

TESTIMONY PREPARED FOR PRESENTATION TO THE  
ASSEMBLY BUDGET COMMITTEE  
CATHERINE Z. BRENNAN  
OFFICE OF LEGISLATIVE SERVICES  
APRIL 5, 2017

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

AS YOU KNOW, EACH YEAR, FOLLOWING THE GOVERNOR'S BUDGET MESSAGE, THE OFFICE OF LEGISLATIVE SERVICES (OLS) PREPARES AN INDEPENDENT ANALYSIS OF THE MAJOR TAX REVENUES AVAILABLE FOR APPROPRIATION FOR THE BALANCE OF THE CURRENT FISCAL YEAR AS WELL AS NEXT FISCAL YEAR.

BEFORE YOU IS A COPY OF OUR "TAX AND REVENUE OUTLOOK." THIS REPORT WAS PREPARED BY THE REVENUE, FINANCE AND APPROPRIATIONS SECTION OF OLS IN COLLABORATION WITH THE LEGISLATIVE BUDGET AND FINANCE OFFICE. IN ADDITION TO CONTAINING OUR REVISED REVENUE ESTIMATES FOR FY 2017, AS WELL AS OUR PRELIMINARY REVENUE PROJECTIONS FOR FY 2018, THIS YEAR'S PUBLICATION INCLUDES A NUMBER OF BACKGROUND PAPERS AUTHORED BY REVENUE SECTION STAFF WHICH WE HOPE YOU WILL FIND USEFUL. TOPICS INCLUDE A RESTATEMENT OF THE FISCAL IMPACT OF THE 2016 TAX REVISIONS; THE POTENTIAL REVENUE IMPACT OF THE FCC BROADCAST AUCTION; AN UPDATE ON CBT TAX CREDIT AWARDS; TRENDS IN TAXPAYER OUT-MIGRATION AND A HISTORY OF THE RECIPROCAL TAX AGREEMENT BETWEEN PENNSYLVANIA AND NEW JERSEY.

IN DETERMINING THE REVENUE ESTIMATES WE ARE PRESENTING TO YOU THIS MORNING, WE HAVE RELIED ON A REVIEW OF CURRENT STATE REVENUE COLLECTIONS, HISTORICAL REVENUE PATTERNS, REVISIONS TO STATUTORY LAW, A VARIETY OF ECONOMIC DATA AND FORECASTS, REVENUE TRENDS IN OTHER STATES, AS WELL AS OUR PROFESSIONAL JUDGMENT. AND WHILE

WE DO OUR BEST TO MINIMIZE ERRORS IN THE PREPARATION OF OUR FORECASTS, REVENUE ESTIMATING IS AN INHERENTLY RISK PRONE ENTERPRISE. OLS CONSIDERS A RANGE OF POSSIBILITIES FOR EACH OF THE MAJOR TAXES, AND CALCULATES THE REVENUE OUTCOMES THAT WOULD RESULT USING VARIOUS ASSUMPTIONS BEFORE ARRIVING AT ESTIMATES WE BELIEVE REFLECT THE MOST LIKELY SCENARIO.

AT THE OUTSET, THE GOOD NEWS IS THAT, IN THE AGGREGATE, OVER THE CURRENT AND NEXT FISCAL YEAR, THE DIFFERENCE BETWEEN OUR ESTIMATES AND THOSE OF THE EXECUTIVE REPRESENTS LESS THAN ONE PERCENT OF BUDGETED REVENUES, WITH THE OLS FORECAST SOMEWHAT BELOW THE EXECUTIVE. THE NOT SO GOOD NEWS IS THAT, SINCE WE APPEARED BEFORE THE COMMITTEE IN DECEMBER TO REPORT MID-YEAR WEAKNESS IN COLLECTIONS, REVENUES HAVE CONTINUED TO TRAIL THE GOVERNOR'S CERTIFICATION. ACCORDINGLY, AFTER ADJUSTING FOR THE HIGHER PETROLEUM PRODUCTS GROSS RECEIPTS TAX RATES ENACTED LAST FALL, BOTH THE EXECUTIVE AND OLS HAVE REVISED AGGREGATE GROWTH EXPECTATIONS FOR FISCAL 2017 DOWNWARD.

BEFORE DIVING INTO THE DETAILS OF OUR FORECAST, FOR WHATEVER REASSURANCE IT MIGHT PROVIDE, NEW JERSEY'S REVENUE PERFORMANCE APPEARS TO BE MIRRORING **NATIONAL TRENDS**. OVER THE LAST TWO QUARTERS OF 2016, THE MAJORITY OF STATES HAVE EXPERIENCED A SOFTENING OF STATE TAX COLLECTIONS, AND ARE PROJECTING REVENUE GROWTH IN THE BIG THREE TAXES--THAT IS INCOME, SALES AND CORPORATE INCOME --ON PAR WITH THE CAUTIOUS OUTLOOK WE WILL BE PRESENTING TODAY.

OVER THE TWO FISCAL YEARS COMBINED – FY 2017 AND FY 2018 - THE **AGGREGATE OLS ESTIMATES** ARE \$436.2 MILLION BELOW THE EXECUTIVE'S FORECAST, A DIFFERENCE OF 0.6% (SIX-TENTHS OF ONE PERCENT) OVER THE TWO FISCAL YEARS. HOWEVER, GIVEN THE EXECUTIVE'S DOWNWARD REVISION OF \$248.0 MILLION IN THE CURRENT YEAR, IF OLS'S REVISED

ESTIMATE FOR FY 2017 IS CORRECT (AND OUR ESTIMATE IS \$223.3 MILLION BELOW THE EXECUTIVE'S), REVENUES WILL FALL \$471.0 MILLION BELOW THE GOVERNOR'S CERTIFICATION, OR ABOUT 1.4% BELOW EXPECTATIONS THIS YEAR. AND WHILE FROM A FORECASTING PERSPECTIVE, SUCH A RELATIVELY SMALL PERCENTAGE SHORTFALL MIGHT BE ACCEPTABLE, FOR THOSE WITH THE RESPONSIBILITY OF CRAFTING A BUDGET, PARTICULARLY A BUDGET THAT ASSUMES ONLY A MODEST SURPLUS, THE DIFFERENCES ARE MEANINGFUL.

IN FY 2017, THE OLS ESTIMATE OF \$13.8 BILLION FOR THE **GROSS INCOME TAX** IS \$140.3 MILLION BELOW THE EXECUTIVE'S ESTIMATE, REPRESENTING 2/3RDS OF THE DIFFERENCE BETWEEN OLS AND THE EXECUTIVE IN THE CURRENT YEAR. THE OLS TARGET FOR THE GIT ASSUMES 3.3% GROWTH FOR THE YEAR, WHILE THE EXECUTIVE'S TARGET ASSUMES 4.4% GROWTH. BOTH ESTIMATES ARE MODEST BY HISTORICAL STANDARDS, BUT BOTH REQUIRE IMPROVEMENT FROM WHAT THE OLS CONCLUDES IS A WEAK UNDERLYING GROWTH RATE OF JUST 0.8% (EIGHT-TENTHS OF ONE PERCENT) THROUGH FEBRUARY. BY OUR CALCULATIONS, THE GIT, WHICH APPEARS TO BE GROWING AT A RATE OF 8.7% THROUGH THE FIRST EIGHT MONTHS OF FY 2017, HAS BEEN ARTIFICIALLY ENHANCED BY A DELAY OF ABOUT \$400 MILLION IN TAXPAYER REFUND PAYMENTS, AND AN ACCELERATED TRANSFER, FROM THE CBT, OF CERTAIN OUT-OF-STATE PARTNERSHIP WITHHOLDING RECEIPTS, WORTH ABOUT \$207 MILLION. AFTER ADJUSTING THE GIT DOWNWARD BY \$607 MILLION FOR THESE TWO FACTORS, THE WEAK UNDERLYING GIT TREND PROVIDES GROUNDS FOR CAUTION.

THAT SAID, GAINS IN THE FINANCIAL MARKETS AT THE END OF LAST YEAR, COUPLED WITH SOME IMPROVEMENT IN THE DECEMBER AND JANUARY ESTIMATED PAYMENTS MADE BY HIGH-INCOME TAXPAYERS (WHICH WERE UP 5.3%) PROVIDE SOME ENCOURAGEMENT FOR IMPROVEMENT IN THE GIT THIS SPRING OVER THE FIRST TWO-THIRDS OF THE FISCAL YEAR. WE CONSIDER THE OLS ESTIMATE TO BE IN THE MIDDLE OF THE RANGE OF

POSSIBLE GIT OUTCOMES, WITH THE EXECUTIVE'S HIGHER ESTIMATE CLOSER TO THE UPPER END OF THAT RANGE. TEMPERING OLS'S EXPECTATIONS FOR A ROBUST APRIL ARE CONCERNS ABOUT HOW TAXPAYER BEHAVIOR MIGHT HAVE BEEN INFLUENCED AT THE END OF CALENDAR YEAR 2016 BY DISCUSSIONS OF FUTURE FEDERAL TAX REDUCTIONS FOLLOWING NOVEMBER'S ELECTION RESULTS, WHICH SOME ANALYSTS BELIEVE MIGHT HAVE DEFERRED AS MUCH AS 10 TO 20 PERCENT OF CAPITAL GAINS FROM 2016 INTO 2017. THUS, OLS ASSUMES STRONG, BUT NOT SPECTACULAR GROWTH IN APRIL. COUPLING THIS ASSUMPTION WITH THE EXPECTATION THAT REFUNDS WILL RETURN TO A MORE NORMAL PATTERN, YIELDS THE OLS ASSUMPTION OF 3.3% GROWTH FOR THE GIT FOR FY 2017.

FOR FY 2018, THE DIFFERENCE BETWEEN THE EXECUTIVE AND THE OLS ESTIMATES FOR THE GIT IS NEGLIGIBLE--JUST \$15 MILLION--AS OUR DIFFERING ASSUMPTIONS REGARDING GROWTH IN THE GIT COMPONENTS SMOOTH OUT OVER THE TWO YEARS. THUS, WHEREAS THE EXECUTIVE'S FY 2017 ASSUMPTION DEPENDS UPON GREATER IMPROVEMENT IN ONE OR MORE OF THE GIT COMPONENTS IN THE REMAINING MONTHS OF THIS FISCAL YEAR, OLS IS FORECASTING STRONGER GROWTH NEXT FISCAL YEAR. WHILE THE EXECUTIVE ASSUMES OVERALL GROWTH OF 3.5% FOR FY 2018, THE OLS ASSUMES 4.5% GROWTH IN THE BELIEF THAT TAXPAYERS SHIFTED CERTAIN INCOME BETWEEN FISCAL YEARS, WHICH WILL RESULT IN CONTINUED POSITIVE GROWTH (8.0%) IN ESTIMATED QUARTERLY PAYMENTS AND FINAL PAYMENTS NEXT YEAR. MOREOVER, THE OLS IS ASSUMING THAT WITHHOLDING RECEIPTS, WHICH ACCOUNT FOR APPROXIMATELY 3/4RDS OF ALL GIT COLLECTIONS, WILL GROW FROM 2.5% TO 3.5% NEXT YEAR DUE TO EXPECTATIONS OF HIGHER WAGES FROM A TIGHTENING LABOR MARKET.

WITH RESPECT TO OUR SECOND LARGEST MAJOR TAX RESOURCE, THE SALES TAX, THE OLS IS, RELATIVELY SPEAKING, LARGELY IN AGREEMENT WITH THE EXECUTIVE FOR FY 2017 AND FY 2018 COMBINED, WITH THE OLS \$55.3 MILLION ABOVE THE EXECUTIVE THIS YEAR, BUT \$65.7 MILLION

BELOW THE EXECUTIVE NEXT YEAR. WHILE GROWTH IN SALES TAX COLLECTIONS YEAR TO DATE HAS BEEN MODEST AT 2.2%, REVENUE GROWTH FOR THE REMAINDER OF THE CURRENT YEAR AND NEXT FISCAL YEAR WILL BE DEPRESSED BY THE IMPACT OF THE RECENTLY ENACTED TWO-STEP REDUCTION IN THE TAX RATE, FROM 7.0% TO 6.875% ON JANUARY 1, 2017 AND TO 6.625% ON JANUARY 1, 2018. THE OLS HAS ESTIMATED THE IMPACT OF THE RATE REDUCTIONS TO DECREASE COLLECTIONS BY APPROXIMATELY \$92.0 MILLION THIS YEAR AND BY AN ADDITIONAL \$290.0 MILLION NEXT FISCAL YEAR. AS A RESULT, THE OLS PROJECTS UNDERLYING GROWTH IN COLLECTIONS TO BE REDUCED FROM 2.6% TO 1.6% THIS FISCAL YEAR, AND FROM 3.6% TO 0.4% (4-TENTHS OF ONE PERCENT) IN THE OUT-YEAR.

MOVING ON TO THE CORPORATION BUSINESS TAX (CBT), AS OUR OFFICE HAS SUGGESTED FOR A NUMBER OF YEARS NOW, THE CBT IS AMONG THE MOST DIFFICULT REVENUES TO FORECAST EACH YEAR. COLLECTIONS TYPICALLY INCLUDE BOTH PAYMENTS AND REFUNDS FROM MULTIPLE TAX YEARS AND ARE INFLUENCED BY CORPORATE ACCOUNTING PRACTICES WHICH WE CAN'T ANTICIPATE. COMPLICATING OUR CBT ESTIMATES IS THE IMPACT OF CBT TAX CREDITS. ALTHOUGH THE DIVISION OF TAXATION ESTIMATES THE VALUE OF THE VARIOUS TAX CREDITS AWARDED BY FISCAL YEAR IN ITS ANNUAL TAX EXPENDITURE REPORT, THESE PROJECTIONS ARE DIFFICULT TO TIE DIRECTLY TO ANNUAL CBT REVENUE FORECASTS, AS THE AMOUNTS AWARDED MAY BE DELAYED OR ADJUSTED. HOWEVER, WHAT WE DO ASSUME, IS THAT THESE CREDITS ACT TO DEPRESS GROWTH IN COLLECTIONS.

CBT COLLECTIONS THROUGH THE FIRST EIGHT MONTHS OF THE FISCAL YEAR, ARE RUNNING 13.0% BELOW LAST YEAR. HOWEVER, AS NOTED IN THE EARLIER DISCUSSION ON THE GIT, THE CBT'S YEAR TO DATE DECLINE IS DUE TO THE ACCELERATED TRANSFER OF OUT-OF-STATE PARTNERSHIP PAYMENTS TO THE GIT. ADJUSTING FOR THIS FACTOR, UNDERLYING CBT GROWTH IS UP 5.4% IN THE CURRENT YEAR. HOWEVER, WHILE POSITIVE,

THIS AMOUNT CURRENTLY STANDS BELOW THE CERTIFIED GROWTH RATE OF 7.6%. THUS ALTHOUGH THE EXECUTIVE HAS NOT ADJUSTED ITS ESTIMATE FOR FY 2017, GIVEN THE CURRENT TREND, THE OLS HAS REVISED ITS EXPECTATIONS FOR THE CBT DOWNWARD THIS YEAR, AND IS ALSO ASSUMING GROWTH BELOW THE 5.0% ANTICIPATED BY THE EXECUTIVE NEXT FISCAL YEAR. THUS, OVER THE TWO FISCAL YEARS, THE OLS ESTIMATE FOR THE CBT IS \$165.5 MILLION BELOW THE EXECUTIVE.

NEXT, I HAVE THE RARE TASK OF DISCUSSING A TAX WHICH USUALLY DOESN'T GARNER ATTENTION AT THESE HEARINGS, THE **INSURANCE PREMIUMS TAX**. OVER THE TWO FISCAL YEARS COMBINED, THE OLS ESTIMATE FOR THIS TAX IS \$149.6 MILLION BELOW THE EXECUTIVE'S ESTIMATES, INCLUDING \$65.5 MILLION THIS FISCAL YEAR AND \$84.1 MILLION NEXT FISCAL YEAR. THIS REVENUE, WHICH IS DERIVED FROM NET PREMIUMS COLLECTED BY INSURANCE COMPANIES TRANSACTING BUSINESS IN THIS STATE, IS DUE IN MARCH AND JUNE OF EACH YEAR. WHAT WE KNOW TO DATE IS THAT A \$22 MILLION REFUND BOOKED IN SEPTEMBER KEPT CASH COLLECTIONS THROUGH EARLY JANUARY VERY LOW, WHICH THE EXECUTIVE APPEARS TO HAVE INCORPORATED INTO ITS REVISED FY 2017 ESTIMATE. HOWEVER, WITH MARCH PAYMENTS NOW REALIZED, IT IS CLEAR THIS TAX IS BELOW CERTIFIED EXPECTATIONS. WE SUSPECT THE DIFFERENCE BETWEEN OUR REVISED NUMBER AND THE EXECUTIVE'S WILL BE MINIMIZED WHEN WE BOTH COME BACK BEFORE THE COMMITTEES IN MAY, AS OLS HAS HAD THE BENEFIT OF AN ADDITION MONTH OF COLLECTIONS FOR ITS REVIEW COMPARED TO THE EXECUTIVE, WHICH SETTLED ON ITS ESTIMATES AT THE TIME OF THE GOVERNOR'S BUDGET MESSAGE, BEFORE THIS TAX'S IMPORTANT MARCH RECEIPTS.

FINALLY, I WOULD LIKE TO CALL TO YOUR TO ATTENTION THE REMAINING TAXES IMPACTED BY THE 2016 TAX LAW REVISIONS UNDER C.57, THE **PETROLEUM PRODUCTS GROSS RECEIPTS TAX (PPGRT)** AND THE **ESTATE TAX**.

AS YOU KNOW, TAXES ON PETROLEUM PRODUCTS WAS SUBSTANTIALLY AMENDED UNDER C.57 TO GENERATE NEW REVENUES FOR TRANSPORTATION TRUST FUND PURPOSES. THESE REVENUES ARE NOW ALLOCATED, PURSUANT TO VOTER APPROVAL, BETWEEN WHAT IS IDENTIFIED IN THE BUDGET AS "PPGRT CAPITAL RESERVES" FOR DEDICATED TRANSPORTATION PROJECTS, AND THE GENERAL FUND FOR THE SUPPORT OF TRANSPORTATION DEBT SERVICE.

LAST JUNE, THE GOVERNOR'S CERTIFICATION ASSUMED PETROLEUM PRODUCTS REVENUES OF \$218.1 MILLION. AS REVISED, THE EXECUTIVE NOW ANTICIPATES \$939.0 MILLION FROM PETROLEUM TAXES FOR THE CURRENT FISCAL YEAR, INCLUDING THE IMPACT, OVER EIGHT MONTHS, OF THE TAX RATE INCREASES WHICH TOOK EFFECT ON NOVEMBER 1. FOR FY 2018, THE EXECUTIVE ESTIMATES PPGRT REVENUES WILL INCREASE TO \$1.458 BILLION, UP 55.3% YEAR OVER YEAR, REFLECTING A FULL YEAR OF TAX IMPLEMENTATION. THE OLS CONCURS WITH THE EXECUTIVE'S ESTIMATES FOR FY 2017 AND FY 2018 BASED ON THE COLLECTIONS REPORTED FOR DECEMBER, JANUARY AND FEBRUARY, WHICH ARE PERFORMING CLOSE TO EXPECTATIONS ASSUMED AT THE TIME C.57 WAS ENACTED.

LASTLY, **STATE INHERITANCE TAX COLLECTIONS** DERIVE FROM TWO TAXES, THE TRANSFER INHERITANCE TAX AND THE ESTATE TAX, EACH OF WHICH, HISTORICALLY, PRODUCES ROUGHLY HALF OF THE TOTAL REVENUE STREAM. WHILE C.57 ELIMINATES THE ESTATE TAX OVER TWO TAX YEARS, COLLECTIONS WILL PHASE DOWN OVER A NUMBER OF FISCAL YEARS AS ESTATES ARE SETTLED. THUS, THE INITIAL IMPACT OF THE FIRST STEP OF THE TAX REVISIONS WILL BE RELATIVELY SMALL IN THE CURRENT FISCAL YEAR, AS ESTATES HAVE NINE MONTHS TO SUBMIT THEIR RETURNS.

IT APPEARS THAT LARGELY BASED ON YEAR-TO-DATE TREND, THE EXECUTIVE HAS DECREASED ITS ESTIMATE FOR COMBINED INHERITANCE TAX COLLECTIONS BY 8.5% BELOW FY 2016, FROM \$848.5 MILLION CERTIFIED

LAST JUNE TO \$703.9 MILLION THIS FISCAL YEAR, AND IS ASSUMING A FURTHER DECLINE OF 6.6% IN FY 2018. IN CONTRAST, OVER THE TWO FISCAL YEARS, THE OLS ANTICIPATES INHERITANCE TAX REVENUES WILL BE \$91.5 MILLION ABOVE THE EXECUTIVE'S ESTIMATE. FOR FY 2017, THE OLS ESTIMATE INCORPORATES A SMALLER DECREASE IN COLLECTIONS YEAR OVER YEAR, IN LINE WITH THE CURRENT YEAR TO DATE DECREASE OF 5.6%. FOR FY 2018, THE OLS ESTIMATE ASSUMES UNDERLYING GROWTH IN BOTH THE TRANSFER INHERITANCE TAX AND THE ESTATE TAX OF 10%, SPURRED BY STRONG RECENT GROWTH IN ASSET VALUES. HOWEVER, THAT GROWTH IS THEN LARGELY OFFSET BY AN ESTIMATED \$73.0 MILLION REDUCTION FROM THE ELIMINATION OF THE ESTATE TAX, AS THE PHASE-IN BEGINS TO HAVE REAL IMPACT.

THE "TAX AND REVENUE OUTLOOK" THAT YOU HAVE BEFORE YOU EXPANDS UPON THE POINTS I HAVE SUMMARIZED AND DISCUSSES THE MAJOR TAX REVENUE SOURCES IN GREATER DETAIL. IN ADDITION, THE OLS IS PROJECTING SMALL UPWARD AND DOWNWARD DIFFERENCES RELATIVE TO THE EXECUTIVE FOR A FEW OF THE OTHER MAJOR TAXES AND THOSE CAN ALSO BE FOUND IN OUR REPORT. AS ALWAYS, THE PROJECTIONS WE ARE PROVIDING TO YOU TODAY ARE SUBJECT TO REVISION WHEN WE COME BACK BEFORE YOU AT THE FINAL BUDGET HEARING IN MAY, AFTER IMPORTANT APRIL TAX COLLECTIONS ARE IN THE DOOR.

AND NOW, WE WOULD BE PLEASED TO ANSWER YOUR QUESTIONS.

FOR FURTHER INFORMATION ABOUT THE OLS REVENUE ESTIMATES, PLEASE CONTACT:	
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