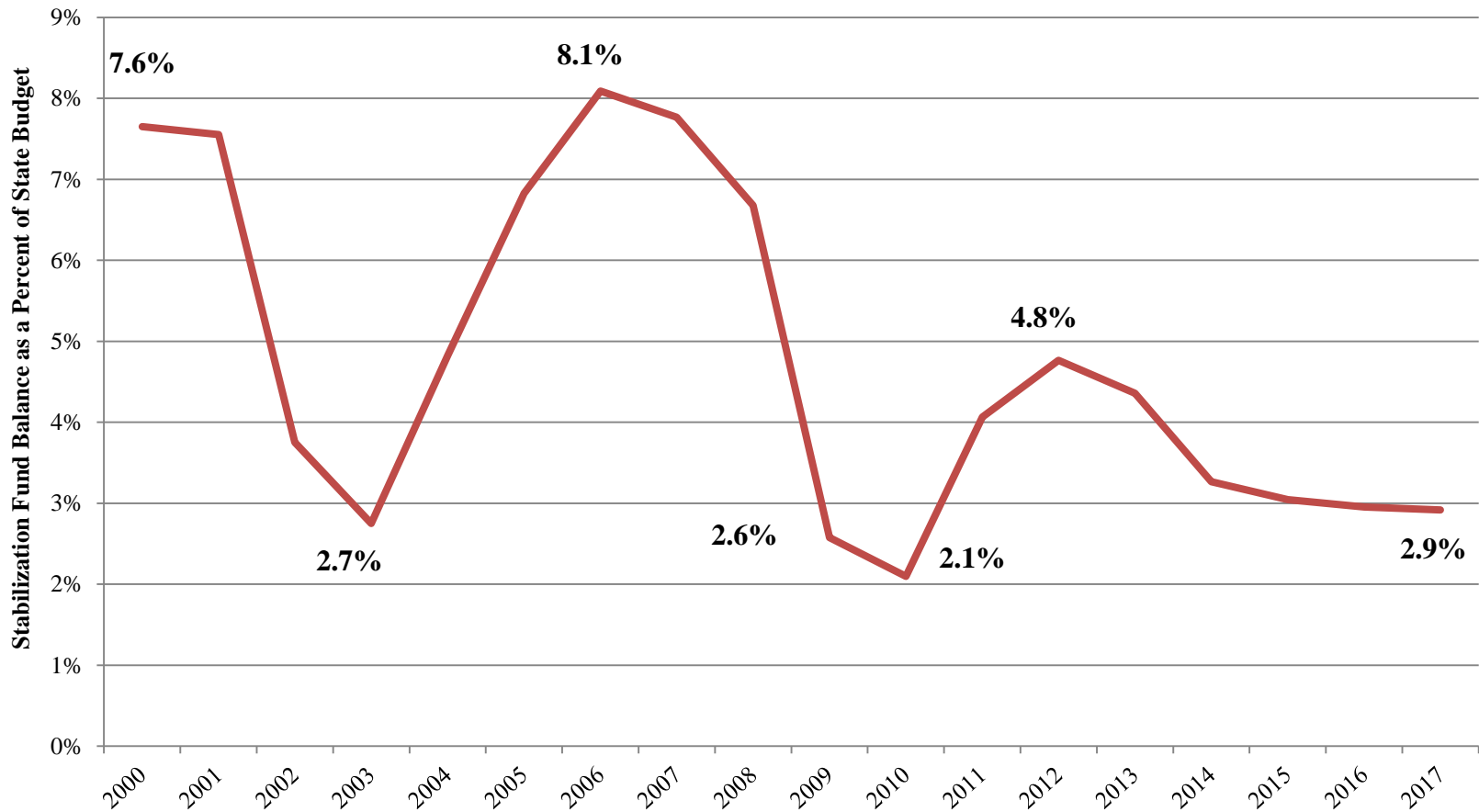


Stabilization Fund Balance Dropped in the Recovery



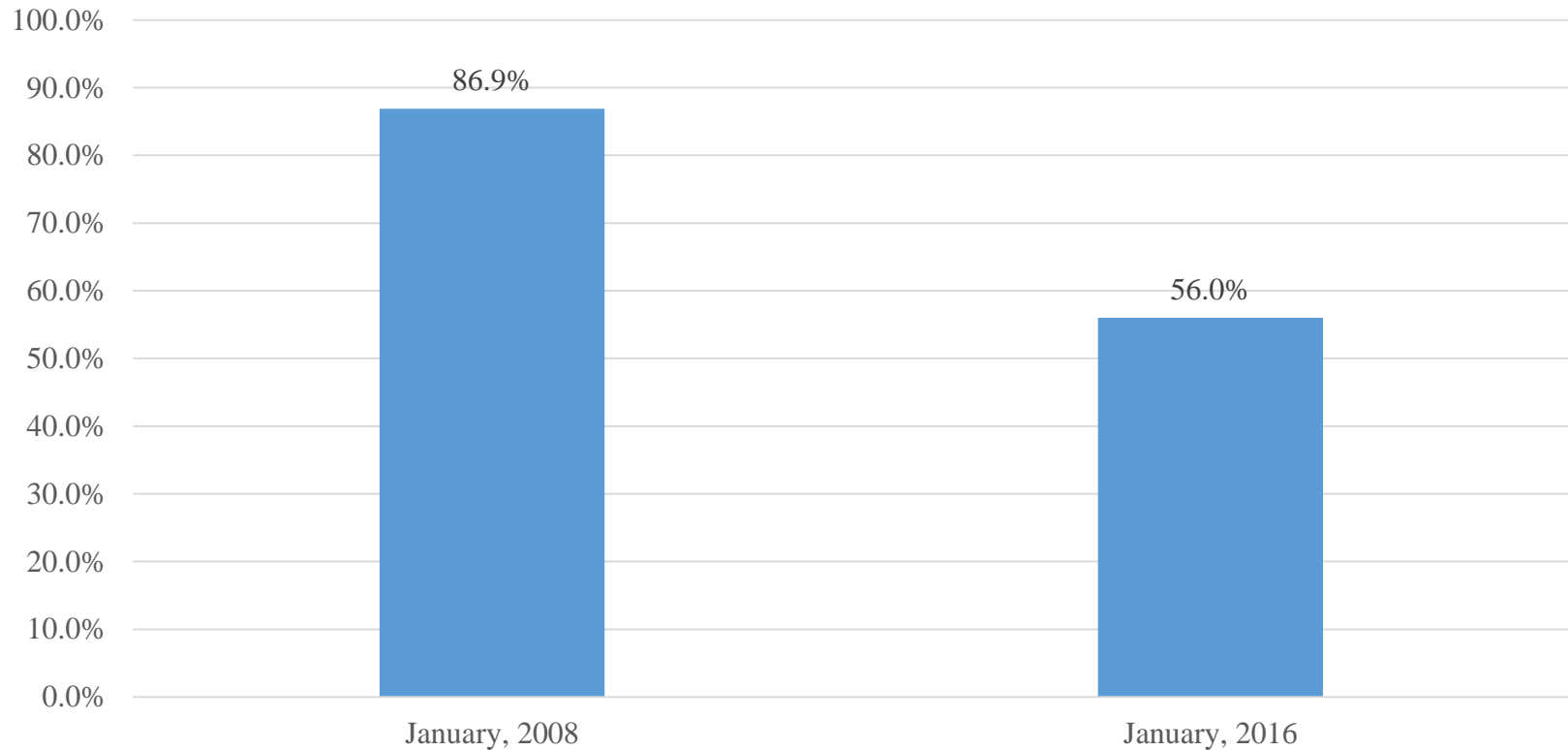
Reserves as a Percentage of Spending are Nearing Lows

Stabilization Fund as a Share of Spending



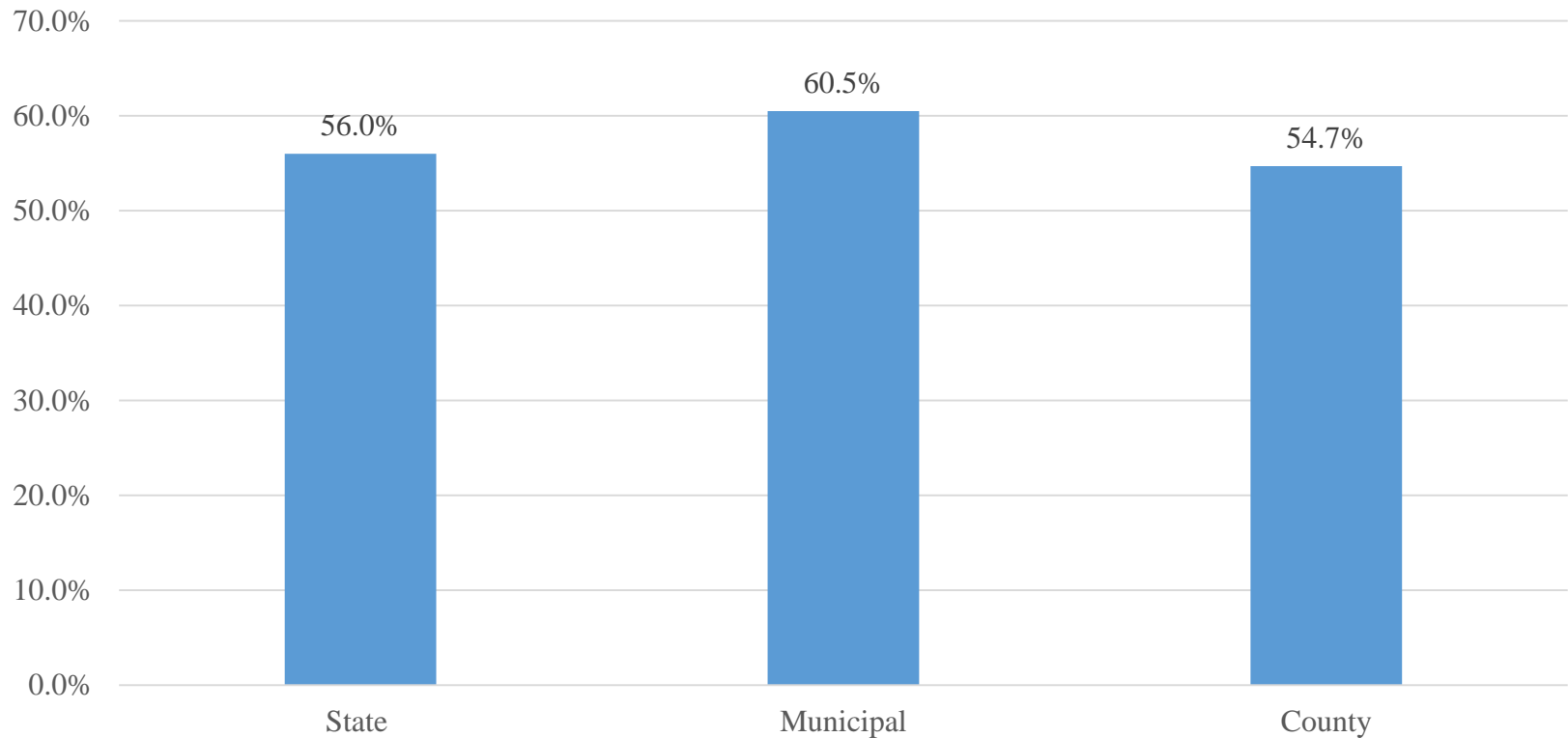
The State Pension has Not Recovered from the Great Recession

Funding Ratio of State Pension Obligation
2008 v. 2016



State & County Pension Systems are in Similar States

Current Funding Ratios
State v. Municipal & County



However, Among Municipalities There is Wide Variance

	Municipal	County
Above 70%	22	3
Between 55% and 70%	36	5
Between 50% and 55%	11	1
Below 50%	17	3



State & Municipal OPEB is Even More Disturbing

Funding Ratio of OPEB Liabilities	
State OPEB	4.5%
Municipal OPEB	Less than 1%

- Of 27 Gateway Cities, only 2 have set aside any funds for their long-term OPEB liability
- Without major changes to retiree benefits and eligibility, this liability will be unaffordable for cities and towns

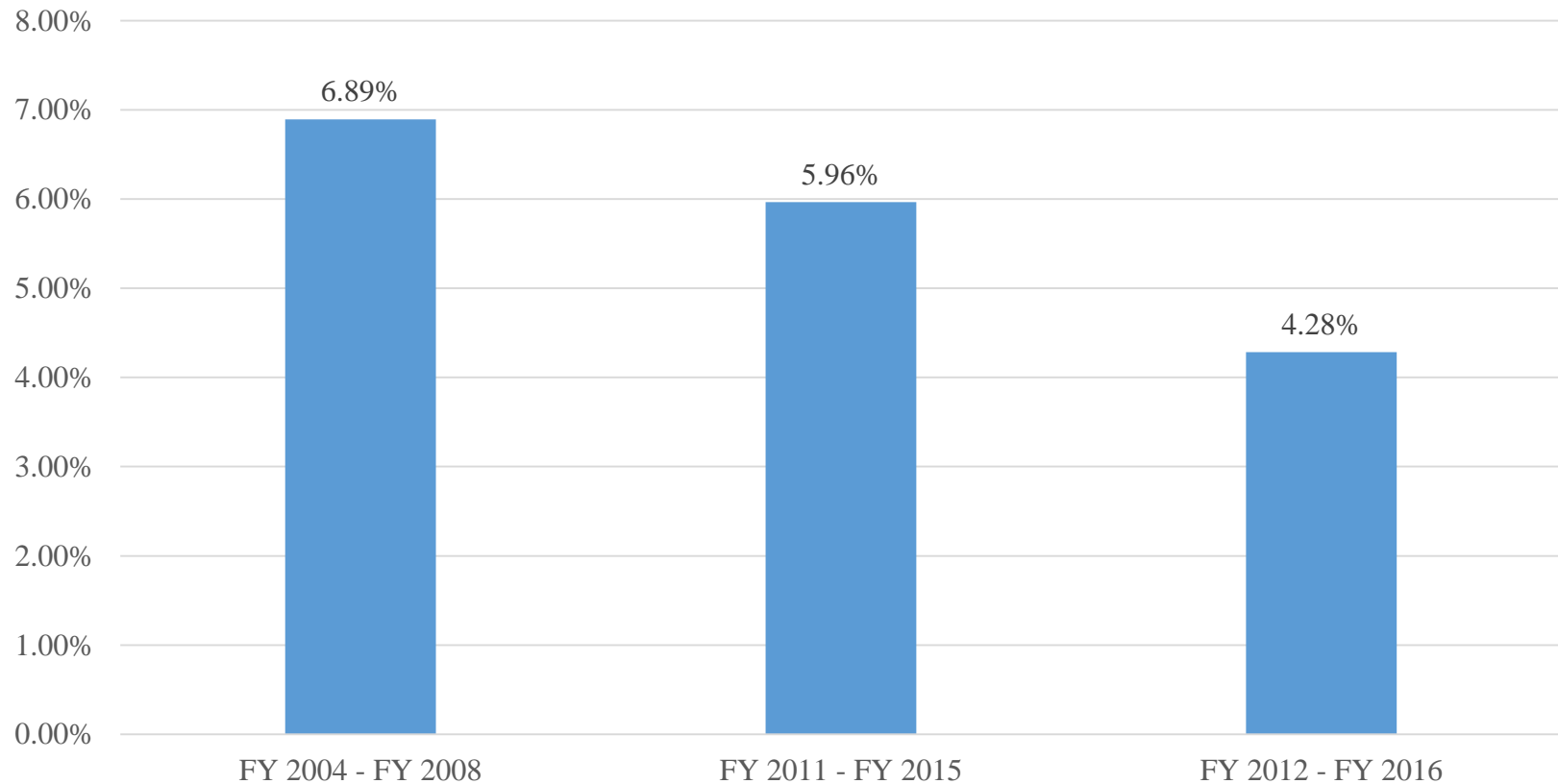


Why Aren't Tax Revenues Keeping Pace With The Economy?



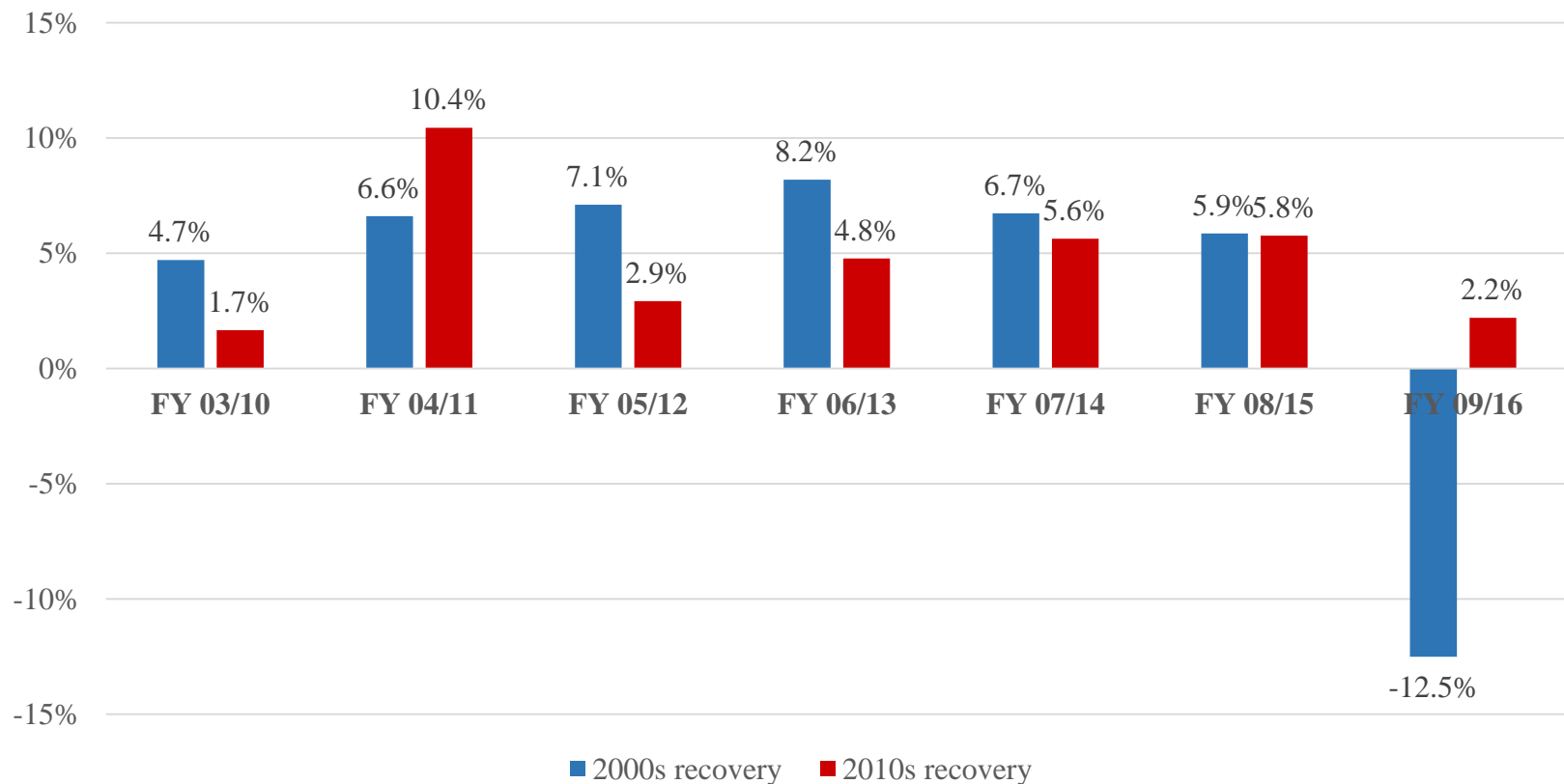
Tax Revenue is Weaker This Recovery and Getting Weaker Still....

Average Tax Revenue Growth Compared

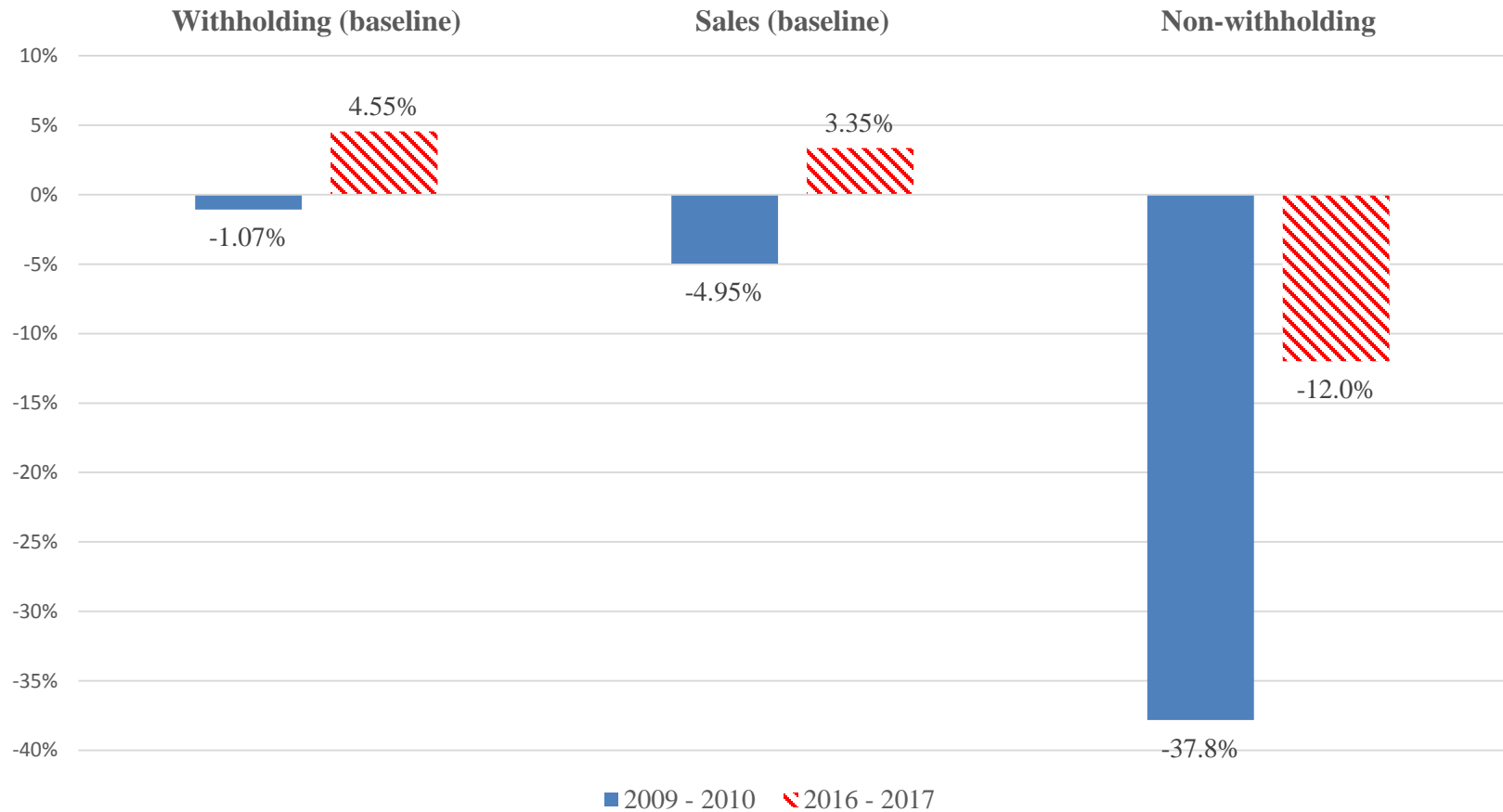


But It Is Still Positive and That is a Key Difference

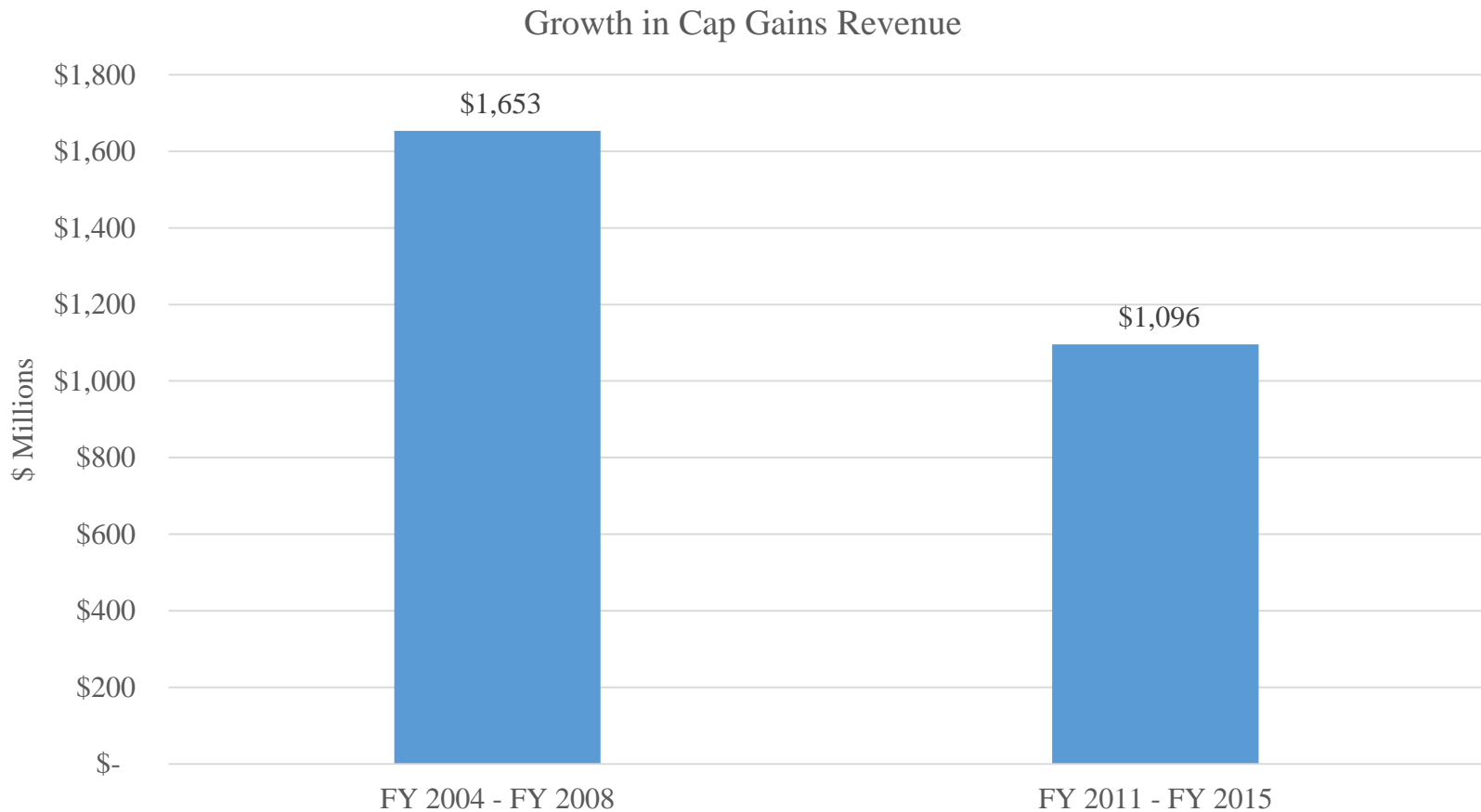
Year by Year Tax Revenue Growth Compared



Average Year-over-Year Growth in Tax Revenues for Years Six and Seven of Recovery



Capital Gains is a Notable Difference Between the Two Recoveries



A Closer Look at Tax Changes

	2000s recovery	2010s recovery	Difference
Income	5.3% (beginning in 2004)	Rate reduced from 5.3% to 5.1% over 5 years	2010s revenue loss
Sales	5%	6.25%	2010s revenue gain
Gas	21 cents	Rate increased to 24 cents in 2014	2010s revenue gain
Corporate	Pre-corporate tax reform	Post-corporate tax reform	2010s revenue gain
Cigarette	1.51 per pack	Increase of 2.51 per pack to 3.51 per pack in 2013	2010s revenue gain



Tax Changes Post 2008 Recession Are Net Positive

	FY 2017 impact
Income tax (5.3% - 5.1%)	-\$590
Sales tax (5% - 6.25%)	\$1,210
Gas tax (21 - 24)	\$100
Cigarette (\$2.51 - \$3.51)	\$180
<i>Net impact</i>	<i>\$900</i>

Spending Has Played a Major Role in Current Budget Struggles

Non-Discretionary Spending as Share of Tax Revenue

