



MEMO

To: Brian S. Dempsey, Chair, House Ways and Means Committee
Karen E. Spilka, Chair, Senate Ways and Means Committee
Kristen Lepore, Secretary, Executive Office of Administration and Finance

From: David Tuerck, Executive Director, Beacon Hill Institute

Date: December 8, 2016

Re: Beacon Hill Institute (BHI), Estimate for Fiscal Year 2018 and the Tax Cut Trigger

Copies: Michael Heffernan, Commissioner, Department of Revenue

At the December 5, 2016 revenue hearing, I was asked by the Joint Ways and Means Committee and the Secretary of Administration and Finance to provide a revenue estimate that assumes the Massachusetts Part B income tax rate reduction would be implemented on January 1, 2018.

Here we supply the requested information and our best estimate as to the probability that the Part B income tax rate reduction would be triggered by the BHI revenue estimate.

General Laws chapter 62, section 4, establishes the personal income tax rates to be applied against different classes of Massachusetts taxable income. The tax rate on most classes of income is scheduled to decrease in years where the state achieves revenue growth benchmarks set forth by the formula in G.L. chapter 62, section 4(b).¹

The trigger formula has two parts. First, the inflation adjusted growth in baseline tax revenues for the preceding fiscal year has to exceed 2.5 percentage points. The second trigger, completed on the 15th of each month between September and December, certifies that the inflation-adjusted growth in baseline tax revenues over the previous three months of the current calendar year compared to the same periods of the prior calendar year is greater than zero.

Adjusting our estimate now to reflect baseline revenues, BHI estimates that total state tax revenues would grow by 4.5 percent in FY 2017 over FY 2016. Baseline revenue measures growth absent any tax law or administrative changes that affected tax collections. Baseline growth also adjusts for fluctuations in the timing of tax collections.

To estimate inflation for FY 2017, we use the Congressional Budget Office (CBO) estimate for inflation for calendar year 2017. CBO estimates that the Consumer Price Index (CPI) will rise

¹ Massachusetts General Laws, Section 4: Rates of tax for residents, non-residents and corporate trusts <https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter62/Section4>.

by 1.8 percent.² Adjusting our FY 2017 forecast by inflation gives us a growth rate of 2.6 percent, which exceeds the first threshold of a 2.4 percent increase. Therefore, our estimate here would set off the first trigger.

The second trigger requires that revenue growth is positive in the three-month period prior to September, October and November in calendar year 2018. The BHI revenue forecast shows positive revenue growth over these periods, thus satisfying the second Income Tax Part B trigger. We present our revised forecast below:

- **\$26.4 billion in FY 2017, 4.5% over FY 2016, and**
- **\$27.7 billion in FY 2018, 4.9% over FY 2017.**

Table 1 Economic Forecasts for Massachusetts, 2016 through 2018						
Massachusetts (calendar year end)¹	Actual 2013	Actual 2014	Actual 2015	Forecast 2016	Forecast 2017	Forecast 2018
Gross State Product	415	425	440	454	463	470
% change p.a.	1.1	2.3	3.5	3.1	2.2	1.5
Personal income (\$ billion)	383	400	422	447	470	488
% change p.a.	1.7	4.3	5.5	6.0	5.1	3.9
Employment ('000)	3,359	3,414	3,482	3,546	3,594	3,619
% change p.a.	1.7	1.6	2.0	1.8	1.4	0.7
Unemployment rate, %	6.6	5.7	4.7	4.4	4.2	4.1
BHI forecast, MA taxes, (fiscal year)	Actual	Actual	Actual	Actual	Forecast	Forecast
Personal income tax (\$ million)	12,829	13,202	14,375	14,388	15,204	16,213
% change p.a.	7.7	2.9	8.9	0.1	5.7	6.6
Sales Tax	5164.0	5495.8	5774.5	6047.0	6,211	6,369
% change p.a.	2.1	6.4	5.1	4.7	2.7	2.5
Corporation Excise	1821.6	2049.0	2054.9	2158.7	2,274	2,430
% change p.a.	2.8	12.5	0.3	5.1	5.3	6.9
Business Excises	439	461	365	377	423	401
% change p.a.	(20.0)	5.0	(20.9)	3.3	12.2	(5.2)
Motor Fuels	652	732	756	766	785	801
% change p.a.	(1.6)	12.4	3.2	1.3	2.5	2.0
Total Taxes	22,121	23,369	24,717	25,267	26,405	27,689
% change p.a.	4.8	5.6	5.8	2.2	4.5	4.9

Notes: ¹ From New England Economic Partnership, Fall Economic Outlook, 2015.

²Congressional Budget Office, "10-Year Economic Projections: Projections of output, prices, labor market measures, interest rates, and income," from Budget and Economic Outlook and Updates <https://www.cbo.gov/about/products/budget-economic-data#4>.

Revenue forecasts, disaggregated, for FY17 and FY18, including technical estimation details

					% change					AR	MA	Vars/Dummies	Dates
	FY15	FY16	FY17	FY18	FY14	FY15	FY16	FY17	FY18				
Income tax													
Estimated payments	3,174	3,217	3,287	3,480	6.0%	15.0%	1.4%	2.2%	5.9%	1,2,5,12	3	PI, PIEST(-12)	79:6-16:08
Tax Withheld	11,063	11,422	12,202	12,920	4.9%	5.3%	3.2%	6.8%	5.9%	1,12	12	PI	79:6-16:08
Returns & Bills	2,183	2,042	2,214	2,365	-8.0%	12.4%	-6.5%	8.4%	6.8%	1,12	1,12	PI	79:6-16:08
Refunds	(2,045)	(2,293)	(2,499)	(2,551)	5.7%	1.9%	12.1%	9.0%	2.1%	1,2,12	1,3,12	PI	79:6-16:08
Income Net	14,375	14,388	15,204	16,213	2.9%	8.9%	0.1%	5.7%	6.6%				
Sales & Use taxes													
Sales & Use taxes	5,774	6,047	6,211	6,369	6.4%	5.1%	4.7%	2.7%	2.5%	4,12	1,13	C	79:6-16:08
Corporation Excise	2,055	2,159	2,274	2,430	12.5%	0.3%	5.1%	5.3%	6.9%	12	3,12	PI	79:6-16:08
Business Excises	365	377	423	401	5.0%	-20.9%	3.3%	12.2%	5.2%	12	3,12	C	79:6-16:08
Alcohol Beverages	80	83	85	88	1.9%	2.7%	3.4%	2.5%	4.3%	1,3,12	12	PI	79:6-16:08
Cigarettes	510	506	492	495	18.3%	-2.0%	-0.9%	-2.7%	0.7%	1,24	1, 12	83:7, 93:1, 96:10, 02:8, 08:7	79:6-16:08
Motor Fuels	756	766	785	801	12.4%	3.2%	1.3%	2.5%	2.0%	1,13	1,12	PI	79:6-16:08
Other taxes	802	942	932	974	18.9%	-3.4%	17.4%	-1.1%	4.5%	1,12	2,12	PI	79:6-16:08
Effect of Tax Law Changes				(83)									
Total Taxes	24,717	25,267	26,405	27,689	5.6%	5.8%	2.2%	4.5%	4.9%				

AR refers to Autoregressive lags used in the regression. MA refers to Moving Average lags used in the regression. "Dummies" gives starting dates of each Dummy variable used (e.g. 01:1 is a dummy that is set equal to 1 from January 2001 onwards and to 0 otherwise). "Dates" refers to period of data used in regression estimates." (PIEST)-12 refers to the income tax estimated payments data lagged by 12 month. PI refers to Personal Income and C, a Constant variable. We directly incorporated into our estimates the cigarette and motor fuels tax increases.