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Assembly Budget Committee
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I am here today to present to you the Office of Legislative Services' (OLS) **Tax and Revenue Outlook**, an independent analysis of the major tax revenues the State can expect to receive in the remaining months of the current fiscal year, as well as the next year. We approach this task in the context of a generally stable, slowly growing economy. Unemployment in New Jersey is around 4%, near its lowest point since the Great Recession. National wage growth is under 2%, low by historical standards, but is improving compared to the past few years. Despite a brief drop in December, stock markets continue to grow fairly steadily. Although there are reasons for concern about risks to the global economy, we assume that this slow growth will continue into the near future.

In total, we expect State revenues to follow a similar pattern of slow growth, but this masks some very erratic behavior in some of the State's major revenue sources. Personal income tax and sales tax collections so far this year have been considerably less than originally assumed in the budget, while corporate tax collections have jumped to more than make up the shortfall. The picture we see is similar to what the Governor has presented, and our estimates differ from the Executive's by less than two tenths of a percent of total State revenues. This volatile behavior leads to a higher degree of uncertainty about always-important April payments, as well as next year's revenue picture. A variety of policy changes and other factors have come together to make fiscal years 2019 and 2020 some of the most difficult to forecast in decades.

In December of 2017, the federal government enacted the Tax Cuts and Jobs Act (TCJA), the largest overhaul of the federal tax code since the 1980s. Half a year later, New Jersey adopted several changes to its individual and corporate income taxes. These laws triggered big shifts in the ways that businesses and individuals choose to spend or save their money, and major changes in tax planning behavior. The impacts of these changes are just starting to appear in State revenue collections, and it is difficult to determine how much of what we are seeing are one-time events and how much will become a new normal.

Returning to actual numbers – in grand total, the OLS expects that the current fiscal year revenues will outpace the targets used to develop the budget by about $218 million. For fiscal year 2020, if we include the Governor's proposed policy changes, we expect additional revenue growth a bit over a billion dollars, about 2.6% of total collections. As in the past, our methodology begins by projecting forward historical revenue collection trends, then making adjustments for recent changes in collections, policy changes, and one-off events that may not recur. Because the policy changes I've mentioned have been so consequential, this year our estimates rely somewhat less on past data and somewhat more on professional judgment in interpreting recent events.

The **Gross Income Tax (GIT)** is New Jersey's largest single revenue source, and as of today it looks to be our most problematic. Collections to date are far short of the same period last fiscal year. Several states have observed the same pattern we have seen – a spike in estimated payments in December 2017, followed by historically low estimated payments in December 2018. The leading theory to explain this phenomenon relates to tax planning behavior to maximize the benefit of the federal state and local tax (SALT) deduction, which was capped at $10,000 under the TCJA. Under this theory, a large part of this December's shortfall will be made up in April final payments – making the "April surprise" this year more important than a typical year.

For the coming fiscal year, we are projecting modest growth in baseline revenues based on continued slow economic growth, with several adjustments around one-time events. The forecast we are presenting today also includes $447 million from the governor's proposed increase of the marginal income tax rate on income between $1 million and $5 million, but of course this would require the legislature's approval to enact.

The **Sales and Use Tax** is a relatively stable and predictable source of revenue, and New Jersey's second largest. Sales tax revenues continue to grow year-over-year, even with the phased-in decrease in the sales tax rate included as part of the 2016 tax law. Unfortunately, it has been underperforming so far this year, causing us to lower our forecast by about $200 million from the certified target, and about $120 million below the Executive – but still $280 million more than fiscal year 2018. A large part of this shortfall is attributed to delays in collecting taxes from out-of-State vendors that were permitted under the U.S. Supreme Court's *Wayfair* ruling in June 2018. The OLS forecast for FY 2020 is also lower than the Governor's, seemingly reflecting the lower FY 2019 base from which we project future growth.

Where the GIT and sales tax are looking weaker than expected this year, the **Corporation Business Tax (CBT)** has made up for the shortfall and more. The CBT has always fluctuated unpredictably and without a clear correlation with corporate profits. Collections in any given year reflect payments, refunds, and tax credits from multiple tax years, and these can all be influenced by corporate accounting practices that may be designed to minimize State or federal taxation. The TCJA's reduction in the federal tax rate, a temporary State surtax, broadening of the tax base, changes in tax planning incentives, and a one-time jump in revenue from repatriated foreign earnings all contribute to an unpredictable environment. Thus far this year, CBT collections are almost double what they were at the same time last year, and are far outpacing the certified forecast. By the end of the year, we are predicting over $3.8 billion in revenue, about $750 million over the certified target. Because a large chunk of this is thought to be non-recurring, our estimate for FY 2020 is about $500 million lower than FY 2019, but still far ahead of prior years, reflecting a generally healthy environment for corporate income and a broader tax base than existed before the TCJA.

The **Motor Fuels Tax** and the **Petroleum Products Gross Receipts Tax (PPGRT)** may warrant your attention this year. One of the most significant parts of New Jersey's 2016 tax overhaul legislation was an increase in the PPGRT rate, and the establishment of a revenue targeting system that allows for subsequent changes in the tax rate by the State Treasurer if collections do not match targets. In October, the rate was increased by 4.3 cents, which has helped FY 2019 revenues remain fairly high despite decreasing fuel consumption. The Governor's revenue forecast appears to assume reasonable consumption levels with no further change in the tax rate. The OLS forecast assumes the statutory target will be met for FY 2020, which may necessitate an increase in the tax rate if consumption does not substantially increase between now and the fall.

I will briefly note that our estimates differ from the Executive significantly on the **insurance premiums tax**, which appears to be continuing to fall as increasing amounts of tax credits are transferred from their original recipients to IPT taxpayers and redeemed against that tax liability. Our forecasting difference is likely due to our being able to account for preliminary collection data for March, a major payment month, which indicate a continued decline in receipts.

The Tax and Revenue Outlook 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 recorded.

And now, we would be pleased to answer your questions.