LEGISLATIVE FISCAL ESTIMATE
ASSEMBLY, No. 12
STATE OF NEW JERSEY
217th LEGISLATURE

DATED: JULY 1, 2016

SUMMARY

Synopsis: Increases petroleum products gross receipts tax, reduces sales and use tax and increases gross income tax pension and retirement income exclusion.

Type of Impact: Annual loss of revenue from the Property Tax Relief Fund; annual loss in General Fund revenue.

Agencies Affected: Department of the Treasury.

Office of Legislative Services Estimate

Fiscal Impact	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
State Revenue Loss:						
Sales and Use Tax (GF)	($376,000,000)	($1,161,000,000)	($1,594,000,000)	($1,642,000,000)	($1,691,000,000)	($1,742,000,000)
GIT Pensions (PTRF)	$0	($60,000,000) to ($90,000,000)	($70,000,000) to ($105,000,000)	($80,000,000) to ($120,000,000)	($85,000,000) to ($130,000,000)	($135,000,000) to ($193,000,000)
Total Loss in GF and PTRF	**($376,000,000)**	**($1,221,000,000) to ($1,251,000,000)**	**($1,664,000,000) to ($1,699,000,000)**	**($1,722,000,000) to ($1,762,000,000)**	**($1,776,000,000) to ($1,821,000,000)**	**($1,877,000,000) to ($1,935,000,000)**
State Revenue Gain:						
12.5% PPGR	$1,029,400,000	$1,106,900,000	$1,106,900,000	$1,106,900,000	$1,106,900,000	$1,106,900,000
7% Non-Motor	$31,100,000	$31,100,000	$31,100,000	$31,100,000	$31,100,000	$31,100,000
4 cent/gal Diesel	$29,700,000	$39,600,000	$39,600,000	$39,600,000	$39,600,000	$39,600,000
Total Gain from Fuels Taxes	**$1,090,200,000**	**$1,177,600,000**	**$1,177,600,000**	**$1,177,600,000**	**$1,177,600,000**	**$1,177,600,000**
Net Total State Revenue All Funds	**$714,200,000**	**($43,400,000) to ($73,400,000)**	**($486,400,000) to ($521,400,000)**	**($544,400,000) to ($584,400,000)**	**($598,400,000) to ($643,400,000)**	**($699,400,000) to ($757,400,000)**

Note: GIT is gross income tax. PTRF is Property Tax Relief Fund. GF is General Fund. PPGR is Petroleum Products Gross Receipts tax.

- The Office of Legislative Services (OLS) estimates this bill will significantly reduce sales and use tax and gross income tax revenues, while also significantly increasing certain fuels tax revenues. The net impact to total State revenues from these changes is estimated at a gain of $714,200,000 in FY 2017, reversing to a State revenue loss of between $43,400,000 to $73,400,000 in FY 2018, and increasing to an estimated revenue loss of between $699,400,000 to $757,400,000 in FY 2022.

- The revenue decreases will be phased in over time, starting with an estimated $376,000,000 loss in FY 2017 and rising to an estimated range of revenue losses between $1,877,000,000 to $1,935,000,000 in FY 2022.

- The revenue increases begin in FY 2017 with an estimated $1,090,200,000, stabilizing to an estimated $1,177,600,000 for FY 2018 and thereafter from the various fuels tax increases.

BILL DESCRIPTION

Assembly Bill No. 12 of 2016 bill adjusts various State taxes as follows:

The bill reduces the New Jersey sales and use tax rate from 7% to 6.5% on January 1, 2017 and to 6% on January 1, 2018. The bill includes special transition provisions for taxing sales transactions which in one way or another stretch across the tax change date (e.g., contractor purchases, installment purchases, leases, and goods or services with delayed delivery or payment).

The bill provides for increases in the petroleum products gross receipts tax rates, which, either by statutory or constitutional dedication, will finance funding for the State's transportation infrastructure.

Currently, the petroleum products tax is imposed at the rate of 2¾ percent on gross receipts from the first sale of petroleum products in New Jersey. In the case of motor fuels, aviation fuels, and heating fuels (home heating fuels are exempt) this rate is converted to $0.04 per gallon.

This bill increases the base rate on petroleum products, other than highway fuel and other than aviation fuel, to 7 percent of gross receipts, and increases the base rate on highway fuel to 12.5 percent of gross receipts.

The 12.5 percent tax on gasoline (which excludes aviation gasoline), gasoline equivalents and liquefied petroleum gas is converted to a cents-per-gallon rate based on the retail price of gasoline before the imposition of State and federal tax. The 12.5 percent tax on diesel fuel, diesel fuel equivalents and kerosene (other than aviation grade kerosene), is converted to a cents-per-gallon rate based on the retail price of number 2 diesel before tax. Initially, the diesel and kerosene rate will be zero; on and after January 1, 2017 it will be 70 percent of the 12.5 percent rate, and on and after July 1, 2017 it will be taxed at the 12.5 percent rate. These cents-per-gallon rates can be adjusted quarterly, but cannot fall below the rates determined for the quarter beginning July 1, 2016.

The bill provides a cap for the total tax on highway fuel, under the petroleum products gross receipts tax and the motor fuel tax. The State Treasurer and the Legislative Budget and Finance Officer calculate an amount based on actual sales data from FY2016 as if taxed at the new tax rates; the 2016 motor fuel tax collections of highway fuel, plus the four cents per gallon petroleum products tax now in effect, plus the 23 cents per gallon new imposition under the petroleum products tax. This is the highway fuel cap amount.

Each year from 2017 through 2026 the Treasurer, using U.S. Energy Administration projections for gasoline price and consumption in New Jersey and other data, determines what tax rate should be imposed under the petroleum products tax on highway fuel so that the revenues from the motor fuels tax on highway fuel, the 4 cent per gallon petroleum tax and the percentage rate petroleum tax will result in the State receiving the highway fuel cap amount for the fiscal year, and the new rate takes effect on October 1. The bill also has a "true-up" provision: if the rate is too high and the State overcollects, then in the next year the rate must be adjusted down to account for the overcollection, and if the State undercollects then the rate is increased to account for the undercollection.

The 7 percent tax on fuel oil is converted to a cents-per-gallon rate based on the pretax retail price of number 2 fuel oil. These rates can be adjusted quarterly, but cannot fall below the rates determined for the quarter beginning July 1, 2016.

Initially, the highway fuels will be subject to an additional cents-per-gallon rate of four cents. On and after July 1, 2017 the additional rate on diesel fuel and kerosene will be raised to eight cents per gallon.

Aviation fuel will be subject to a 4 cents per gallon tax, and taxation of common carriers in interstate and foreign commerce will be limited to the "burnout" portion, both of which are identical to practice under current law.

The bill increases the New Jersey gross income tax pension and retirement income exclusions fivefold over four years. This is intended to reduce the capacity of the State's personal income tax to diminish the after-tax retirement income available to retired taxpayers in this State.

Generally under current law, taxpayers with $100,000 or less of annual income, who are at least 62 years old, may claim a pension and retirement income exclusion of up to $20,000 for joint filers, $15,000 for individuals, and $10,000 for married but filing separately.

This bill increases the personal income tax's pension and retirement income exclusion to $100,000 for joint filers, $75,000 for individuals, and $50,000 for married but filing separately. The bill phases in the five-fold exclusion increase over four years as follows:

Filer Type	Present	2017	2018	2019	2020
Joint	$20,000	$40,000	$60,000	$80,000	$100,000
Individual	$15,000	$30,000	$50,000	$60,000	$75,000
Separate	$10,000	$20,000	$30,000	$40,000	$50,000

Currently, the pension and retirement income exclusions are not allowed to a taxpayer who has gross income of more than $100,000 for the taxable year. For taxable years beginning on or after January 1, 2021, the bill allows a taxpayer with income of more than $100,000 but not over $125,000 to exclude 50 percent of the amount of pension and retirement income otherwise allowed and a taxpayer with more than $125,000 but not more than $150,000 of gross income to exclude 25 percent of the amount otherwise allowed.

The bill establishes a three-member review council, composed of the State Treasurer, the Legislative Budget and Finance Officer, and a third public member selected by both. The review council will report to the Governor and the Legislature by January 15, 2020, on the council's consensus estimate of the increase or decrease in State revenues caused by each section of this bill during the three prior fiscal years compared to the estimates at the time of enactment.

The review council will monitor the actions of the Legislature on an ongoing basis for interference with the implementation of the provisions of the bill. If implementation is impeded, (by, for example, delaying a phase-in of an increased tax exclusion, freezing a scheduled rate reduction, or repealing one of the bill's provisions), the council will certify this interference to the Director of the Division of Taxation. This certification triggers the cessation of imposition of one of the components of the petroleum products gross receipts tax, and collection of that part of the tax ends.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS estimates this bill will significantly reduce sales and use tax and gross income tax revenues, while also significantly increasing certain fuels tax revenues. The net impact to total State revenues from these changes is estimated at a gain of $714,200,000 in FY 2017, reversing to a State revenue loss of between $43,400,000 to $73,400,000 in FY 2018, and increasing to an estimated revenue loss of between $699,400,000 to $757,400,000 in FY 2022. The revenue decreases will be phased in over time, starting with an estimated $376,000,000 loss in FY 2017 and rising to an estimated range of between $1,877,000,000 to $1,935,000,000 in FY 2022. The revenue increases begin in FY 2017 with an estimated $1,090,200,000, stabilizing to an estimated $1,177,600,000 for FY 2018 and thereafter from the various fuels tax increases. These estimates are discussed in greater detail below.

Sales and Use Tax (GF)

The OLS estimates this bill would reduce annual sales and use tax revenues deposited into the General Fund by $376 million in FY 2017, $1.161 billion in FY 2018, $1.594 billion in FY 2019, $1.642 billion in FY 2020, $1.691 billion in FY 2021, and $1.742 billion in FY 2022.

This estimate is based on OLS projections utilizing the Treasurer's revised revenue estimates for FY 2017, as presented to the Senate and Assembly budget committees in May 2016. The Treasurer estimated sales and use tax revenues of $9.597.4 billion, plus $164.2 million from the sales tax on energy, plus $753.5 million from the municipal share of the sales tax on energy, for total sales and use tax collections of $10.515 billion for FY 2017. Accordingly, each 1.0 cent of the current 7.0 cent sales and use tax is worth approximately $1.502 billion. In FY 2017, a six month revenue loss from a 0.5 cent tax reduction would equal an estimated $376.0 million.

In FY 2018, assuming revenue growth of 3.0%, the total revenue loss would equal approximately $1.161 billion, including $387 million attributable to the six month revenue loss from a 0.5 cent tax reduction plus the six month impact of a 1.0 cent tax reduction equal to approximately $774.0 million. FY 2019 would forego sales and use tax revenues equal to 12 months from a 1.0 cent tax rate decrease, or $1.594 billion. Thereafter, assuming continued annual growth of 3.0%, the FY 2020 revenue loss would increase to $1.642 billion, growing to $1.691 billion in FY 2021, and an estimated $1.742 billion by FY 2022.

The OLS also notes that the constitutionally required annual transfer of certain dedicated revenues from the sales and use tax to the Property Tax Relief Fund will be unaffected by the sales and use tax revenue reductions under this bill.

Gross Income Tax – Pension and Retirement Income (PTRF)

The OLS estimates the increase in the pension and retirement exclusion will yield a range of potential annual gross income tax revenue losses to the Property Tax Relief Fund. With the five-year phase-in period beginning on January 1, 2017, the bill may reduce FY 2018 revenues by between $60 million and $90 million, FY 2019 revenues by between $70 million and $105 million, FY 2020 revenues by between $80 million and $120 million, FY 2021 revenues by between $85 million and $130 million, and FY 2022 revenues by between $135 million and $193 million. Thereafter revenue losses may grow by between 3.0% and 4.0% annually.

Precise estimates are not possible, as the OLS is extrapolating from aggregate data using Division of Taxation's annual *Statistics of Income (SOI)* publication. This data does not allow for a detailed analysis of individual returns, nor an understanding of the interactions between gross income, pension and retirement income, and the statutory exclusion levels for individual returns. Using the SOI's aggregate data in broad income bands, the OLS estimates current pension and retirement income exclusion levels and then projects the potential exclusion increases under the bill.

The OLS notes that average pension income for senior returns in gross income brackets under $100,000 varies from approximately $18,000 at the lower income levels to about $45,000 at the higher income levels, based on SOI data. Most senior taxpayers do not receive enough pension and retirement income to claim an exclusion near the new maximum levels proposed under this bill. Accordingly, most of the estimated revenue loss from this bill will occur in the first step of the five-year phase-in, followed by smaller incremental increases in subsequent years as the majority of taxpayers with gross income under $100,000 will have maximized their exclusion amount, followed by a larger increase in the fifth year as taxpayer with gross income between $100,000 and $150,000 become eligible for a partial exclusion for the first time.

In comparison to the overall revenue losses estimated under this bill, the Division of Taxation's publication, *A Report on Tax Expenditures in New Jersey (February 2015)*, reports that the current gross income tax exclusion for pension income and other retirement income reduces State revenues by an estimated $125.5 million annually. While this bill will increase the current maximum exclusion levels fivefold, it is projected to less than double the estimated revenue loss under current law for taxpayers with gross income under $100,000. Few of these taxpayers will be able to claim an exclusion near the new maximum levels under this bill. Most such taxpayers will claim exemptions substantially below the proposed maximum levels, and some unknown number of taxpayers who already exempt all their pension and other retirement income under current law will see no benefit from this bill. Taxpayers with gross income between $100,000 and $150,000 will see a substantial tax benefit on income that is fully taxable under current law but will be partially excluded under the bill.

Lastly, while the OLS expects the preponderance of the fiscal impact to begin in FY 2018 when taxpayers file their final returns in April of 2018 for the 2017 Tax Year, some revenue reductions may occur in the Spring of FY 2017, to the extent that certain taxpayers adjust their quarterly estimated payments downward in April and June of 2017. The OLS has no data on the value of senior taxpayer's quarterly estimated payments, nor the extent to which such adjustments might occur, and is unable to project the size of this potential impact in FY 2017.

Motor Fuels and Petroleum Taxes

The increase in taxes imposed under the Petroleum Products Gross Receipts Tax (PPGRT) consists of three major components: (1) an increase in the tax rate on motor fuels by 12.5 percent with a gradual phase-in of the diesel component; (2) increasing the tax on non-motor fuels subject to the PPGRT from 2.75% to 7%; and (3) an increase in the tax on diesel fuels by 3 cents per gallon in the first year and 4 cents per gallon in future years. The estimated amounts for these four components are shown in the table below.

Estimated Impact of Various Fuels Tax Changes ***$ in Millions***						
	FY 2017	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
12.5% PPGR Tax	$1,029.4	$1,106.9	$1,106.9	$1,106.9	$1,106.9	$1,106.9
7% Tax on Non-Motor Fuels PPGR	$31.1	$31.1	$31.1	$31.1	$31.1	$31.1
4 Cent/gal Tax on Diesel PPGR	$29.7	$39.6	$39.6	$39.6	$39.6	$39.6
Total Fuel Taxes	**$1,090.2**	**$1,177.6**	**$1,177.6**	**$1,177.6**	**$1,177.6**	**$1,177.6**

These tax changes are expected to increase PPGRT revenue by $1.09 billion in FY 2017 and $1.18 billion per year for FY 2018 and beyond. The bill is structured in a manner that adjusts the cents-per-gallon 12.5% PPGRT tax rate annually to target the amount of revenue generated in FY 2016 when using 23 cents-per-gallon as the 12.5% cents-per-gallon equivalent. This will result in variation of the cents-per-gallon rate depending on the future total annual sales of products subject to the PPGRT. The volume of future consumption is highly uncertain due to increasing vehicle fuel efficiency, increasing adoption of alternative fuel vehicles, and slowing State population growth which accordingly makes the likely future tax rate uncertain as well. It is likely that changes in the consumption of fuels will require increases in the cents-per-gallon PPGRT tax rate, in order to ensure a level amount of revenue.

(1) The motor fuels subject to the PPGRT are likely to generate approximately $49.47 million per year for each cent-per-gallon imposed on motor fuels. This is consistent with revenues from the existing taxes on motor fuels. The 12.5% rate applied to the current average retail price of $1.79 after subtracting existing taxes, results in a cents-per-gallon rate of 22.375 cents. This results in revenues of $1.107 billion. The amount for FY 2017 needs to be reduced according to the phase in schedule for the diesel component. The distribution of motor fuel sales in the State is approximately 80% gasoline and 20% diesel. Applying that ratio to the phase in schedule and reducing the revenue accordingly nets a FY 2017 revenue of $1.029 billion.

(2) After multiplying the $49.47 million for each cent-per-gallon estimate of motor fuels by the existing 4 cents per gallon, the motor fuels component of the PPGRT is calculated to be $197.88 million. Subtracting that from the $218 million in total current PPGRT revenues, the non-motor fuel revenue is calculated to generate $20.12 million at the 2.75% rate. Using these same ratios, an increase to 7% is likely to generate an additional $31.1 million in additional revenue per year.

(3) Using the above motor fuel distribution and applying it to the $49.47 million per year revenue for each cent-per-gallon imposed on motor fuels results in $9.9 million per year in revenue per cent-per-gallon imposed on diesel fuel. As a result the FY 2017 revenue from this provision will generate $29.7 million at the 3 cents-per-gallon rate and $39.6 million in FY 2018 and beyond from the 4 cents-per-gallon rate.

Review Council

Lastly, the OLS notes that the legislation requires the review council, established in section 13 of the bill, to monitor the actions of the Legislature on an ongoing basis for interference with the implementation of the provisions of the bill. If implementation is impeded, (by, for example, extending a phase-in, freezing a phase-out at a particular level, or repealing one of the bill's provisions), the council would certify this interference to the Director of the Division of Taxation. This certification would in turn trigger the cessation of the imposition of one of the components of the petroleum products gross receipts tax comprising a portion of the non-motor fuels tax revenue under current law, and all of the fuels tax increases estimated above under the bill, except for the additional 4 cents per gallon of tax on diesel fuel to be imposed beginning July 1, 2017. In the event of such cessation, the projected State tax revenue impact estimated in this analysis would no longer apply.

Section: *Revenue, Finance, and Appropriations*

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This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).