NJ SENATE BUDGET AND APPROPRIATIONS COMMITTEE
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State Treasurer Elizabeth Maher Muoio
Revenue Update
(Testimony as Prepared for Delivery)

Good afternoon, Chairman Sarlo, Vice Chair Cunningham, Budget Officer Oroho, members of the committee. Thank you for the opportunity to come before you again today to present an update on revenue forecasts and their impact on the Governor's proposed Fiscal Year 2020 budget.

I'd like to once again start by introducing my colleagues here at the table with me - Deputy Treasurer Catherine Brennan, Acting Director of the Office of Management and Budget (OMB) David Ridolfino, OMB Deputy Director Lynn Azarchi, and the Director of the Office of Revenue and Economic Analysis (OREA) Martin Poethke.

They and their staff, along with the many other divisions in Treasury, have been invaluable in putting together what I truly believe is a fair budget. It is a budget built on $1.1 billion in real and lasting savings. It is a budget that grows our surplus and honors our commitments. It is a budget that the ratings agencies want to see. It is a budget that continues to focus on course correcting after years of neglect.

For the second year in a row, the Governor is proposing to ask a little more from the most fortunate among us who have reaped enormous dividends from a bullish economy and lavish federal tax cuts so that the working and middle class families of this state can finally get a fair shake.

We were challenged, more so than usual, in putting this budget together because of the unprecedented nature of tax policy changes at the federal level, the likes of which we haven't seen in recent history, which made forecasting this year all the more difficult. When coupled with the significant tax changes ushered in at the state level last year, revenue forecasting became a Herculean effort this year.

So I would like to thank our team at the Office of Revenue and Economic Analysis, led by Director Martin Poethke who is sitting up here, for their acute analysis, which honed in on exactly what was going on with taxpayer behavior to predict with near precision the activity we have just seen pan out. When the all-important income tax month of April was bearing down on us, we relied on their expertise and they unequivocally delivered, which means I have some encouraging news to report to you today.

FY19 Revised Revenue Estimates

As you probably remember, **Gross Income Tax (GIT)** collections for December fell 35 percent below the prior December and January collections fell by 4.8 percent. This two-month dip was also seen in many other states, and produced concerns that the economy, or the stock market, or other long-term factors, were producing a serious revenue shortfall.

However, we urged caution about jumping to negative conclusions and projecting shortfalls before a clear picture of April revenue collections emerged. We knew certain temporary factors were masking what should otherwise have been increasing GIT revenue from solid economic, wage, and income growth.

We also had compelling reasons to believe that the two-month dip in GIT collections was largely attributable to a significant shift in historical tax planning behavior as a result of the cap on the SALT (State and Local Tax) deduction that was enacted as part of the federal tax law changes. For decades, taxpayers had an incentive to prepay state income taxes in December for federal tax planning purposes. With the unlimited deduction now gone, the incentive to prepay evaporated and most taxpayers waited until April to complete their tax payments. As a result, April's final 1040 payments soared by 81.7 percent.

Last month when I spoke with you, we discussed the nuances between *anticipating* strong revenue growth in April AND being *surprised* by strong revenue growth in April. I am happy to tell you that both perspectives have been validated. While we correctly anticipated the taxpayer behavior that played out, we not only met our robust April tax collection targets, but we encountered somewhat of a surprise when Gross Income Tax Collections set a new April record, slightly increasing our revenue forecast for FY19.

All told, Gross Income Tax receipts for April totaled $3.627 billion. These collections top the previous record of $3.14 billion that was recorded in April of 2008. Moreover, GIT funds, which are constitutionally dedicated to the Property Tax Relief Fund, are up 56.8 percent compared to last April. Withholding collections are also up 9.9 percent and estimated tax payments are up 10.4 percent. In total, year-to-date GIT collections of $13.075 billion are up 7.7 percent, or $930 million.

While all of the winter GIT revenue shortfall has been reversed, April also pulled forward some final 1040 payments that lagged into May last year due in part to a delayed April 17 filing date last year. Accordingly, we expect to see a reduction this month in total net GIT collections compared to last May. However, both the large April rebound and the smaller May reduction have been factored into the updated FY19 forecast I am providing today.

Taking these factors into account, we are now projecting 5.8 percent growth in GIT revenues over last year, for a total of $15.912 billion in FY19, $349 million above our prior forecast. As part of this improved revenue forecast, we are also increasing our estimate for revenue from the new 10.75 percent marginal tax rate on income above $5 million from $275 million to $350 million.

This GIT increase accounts for most of the FY19 upward revision in total revenue since the Governor's Budget Message.

Our current fiscal year forecast for total revenues has now been revised upward by another $377 million for a total of $38.115 billion. That is a modest increase of 1.0 percent from the forecast we discussed last month when we presented the Governor's proposed budget, and 1.9 percent from the amount certified last summer. Continued robust growth in corporate tax revenue and improved Gross Income Tax (GIT) collections are exceeding downward adjustments in the Sales Tax and the Insurance Premiums Tax. As a result, we expect to close out FY19 with a surplus balance of $1.139 billion, up from the $1.098 we projected at the time of the Governor's Budget Message.

This means I have more good news to report.

As you have probably heard, this improved revenue outlook means we will be making a deposit into the state's Surplus Revenue Fund (SRF) for the first time in more than a decade. This fund, which is more commonly referred to as the **"Rainy Day Fund,"** has been dry since the Great Recession. In FY08 this

fund had a balance of $734.7 million. When the economy collapsed, the entire balance was drawn down in just one year's time.

Everyone is taught the importance of saving for a rainy day. That fundamental lesson is also embodied in our laws. State statutes (52:9H-16) require 50 percent of any General Fund revenues in excess of the amount certified at the time of the Appropriations Act to be deposited into the Surplus Revenue Fund, minus any funds that may be needed to cover a shortfall in the Property Tax Relief Fund.

Based on the law and our revised revenue estimates for FY19, this long-absent deposit is projected to equal $317.1 million, helping to minimize any future disruption in services and benefits in the event of an economic downturn.

It is always satisfying to come here bearing good news about revenue projections rather than bad news.

That story continues with the performance of the **Corporation Business Tax (CBT)** in FY19. Through the end of April, the CBT is up 91.2 percent. As a result, we have increased the CBT forecast by another $99.4 million to a total of $3.808 billion for FY19.

While the CBT is now projected to be up by about $1.5 billion over last year, or about 64.5 percent, there are many caveats that surround this growth.

As we discussed last month, the full CBT picture will not be clear until the fall, when corporations which have filed for extensions will be required to submit their final tax returns. We do know that growth is being driven by a combination of factors, chief among them: the 2.5 percent state CBT surtax on earnings over $1 million and expansion of the tax base due to federal tax law changes.

However, and this is the most important caveat, we currently estimate that nearly one-half of the CBT growth in FY19 – about $721 million – is comprised of one-time, non-recurring revenues that will evaporate next year. This includes certain statutory one-time revenues such as $200 million in deemed repatriated dividends and $82 million from the now concluded tax amnesty program; an unexpected, one-time, single-taxpayer payment of $100 million; $35 million from one-time tax planning behavior; and lastly, substantial catch-up payments of roughly $304 million as a result of the surtax enacted last July being applied retroactively to the beginning of the year. This is an important point to underscore because these catch-up payments mean FY19 will essentially include 18 months of CBT surtax payments in a 12-month period. Overall, about half the FY19 CBT growth is due to statutory state and federal tax law changes, while the other half is from temporary, one-year enhancements.

Offsetting the growth in GIT and CBT revenue, is the **Sales Tax** forecast for FY19, which has been further reduced by $103.5 million, to $9.954 billion. Year-to-date trends have remained slightly below forecast, and growth during the last three months has averaged only about 3.7 percent. Within the Sales Tax, collections from online remote sellers related to the U.S. Supreme Court's "Wayfair" ruling last June are growing, after some implementation delays, and have yielded about $84 million so far this year. We are maintaining our projection for a total of $130 million from this source by the end of FY19.

The **Insurance Premiums Tax (IPT)** is also under-performing. Payments around the March 1 due date are down 14.2 percent from last year and further weakness is expected from the June 1 payments. As a result, we are reducing this IPT forecast by $62.7 million to $496.0 million in FY19. It is important to note

that insurance companies are the largest purchaser of EDA tax credits in the credit transfer market, acquiring about half of all credits sold, which holds down growth in this revenue source.

On that note, let me now turn to our forecast for FY20 revenues.

FY20 REVISED REVENUE FORECAST

The improved revenue outlook for FY19 has ripple effects going into FY20. Revenues revised upward or downward in FY19 will usually also be revised upward or downward in FY20.

Our total FY20 revised forecast is increasing by $240 million, to a total of $39.073 billion. This is a $958 million increase over FY19, or growth of 2.5 percent. I would like to discuss the major revenues in some detail, before circling back to the bigger picture.

Our **Gross Income Tax** revenue projection for FY20 is $17.059 billion, an increase of $419.4 million from the amount forecast in the Governor's Budget Message. Improved growth in the FY19 base plus the assumption of steady underlying growth of 4.0 percent drives much of this revenue. Our FY20 projection also still includes the second of three planned increases in the Earned Income Tax Credit to raise it to 40 percent of the federal benefit, providing an additional $30.2 million in tax relief for working families in New Jersey who need it most.

As part of our improved GIT outlook, we are revising the estimate for our proposed expansion of the millionaire's tax due to improved income data in our taxpayer model. Our proposal to extend the 10.75 percent tax rate enacted last year on income over $5 million, to all taxable income over $1.0 million, is now expected to generate a total of $536 million in FY20, up from the $447 million we forecasted at the time of the Governor's Budget Message (GBM).

What this means is that the vast majority of millionaires will pay roughly two cents more on every dollar over $1 million while generating more than half a billion dollars to help fund critical priorities, including property tax relief. As the Governor has repeatedly said, this is about tax fairness - asking a little more from those among us who have realized the greatest financial rewards from all that our state has to offer.

Extending the 10.75 percent rate will raise recurring revenues to support continued crucial investments in many of our shared priorities, most notably education funding and property tax relief. With the current surge in the GIT outlook, the Governor is proposing to take advantage of this good fortune by returning $250 million of this revenue directly back to taxpayers in the form of property tax relief in FY20. But without the half a billion dollars generated by the true millionaire's tax, the GIT revenue boost will be eliminated, and funding for increased property tax relief and other priorities will be nearly impossible.

Given our current forecasts, we cannot rely on a surge from our two other largest revenue sources.

When it comes to the **Sales Tax**, we are projecting $10.253 billion in revenue for FY20, or 3.0 percent growth over FY19. This is a reduction of $203.7 million from the GBM, due to slowing growth forecasts in FY19 and FY20. A full year of collections from online remote sellers is expected to yield an additional $60 million for an estimated annual total of about $190 million for FY20. But the sales tax base is also reduced by $104.4 million due to the non-recurring tax amnesty collection in FY19.

Our **CBT** projection for FY20 has been revised downward by $75.4 million from the GBM for a total of $3.142 billion. That is a decline of 17.5 percent from our revised FY19 forecast of $3.808 billion. This year over year decline in the CBT is not due to economic activity, but instead due to several factors, including: the loss of substantial, non-recurring revenues that we are seeing this year; a marginal increase in CBT tax credit use; and the initial impact of the wind-down in the surtax rate that was dictated in the law enacted last year. We anticipate that in the spring of 2020, estimated tax payments will decline by about $67 million as the surtax decreases from 2.5 percent to 1.5 percent for Tax Year 2020 before fully expiring in Tax Year 2022.

As I noted earlier in this discussion, we estimate that about $721 million of the FY19 CBT base consists of one-time, non-recurring revenues, which will have a significant impact on projected FY20 revenues.

Lastly among the revenues, I'd like to touch upon our petroleum products and motor fuels tax forecasts for both fiscal years. Fuel consumption data has improved somewhat since we last met in April, and revenue collections are slightly better. We have increased our FY19 forecast for the **Petroleum Products Gross Receipts Tax (PPGRT)** by another $42.1 million for a total projection of $1.509 billion. **Motor Fuels Tax** projections are also up by $6.3 million for a total of $507 million for FY19. As you know, most of this money is transferred out of the budget to Capital Reserves to support critical Transportation Trust Fund (TTF) projects throughout our state.

For FY20, we are projecting 4.1 percent revenue growth in the PPGRT for a total of $1.570 billion. Our revenue projections include the 4.3 cent rate increase that went into effect on October 1st. While consumption is likely to decline somewhat further, having the 4.3 cent rate increase in effect for an entire 12-month cycle is expected to generate some net growth.

As you are aware, the statutory formula in the gas tax law passed in 2016 directs us to annually assess this revenue stream to determine if a recalculation of the PPGRT rate is warranted based on fuel consumption data, revenue collections, and future projections compared to the 2016 base year. This is done to ensure that the TTF program can support $2 billion in crucial road and bridge construction projects each year. As required by law, we will revisit this data in August to determine if the rate must be recalculated either upward or downward. However, as of now, we are still cautiously optimistic that this rate will remain unchanged and we have not budgeted for an increase in FY20.

This brings us to the bigger picture for FY20. While non-recurring revenues have had a substantial positive impact on FY19 growth, the pendulum ultimately has to swing in the other direction. In addition to the estimated $721 million in one-time CBT revenues for FY19, we are anticipating a sizable number of other one-time revenues, including: $104.4 million from Sales Tax amnesty receipts; $102.7 million from GIT amnesty receipts; certain catch-up payments from the millionaire's tax; $24.6 million from other amnesty collections; $71 million from the last year of the estate tax before it is fully phased out; and $33.5 million from one-time catch-up payments under the CBT for Banks and Financial Institutions. Combined, this amounts to a total of $1.057 billion in non-recurring revenues in FY19.

While we could typically expect aggregate revenues to increase between three and four percent in a normal year with moderate economic growth, the potential revenue growth in FY20 is largely eliminated due to this loss of more than $1 billion in non-recurring revenues.

Of the $958 million total revenue increase forecasted for FY20, only $311.5 million, or less than one percent, is from growth in the existing base over FY19. The remaining $646.5 million revenue growth we are projecting for FY20 will come from four new policy proposals: $536 million from extending the millionaire's tax; $60 million from half a year of adult use marijuana; $30 million from the Corporate Responsibility Fee; and $21.5 million from the assessment on opioid drug manufacturers and distributors.

As the Governor has repeatedly stressed, the issue of recurring and non-recurring revenues is an important one. FY19 benefitted from substantial non-recurring revenues, but the loss of these funds curtails growth in FY20 and increases structural budget pressures. As the CBT surtax expires over the next couple of years, recurring revenue growth will continue to be restricted. The Governor's continued push for reliable, recurring revenues, such as the true millionaire's tax, are crucial to boosting our credit rating and providing the critical resources to fund the policies that will help grow our middle class.

The ratings agencies have made it clear what they want to see in a budget. The principles they look for are important, not just because they would lower our borrowing rate and save taxpayer money, but because they are sound, financial practices to have in place.

In order for us to reverse the trend from the previous administration, which saw a record number of credit downgrades, the Governor's proposed budget:

- Reduces one-shots to less than 2 percent of the total budget - half the 3.4 percent average under the previous administration;
- Incorporates over a billion in sustainable savings;
- Focuses once again on generating reliable, recurring revenue sources to sustain us;
- Delivers another record pension payment on the path to full ARC funding;
- Reduces diversions significantly so those funds can meet their intended purpose; and
- Builds our surplus and makes a deposit in the rainy day fund for the first time in 11 years.

Our surplus and rainy day fund are crucial to sustaining us in the event of an economic downturn, which most economists view as inevitable, sooner than later.

While our proposed surplus is roughly double the average of the previous administration, it represents only three percent of our total budget. So we still have a long way to go to get to the recommended average of 10 percent of our total budget.

And while we expect to deposit $317 million in our rainy day fund, I'd like to remind everyone that this fund had a balance of roughly $735 million in FY08. That balance was drawn down in just one year's time when the Great Recession hit and our rainy day fund has been empty ever since.

So it is absolutely crucial that these funds remain in a "lock box." We have to prepare for forces both inside and outside of our control.

The Governor believes strongly that we should boost direct property tax relief to the people of this state while we have a little breathing room in this budget. Given what lies ahead, we may not have this opportunity again soon.

Accordingly, he is proposing a new, stand-alone, one-year program that would return $250 million directly to state taxpayers through a refundable tax credit. While this plan would require legislation, we expect a broad population of over a million New Jersey taxpayers to benefit.

Everyone has a different opinion on what should be a priority, but the bottom line is that without sustainable revenues and a robust surplus to help us weather any storms, none of our priorities can be addressed. Asking millionaires to pay a few more cents on the dollar is the right thing to do, both morally and fiscally.

Thank you for your time. I'll be happy to answer any questions, but first I'd like to note that we have some additional testimony prepared on our departmental highlights, which I'd be happy to run through quickly with you or, if you prefer, we can submit them in writing.

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