LEGISLATIVE FISCAL ESTIMATE

[Second Reprint]

ASSEMBLY, No. 12

STATE OF NEW JERSEY
217th LEGISLATURE

DATED: OCTOBER 12, 2016

SUMMARY

Synopsis: Adjusts certain State taxes to support strengthened investments in public and private assets in this State.

Type of Impact: Annual loss of revenue from the Property Tax Relief Fund and the General Fund.

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:						
General Fund Sales & Use Tax	($92,400,000)	($382,200,000)	($592,800,000)	($613,900,000)	($633,800,000)	($655,400,000)
Estate Tax	($16,000,000)	($116,400,000)	($320,000,000)	($470,100,000)	($521,900,000)	($561,900,000)
PTRF Pensions	$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)	($87,550,000) to ($133,900,000)
Veterans' Exclusion	$0	($23,000,000)	($23,000,000)	($23,000,000)	($23,000,000)	($23,000,000)
EITC	($62,000,000)	($63,500,000)	($65,000,000)	($66,500,000)	($68,500,000)	($70,500,000)
Total Loss in GF and PTRF	**($170,400,000)**	**($645,100,000) to ($675,100,000)**	**($1,070,800,000) to ($1,105,800,000)**	**($1,253,500,000) to ($1,293,500,000)**	**($1,332,200,000) to ($1,377,200,000)**	**($1,398,350,000) to ($1,444,700,000)**
State Revenue Gain:						
12.5% PPGR	$694,120,000	$1,159,600,000	$1,159,600,000	$1,159,600,000	$1,159,600,000	$1,159,600,000
7% Non-Motor	$20,720,000	$31,100,000	$31,100,000	$31,100,000	$31,100,000	$31,100,000
4 cent/gal Diesel	$0	$39,600,000	$39,600,000	$39,600,000	$39,600,000	$39,600,000
Total Gain, Fuels Taxes	**$714,840,000**	**$1,230,300,000**	**$1,230,300,000**	**$1,230,300,000**	**$1,230,300,000**	**$1,230,300,000**
Net Total State Revenue All Funds	**$544,440,000**	**$585,200,000 to $555,200,000**	**$159,500,000 to $124,500,000**	**($23,200,000) to ($63,200,000)**	**($101,900,000) to ($146,900,000)**	**($168,050,000) to ($214,400,000)**

Note: GIT is gross income tax. PTRF is Property Tax Relief Fund. GF is General Fund. EITC is Earned Income Tax Credit. PPRG is Petroleum Products Gross Receipts tax.

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- The Office of Legislative Services estimates this bill will significantly reduce sales and use tax, estate 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 $544,440,000 in FY 2017, and a gain of between $555,200,000 and $585,200,000 in FY 2018. In FY 2019, a smaller net gain of between $124,500,000 and $159,500,000 is estimated. Thereafter, the OLS estimates that the bill will result in an annual net revenue decline of between $23,200,000 and $63,200,000 in FY 2020, rising to an estimated loss of between $168,050,000 and $214,400,000 by FY 2022.

- The revenue decreases will be phased in over time, starting with an estimated $170,400,000 loss in FY 2017 and rising to an estimated range of revenue losses between $1,398,350,000 and $1,444,700,000 in FY 2022.

- The revenue increases begin in FY 2017 with an estimated gain of $714,840,000 stabilizing to an estimated gain of $1,230,300,000 for FY 2018 and thereafter from the various fuels tax increases.

BILL DESCRIPTION

Assembly Bill No. 12 (2R) of 2016 bill adjusts various State taxes as follows:

- Sections 1 – 6: Reduce the rate of the New Jersey sales and use tax from 7% to 6.875% on January 1, 2017 and to 6.625% on January 1, 2018. The bill includes special transition provisions for taxing certain sales transactions that stretch across the tax rate change dates.

- Section 7: Phases out the New Jersey estate tax by increasing the tax exclusion threshold under the New Jersey estate tax, first by replacing the current $675,000 threshold with a "true" exclusion amount initially established at $2.0 million for decedents dying on or after January 1, 2017, and eliminating the estate tax for decedents dying on and after January 1, 2018.

- Section 8: Provides an annual personal exemption under the New Jersey gross income tax of $3,000 for any individual New Jersey gross income taxpayer who is a veteran honorably discharged or released under honorable circumstances from active duty in the Armed Forces of the United States, a reserve component thereof, or the National Guard of New Jersey in a federal active duty status.

- Sections 9 – 10: Increases the gross income tax 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 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	$45,000	$60,000	$75,000
Separate	$10,000	$20,000	$30,000	$40,000	$50,000

The bill retains provisions in current law that exclude taxpayers having gross income of more than $100,000 for the taxable year from receiving the benefit of the pension and retirement income exclusions.

- Section 11: Increases the New Jersey Earned Income Tax Credit (NJ EITC) from 30 percent to 35 percent of the federal benefit amount beginning in Tax Year 2016.

- Sections 12 – 18: Increases the petroleum products gross receipts tax rates, which, either by statutory or constitutional dedication, will finance funding for the State's transportation infrastructure.

- Section 19: Establishes a three-member review council to report to the Governor and the Legislature on the council's consensus estimate of the increase or decrease in State revenues caused by each section of this bill, and to monitor the actions of the Legislature on an ongoing basis for modification of the implementation of the bill's tax changes.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS estimates this bill will significantly reduce sales and use tax, estate 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 $544,440,000 in FY 2017, and a gain of between $555,200,000 and $585,200,000 in FY 2018. In FY 2019, a smaller net gain of between $124,500,000 and $159,500,000 is estimated. Thereafter, the OLS estimates that the bill will result in an annual net revenue decline of between $23,200,000 and $63,200,000 in FY 2020, rising to an estimated loss of between $168,050,000 and $214,400,000 by FY 2022. The revenue decreases will be phased in over time, starting with an estimated $170,400,000 loss in FY 2017 and rising to an estimated range of revenue losses between $1,398,350,000 and $1,444,700,000 in FY 2022. The revenue increases begin in FY 2017 with an estimated gain of $714,840,000 stabilizing to an estimated gain of $1,230,300,000 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 will reduce annual sales and use tax revenues deposited into the General Fund by $92.4 million in FY 2017, $382.2 million in FY 2018, $592.8 million in FY 2019, $613.9 million in FY 2020, $633.8 million in FY 2021, and $655.4 million in FY 2022.

This estimate is based on OLS extrapolations from the Governor's certified revenue estimates for FY 2017. The certification estimated sales and use tax revenues of $9.597 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 1/8th of a cent of the current 7.0 cent sales and use tax is worth about $186.0 million.

In FY 2017 the sales and use tax revenue loss from a 1/8th cent tax decrease for six months would equal an estimated $92.4 million. Assuming annual sales tax revenue growth between 3.0% and 3.5%, and an additional 2/8ths cent tax rate decrease on January 1, 2018, revenues would decline by $382.2 million in FY 2018, by $592.8 million in FY 2019, by $613.9 million in FY 2020, by $633.8 million in FY 2021, and the revenue loss would increase to an estimated $655.4 million in FY 2022.

Estate Tax (GF)

The OLS estimates the elimination of the estate tax in two steps by January 1, 2018 and the incorporation of a "true" exclusion amount for estates below the applicable exclusion amounts, will reduce annual estate tax revenues deposited into the General Fund by $16.0 million in FY 2017, $116.4 million in FY 2018, $320.0 million in FY 2019, $470.1 million in FY 2020, $521.9 million in FY 2021, and $561.9 million in FY 2022. The amount of revenue forgone will continue to change with the value of estates.

Given that estates typically take nine months to complete the tax filing process, this bill would have a relatively small fiscal impact in FY 2017. Significant impacts would begin in FY 2018 and would be fully phased-in over subsequent years. The OLS estimates the annual revenue loss at each step of the process as follows:

Estimated Impact of Estate Tax Change			
Fiscal Year	**Est. Estate Tax Revenue Current Law**	**Est. Estate Tax Revenue Under Bill**	**Est. Revenue Loss Under Bill**
2017	$464,000,000	$448,000,000	$16,000,000
2018	$485,000,000	$368,600,000	$116,400,000
2019	$507,000,000	$187,000,000	$320,000,000
2020	$530,000,000	$59,900,000	$470,100,000
2021	$554,000,000	$32,100,000	$521,900,000
2022	$579,000,000	$17,100,000	$561,900,000
After 2022	The amount of revenue forgone will continue to change with the value of estates.		

These estimates are based on Treasury data from FY 2014, the most recent year for which OLS has tax collections data by size of estate, during which the estate tax accounted for $320.0 million in revenue. In the two most recent years, FY 2014 and FY 2015, total estate and inheritance taxes increased by 10% and 15% respectively, while growth over the last five completed years has averaged about 7%. The OLS assumes annual growth in future years of 4.5%. For the phase-in years, the OLS applied the annual growth to estate tax amounts at the different levels of the value of estates, as detailed in the Treasury data. In addition, the OLS estimated the impact of eliminating the "bump" below the "true" exclusion amounts using the number of estates at each level applied to the tax table amounts from the Division of Taxation's estate tax worksheet.

Data from the Department of the Treasury indicate that this bill, once fully implemented, would eliminate the estate tax on approximately 3,500 estates annually. This number equals about 5% of the approximately 70,000 deaths reported by the Department of Health each year in the State.

The OLS notes that the estate tax is a volatile revenue source. Much of that volatility reflects assets such as stocks, which can see sharp increases and decreases in value, as measured by the major stock indexes such as the Standard and Poor's 500 index. Accordingly, a prolonged or severe "bear" or "bull" market could indicate subsequent downward or upward volatility in the potential value of the forgone revenues under this bill. In addition, there may be some remnant of estate tax revenue received over a number of fiscal years to the extent that some estates may face longer delays in filings and processing.

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, and FY 2021 revenues by between $85 million and $130 million. For FY 2022 and thereafter revenue losses may grow by about 3.0% 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.

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 to five times the current limit, 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.

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 taxpayers' 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.

Gross Income Tax – Veterans' Exclusion (PTRF)

The OLS estimates the $3,000 exclusion for certain veterans under this bill may reduce GIT revenues by an estimated $23,000,000 annually. The State's published gross income tax statistics do not reveal how many veterans currently face a GIT liability each year, so the potential number of taxpayers who may benefit from this additional personal exemption is unknown. However, a $3,000 personal exemption may provide an average tax benefit of $105.00 when assuming an average marginal tax rate of 3.50%. According to the federal Department of Veterans Affairs, there were 428,396 living veterans in New Jersey in 2014. A majority of senior citizens do not have an annual New Jersey GIT liability; about 55% of New Jersey veterans are age 65 or older. Low income joint filers with less than $20,000 gross income ($10,000 for single or separate filers) also do not owe State GIT. Accordingly, it is possible that more than half of all New Jersey veterans do not currently have a State GIT liability and would therefore not gain a tax benefit from the $3,000 veterans exemption under this bill. Assuming about 220,000 veterans currently have a State GIT liability and would therefore gain an estimated average tax benefit of $105.00 from a $3,000 personal exemption, the potential tax savings, or potential State revenue loss, may equal about $23,000,000 annually beginning in FY 2018.

Gross Income Tax – Earned Income Tax Credit (PTRF)

The OLS estimates that the Earned Income Tax Credit (EITC) portion of this bill may reduce gross income tax revenues deposited into the Property Tax Relief Fund by about $62.0 million in FY 2017, $63.5 million in FY 2018, $65.0 million in FY 2019, $66.5 million in FY 2020, $68.5 million in FY 2021, and $70.5 million in FY 2022. In future years, growth of about 2.0 percent per year may continue.

The NJ EITC is a refundable credit based on the federal EITC and is paid to eligible taxpayers through the State's gross income tax. The OLS estimate begins with the Executive's assessment that the recent increase of the NJ EITC, from 20 percent to 30 percent of the federal credit (P.L. 2015, c.73), would reduce gross income tax revenues by $122.0 million in FY 2016, as reported on pages 30 and 33 in the FY 2017 Budget Summary. The increase under this bill, from 30 percent of the federal credit to 35 percent, is projected to have approximately half the incremental impact as the previously enacted increase. Historically, the federal credit amounts have grown by approximately 2.0 percent annually, but recent Internal Revenue Service preview data indicate the value of federal credits may grow by less than 1.0 percent in 2016. Lower levels of growth in the federal benefit, combined with the New Jersey Division of Taxation's recent enhanced enforcement efforts, suggests growth in the State program may be contained in FY 2017, the first year of impact under this bill. Accordingly, the OLS assumes a revenue loss of $62.0 million in FY 2017 with low growth annually thereafter.

Based on available federal Internal Revenue Service preview data, it is estimated that under the bill, the average NJ EITC benefit amount will increase by about $128, from $708 in TY 2015 to approximately $836 in TY 2016. According to the New Jersey Department of the Treasury, it is estimated that some 552,900 taxpayers claimed a credit during TY 2014, the most recent year for which data are available. It is noted, however, that the number of taxpayers receiving an EITC in recent years has experienced some variance due in part to the Division of Taxation's enforcement efforts.

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 12.85 percent with a 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 4 cents per gallon in in FY 2018 and beyond. The estimated amounts for these components are shown in the table below.

Estimated Impact of Various Petroleum Products Tax Changes *$ in Millions*						
	FY 2017	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
12.85% PPGR Tax	$694.1	$1,159.6	$1,159.6	$1,159.6	$1,159.6	$1,159.6
7% Tax on Non-Motor Fuels PPGR	$20.7	$31.1	$31.1	$31.1	$31.1	$31.1
4 Cent/gal Tax on Diesel PPGR	$0	$39.6	$39.6	$39.6	$39.6	$39.6
Total Fuel Taxes	**$714.8**	**$1,230.3**	**$1,230.3**	**$1,230.3**	**$1,230.3**	**$1,230.3**

These tax changes are expected to increase PPGR revenue by about $714.8 million in FY 2017, assuming eight months of collections, and about $1.23 billion per year for FY 2018 and beyond. The bill is structured in a manner that adjusts the cents-per-gallon 12.85% PPGRT tax rate annually to target the amount of revenue generated in FY 2016 when using 23 cents-per-gallon on gasoline as the 12.85% 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 12.85% rate applied to the current average retail price of $1.79 for gasoline after subtracting existing taxes, results in a cents-per-gallon rate of 23 cents. This results in revenues of $1.16 billion. The amount for FY 2017 needs to be reduced according to the phase-in schedule for the diesel component and due to only eight months of tax collections in FY 2017. 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 $694.1 million over eight months.

(2) 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 FY 2016 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. The FY 2017 $20.7 million amount reflects eight months of collections.

(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 additional 4 cents-per-gallon

rate above the existing 4 cents-per-gallon rate imposed by the PPGRT will generate $39.6 million beginning in FY 2018.

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 revisions to 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 action 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 legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

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