Massachusetts Taxpayers Foundation

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000

Bulletin

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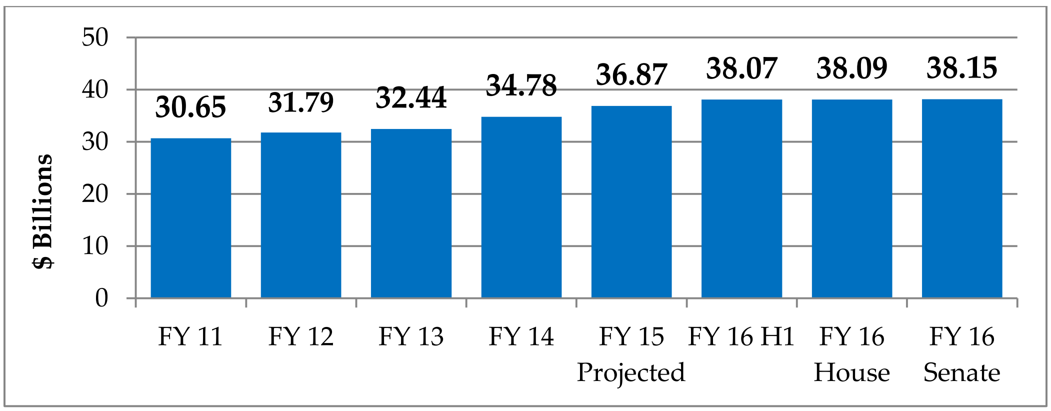
Senate Puts its Own Mark on FY2016 Budget

The Senate finalized its version of the FY 2016 budget using many of the same deficit closing and spending approaches as the House and Governor but with significant differences on revenues. The Senate's budget adds a total of $119 million in new revenues, $72 million of which would be used to increase the Earned Income Tax Credit (EITC) and personal exemptions. Facing the same $1.8 billion structural gap for the FY 2016 budget as the Governor and House, the Senate's budget totals $38.15 billion, an increase of $1.28 billion or 3.4 percent from projected FY 2015 spending. It is approximately $60 million more than the House and $80 million more than the Governor's proposals (Figure 1).

Figure 1 – State Spending for Fiscal Years 2011 – 2016[1]



While the variance in overall spending is relatively small, the budget picture is complicated by a disagreement between House and Senate leaders as to whether the House budget can be considered a "money bill" and thereby permit the Senate to introduce tax initiatives. The House has asked the Supreme Judicial Court (SJC) to provide an advisory opinion on the Senate's interpretation that could slow negotiations and push a completed budget past the July 1 start of the fiscal year.

Senate Follows Governor and House on Closing the Structural Deficit

The Senate accepts the Governor's framework, also adopted by the House, to help close the structural shortfall in the FY 2016 budget. This framework includes the Early Retirement Incentive Program (ERIP), signed into law in May, which will save an estimated $172 million

[1] The budget data for fiscal years 2011 through 2016 do not include pre-budget transfers for pensions, the Workforce Training Fund, and dedicated sales tax revenues to the MBTA, and the Massachusetts School Building Authority which totals $3.8 billion in FY 2016.

and $220 million in reduced spending on MassHealth driven by reduced caseloads due to redeterminations.

Table 1 – One-Time Revenues in the Senate FY 2016 Budget (in $ millions)

One-Time Revenues	
Capital Gains Tax Revenues in Excess of $1.087 Billion Cap	300
Tax Amnesty	100
Courthouse Sale	30
MassHealth Cash Management	116
FAS 109	46
FEMA - Reimbursement	17
Total One-Time Revenues	**609**

The budget also relies on the same $600 million of one-time revenues, as detailed in Table 1. The Senate, like the House and Governor, suspends the transfer to the Stabilization Fund of $300 million from capital gains tax revenues and instead uses it for for operating expenses.[2] In addition, the Senate also delays the implementation of the FAS 109 deduction to avoid $46 million in foregone revenue; creates a tax amnesty program for non-filers estimated to collect $100 million in new tax revenues ($20 million of which is recurring); and postpones $116 million of MassHealth payments until FY 2017. Although the $600 million of one-time funds in FY 2016 is half the amount employed in FY 2015, it compounds the challenges in the FY 2017 budget.

Senate Increases Revenues to Support Additional Spending

The Senate differs significantly from the Governor and House budgets in its reliance on nearly $120 million in additional revenue, $77 million of which depends on the House budget being deemed a money bill. Most notably, the Senate freezes the state's personal income tax rate at 5.15 percent, instead of allowing it to decline when certain economic benchmarks are achieved.[3] This freeze generates an additional $72 million in FY 2016, and the Senate uses this to pay for increasing the state's Earned Income Tax Credit and personal exemptions. If the House budget is determined not to be a money bill, the provision to freeze the income tax rate at 5.15 percent – and the $72 million – is considered outside the scope of the budget and eliminated.

The Senate also projects total revenues to be $45 million greater than the consensus revenue estimate used by the Governor and the House. Most of this amount is unlikely to be affected by the money bill determination, with the hiring of additional DOR auditors resulting in $20 million in enhanced tax collections and enhanced tobacco tax collections generating another $20 million. However, $5 million is potentially at risk because it changes the state's combined reporting law.

[2] To minimize dependence on capital gains revenue due to its volatility, the Legislature required revenues in excess of the statutory cap to be automatically transferred to the Stabilization Fund each year. This year's capital gains revenue is projected to exceed the cap of $1.087 billion by $300 million.

[3] After voters endorsed a reduction in the income tax rate to 5 percent in a 2000 ballot initiative, the legislators created a statutory trigger for phasing down the rate over time. When certain economic conditions are met, the rate decreases by .05 percent per year until it is fully phased down.

The proposed change, listed as a technical edit, would treat a business organized in U.S. territories and/or possessions as if it is organized in the United States rather than a foreign country.

Tight Budget Leaves Little Opportunity for New Spending

The Senate faces the same restrictions on discretionary spending as the House and Governor because increased spending on five non-discretionary expenditures – MassHealth, Chapter 70 local education aid, pensions, debt service, and increased contract assistance for the MBTA – account for all of the $1.28 billion increase in the 2016 budget (Table 2). As a result, over 700 accounts in the remainder of the budget received no additional funding compared to FY 2015 spending levels.

Table 2 – Five Accounts Consume $1.28 Billion in Increased Spending (in $ Millions)

	FY 15 Projected	FY 16 Senate	Increase $
MassHealth	13,838	14,730	892
Chapter 70 Local Aid	4,401	4,514	113
Pensions	1,793	1,972	179
Debt Service	2,219	2,252	33
MBTA Contract Assistance	123	187	64
Remainder of the Budget	14,495	14,497	2
Total	**36,869**	**38,152**	**1,283**

However, the Senate budget does advance its priorities by shifting spending among a small number of accounts, with a particular emphasis on education. Like the House, it deletes an $84 million direct appropriation from tobacco settlement funds to the state's trust fund for retiree health care benefits (State Retirement Benefits Trust Fund). In its place, both branches renewed the FY 2015 budget language that funds the contribution from unspent balances in four debt service accounts. Since both branches included identical language, this item will go unchanged in conference committee. It is important to note that if the unspent balances fall short, the state would be responsible for the remainder, and the $84 million appropriation is equal to 30 percent of tobacco settlement funds which is less than the statutorily- required 40 percent, or $110 million. As a result, the state could be required to fund the additional $26 million.[4]

In addition, the Senate reduces House appropriations for kindergarten expansion grants by $17.6 million and distributes $10 million of the savings to reimbursements for special education (circuit breaker) and $7.6 million to charter schools. The Senate also reduces House appropriations for developmental services (which include transportation, community day and work programs, and autism) by approximately $15 million while increasing funding for UMass by $18.9 million.

[4] The Governor's budget appropriated $84 million or 30 percent of tobacco settlement funds rather than 40 percent required in statute. The House and Senate do not appropriate funds to be deposited to the SRBTF but instead rely on savings from debt service accounts and (for the Senate) excess tax amnesty funds to cover the $84 million deposit.

Senate Includes Key Income Tax and MBTA Policy Proposals in Budget

Proposed Changes to the State Income Tax

The Senate budget has a plan to phase-in an increase in the state's Earned Income Tax Credit (EITC) from 15 percent to 22.5 percent of the federal credit over a three-year period. At the same time, it increases personal income tax exemptions by $400 for individual filers, $600 for heads of households, and $800 for joint tax filers. To fund these changes, the Senate statutorily freezes the income tax rate at 5.15 percent rather than maintaining the state's trigger mechanism that would allow the tax rate to decline to 5.0 percent. (See the MTF's separate analysis of the Senate tax proposal for more information.)

By comparison, the Governor put forth legislation to double the state's EITC from 15 percent to 30 percent over three years. To fund this increase in the first year, the Governor proposes eliminating the film tax credit. There is no defined funding source for incremental increases in the state's EITC in later years. The House has not formally proposed a separate increase to the EITC in its 2016 budget. Worth noting, while an increase in the EITC is within the purview of the conference committee, the Senate's method of funding the increase by freezing the income tax rate could be ruled ineligible if the SJC rules that the House budget is not a money bill.

MBTA

After considerable debate and negotiations, the Senate agreed to a modified Fiscal and Management Control Board, a key proposal for fixing the MBTA's operations and one of the MTF's top legislative priorities for this session. The House budget plan contained procurement reform, including a five-year moratorium on the Pacheco Law. Taken together, these two components represent meaningful reforms and are critical to the Governor's transformation plan for the MBTA. In conference committee, the House and Senate will negotiate regarding these two components while leaving the remaining issues to be addressed through a separate MBTA reform bill.

Next Steps

The debate now heads to a conference committee responsible for resolving the differences between the House and Senate budgets before the July 1st start of the fiscal year. This year the process will be more complicated due to the pending advisory opinion from the. Should the legislature not be able to reach agreement before the July 1st deadline, they could pass a short-term spending bill to fund the government in the interim.

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