



September Tax Collections in Perspective: Will There Be a Surplus in FY 2006?

Earlier this week, the Massachusetts Department of Revenue announced that tax collections for the first quarter of FY 2006 are ahead of both its anticipated benchmarks and collections for the first quarter of FY 2005. This does not mean, however, that the Commonwealth should expect a large structural surplus in FY 2006, since the Legislature relied on significant infusions of one-time funds to balance the budget in the current fiscal year. For the FY06 budget to be considered structurally balanced, FY06 tax collections must come in at much higher levels than either FY05 collections or the DOR’s anticipated benchmarks for FY06.

Tax collections in FY05 amounted to \$17.087 billion, while the Department of Revenue’s current benchmarks put FY06 tax collections at \$17.448 billion. Yet, in order for ongoing revenue to match ongoing expenditures in FY06, baseline tax collections must total at least \$17.883 billion, as the figure below demonstrates. In adopting the FY06 budget, the Legislature assumed that baseline tax collections would total \$17.1 billion, while simultaneously mandating a \$600 million transfer from the Stabilization Fund to the General Fund. If FY06 tax collections reach the DOR benchmarks of \$17.448 billion, that transfer could be reduced to \$252 million, but, unless, collections exceed those benchmarks, this remains a \$252 million structural problem. In addition, the FY06 budget diverts approximately \$183 million in tobacco settlement funds to cover current expenses; as this revenue stream, under existing law, will not be available in FY 2007, this creates an additional structural problem of \$183 million.¹ Consequently, tax collections must exceed the DOR benchmarks by at least \$435 million – that is, they must total at least \$17.833 billion – to compensate for temporary sources of revenue and to attain structural balance.

	<u>AMOUNT (\$M)</u>
DOR FY 2006 tax revenue benchmark	17,448
Stabilization Fund transfer needed for balance	252
Diversion of tobacco settlement funds	183
<i>SUBTOTAL - Tax revenue needed above benchmark for structural balance</i>	435
TOTAL - Tax revenue needed for structural balance	17,883

For the first quarter of FY06 (July through September 2005) tax collections totaled \$4.3 billion or 7.9 percent more than the same period in FY05. If this 7.9 percent growth rate is sustained throughout the year, then tax collections will amount to roughly \$18.4 billion. This in turn would yield a surplus of approximately \$552 million in FY06 (relative to the \$17.9 billion needed for structural balance).

¹ Under current law, only 30 percent of the annual tobacco settlement payment the Commonwealth receives each year – as well as 30 percent of the investment earnings of the Health Care Security Trust – is intended to be used for current expenditures. The remainder is set aside to fund health related services and programs in the future. Yet, the FY06 budget alters current law to use 100 percent of the settlement payment and 50 percent of the Trust’s investment earnings for immediate purposes.

This potential surplus of \$552 million should be kept in perspective. Just last month, year to date tax collections for FY06 were just 3.2 percent ahead of the same period for FY05. If this 3.2 percent growth rate were used in place of the 7.9 percent rate above, then the Commonwealth would likely experience a structural deficit of over \$200 million in FY06. Moreover, it is not entirely clear how much of the present growth in tax collections is sustainable and how much is temporary, due to a short burst of economic growth. If, for instance, tax collections simply grew in line with the rate of personal income growth over the past thirty-five years or so, then the growth in tax collections would be closer to 4.8 percent over the course of the current fiscal year, a rate that would likely be just barely enough to attain structural balance. In any event, fiscal prudence would suggest that the Commonwealth use any funds generated by faster than sustainable growth rates for one-time purposes, such as capital expenditures, rather than to meet ongoing expenses or to finance permanent tax cuts.

FY 2006 YTD TAX COLLECTIONS IN PERSPECTIVE		
TOTALS		
	<u>AMOUNT (\$M)</u>	
FY05 - Actual		\$17,087
FY06 - DOR Benchmark (requires 2.1% growth above FY05 Actual)		\$17,448
FY06 - Tax revenue needed for structural balance (requires 5.7% growth above FY05 Actual)		\$17,883
YTD GROWTH		
	<u>PERCENTAGE INCREASE</u>	<u>RESULTING FY06 SURPLUS (DEFICIT)</u>
FY06 Actual vs. FY05 Actual (July to September)	7.9%	552
FY06 Actual vs. FY05 Actual (July to August)	3.2%	(243)
"Historic" revenue growth (<i>real personal income growth, 1970 to 2004, plus anticipated FY06 inflation</i>)	4.8%	24

Of note, the above figures do not account for any additional spending or tax cuts that will or may occur in FY06. For instance, another \$95 million in appropriations have been made since the enactment of the General Appropriations Act, while legislation to provide significant tax incentives for motion picture production in Massachusetts is pending in conference committee. In addition, the Legislature also appears poised to act on economic stimulus and health care initiatives that could have a major impact on the Commonwealth's fiscal situation. As a result, any potential surpluses resulting from faster than anticipated revenue growth will be that much smaller.