Massachusetts Taxpayers Foundation

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COVID-19 Impact: Moving the Tax Filing Deadline

Policymakers Face Statutory Balance, Cash Flow Issues By Postponing Tax Day

Introduction

On March 21, 2020, the Internal Revenue Service (IRS) changed the federal income tax filing deadline from April 15 to July 15 in response to the novel coronavirus (COVID-19) pandemic. Taxpayers can delay their tax return and any associated payments without incurring interest charges or penalties.[1] Massachusetts Governor Charlie Baker, Senate President Karen Spilka, and Speaker Robert DeLeo announced the corresponding change for the state tax filing deadline on March 27, 2020.[2]

The policy change impacts the Commonwealth of Massachusetts very differently than the federal government and will present tough financial challenges to state decision-makers.

This brief summarizes these challenges and describes solutions policymakers may consider in the coming weeks and months to address the crisis.

Background

At both the federal and state level, income tax returns and any required payments for the preceding tax year are usually due on April 15. Though the Commonwealth imposes an array of tax types, about $17.5 billion, or 58 percent of the state's anticipated $30.3 billion in fiscal 2020 tax revenue was expected to be generated by the income tax. Income taxes collected via paycheck withholding were expected to generate $13.8 billion with the remaining $3.6 billion collected through estimated and final payments

[1] IRS-2020-58, March 21, 2020.

[2] *Massachusetts Announces State Income Tax Filing Deadline Being Extended to July 15*. Office of Governor Charlie Baker, March 27, 2020.

(i.e. "non-withheld income" or NWI) taxpayers are required to make at different times during the year, usually on a quarterly basis.

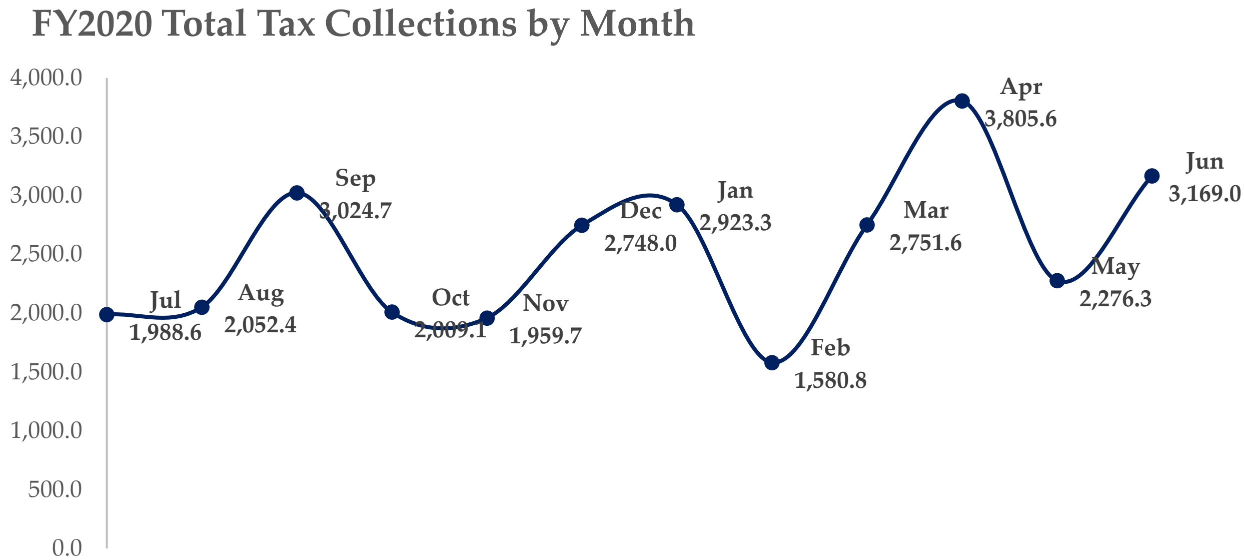

Figure 1: MTF estimates of total monthly tax collections based on fiscal 2020 tax benchmark of $30.289 billion. MTF uses a different monthly estimation methodology than the Massachusetts Department of Revenue. Figures in $ millions.

Approximately $2.4 billion, or 65 percent of NWI is expected to be paid between March and June 2020. Importantly, NWI as reported by the Commonwealth includes estimated payments, final payments with returns, and all refunds as depicted in the figure in Appendix I. NWI payment activity is anticipated to peak in April with $2.1 billion in inflows from estimated and final payments offset by $300 million in refunds.

Impact of Moving Tax Day

Extending the tax filing deadline to July 15, 2020, will cause an unknown number of filers to delay NWI payments, though presumably taxpayers owed a refund will file their returns normally. As a result, some portion of the $3.2 billion in NWI revenue expected between March and June will be delayed until July (See Appendix I).

This timing shift will have two material impacts on the Commonwealth's finances. First, since state fiscal year 2020 ends on June 30, 2020, the change will push a considerable amount of tax revenue from fiscal 2020 to fiscal year 2021, which begins July 1, and leave fiscal 2020 without the revenue necessary to support the enacted spending appropriations. Second, the shift will dramatically alter the state's cash flow and could drain the general cash pool by May 2020.

Challenge: Statutory Balance

The Commonwealth is required to balance revenue and spending in each fiscal year by statute.[3] Shifting some portion of $3.2 billion in tax revenue would cause a significant imbalance in fiscal 2020.

A potential solution to this issue would be for the Commonwealth to "book back" a portion of tax revenue collected in July 2020 from fiscal 2021 to fiscal 2020. This approach has been used in the past, though on a much smaller scale. In the fiscal 2018 General Appropriations Act (GAA), policymakers approved an Accelerated Sales Tax Remittance (ASTR) plan to require certain vendors to remit sales tax collections to the state daily rather than the current monthly remittance schedule. That plan included a provision to count a portion of July tax collections as the previous year's revenue for the purpose of calculating statutory balance.[4]

Tax collections in fiscal 2018 far exceeded expectations and budget managers did not implement that provision of the law. Nonetheless, the same basic principle could be applied in this instance.

Challenge: Cash Flow

In the most recent quarterly cash flow report, the Commonwealth anticipated gross total tax revenue inflows of approximately $4.5 billion in April 2020 and an ending cash balance in the general cash pool of about $3.6 billion.[5] The same report projected an ending balance of $2.5 billion for May 2020. Extending the tax filing deadline will reduce gross tax revenue inflows, potentially by billions of dollars, and pose a real risk that the general cash pool could be depleted in May and leave the state unable to make payments.

There are at least two solutions to this challenge. In order to meet cash flow needs through the fiscal year, the Commonwealth typically engages in intra-fiscal year borrowing. The Treasurer issues Revenue Anticipation Notes (RANs) to provide enough cash to support spending needs through months when outflows exceed inflows. In fiscal 2020, the Commonwealth sold RANs totaling $1.4 billion in October 2019 and expects to repay these notes in April, May, and June.

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[3] M.G.L. Chapter 29 § 6E. Note there is a statutory interpretation that the law does not require the budget to balance at the end of a fiscal year, rather that it must be in balance when proposed and enacted.

[4] Section 95 of Chapter 47 of the Acts of 2017

[5] Quarterly Cash Flow Letter dated January 13, 2020

As indicated in the announcement, it appears that the Treasurer will issue more RANs to bridge the gap created by delaying the tax deadline. Like other capital markets, municipal bond markets have experienced some turmoil in recent weeks as a result of the COVID-19 pandemic. It is unclear how such further issuances would be received by the bond market and rating agencies that evaluate the state's creditworthiness.

An alternate solution would be to tap use the state's "rainy day" fund, the Commonwealth Stabilization Fund, which has a balance of approximately $3.5 billion. The state could change the existing law to allow for inter-fund borrowing such that the "rainy day" fund would make a loan to the state's general cash pool. This would provide the state liquidity without the need to sell RANs but leave the state less prepared for further economic turmoil.

Conclusion

The COVID-19 pandemic is a public health emergency that is causing a public finance emergency in Massachusetts. Providing taxpayer relief in the form of extending the tax filing deadline is understandable, especially given that the federal government has taken the same step; however, doing so further complicates the state's short-term finances.

The management of the public health emergency is and should be the top concern for policymakers. The response to the public finance emergency, however, also warrants attention as it will determine how Massachusetts addresses its potential cash flow issues, positions the state to determine its budget for FY21 and ultimately bounces back from the crisis.

Appendix I

Fiscal 2020 Non-Withheld Income Tax Collections (MTF Monthly Estimates)													
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Mar-Jun
Estimates	27.5	22.3	500.0	40.6	18.6	203.1	713.1	16.0	19.8	255.2	25.5	471.1	771.6
Final Payments	39.3	54.1	49.5	132.3	47.5	42.4	42.8	46.3	117.1	1,885.5	361.7	75.6	2,439.9
Subtotal, Inflows	***66.9***	***76.4***	***549.5***	***172.8***	***66.1***	***245.4***	***755.8***	***62.3***	***136.9***	***2,140.7***	***387.2***	***546.6***	***3,211.5***
Refunds	-16.5	-29.1	-26.2	-85.0	-56.7	-8.5	-73.6	-410.4	-338.6	-331.6	-102.2	-81.2	-853.5
Total	50.3	47.2	523.3	87.8	9.4	237.0	682.2	-348.2	-201.6	1,809.1	285.0	465.5	2,357.9

Figures in $ millions.

Figure 2: MTF estimates of total non-withheld income tax collections by month based on fiscal 2020 tax benchmark of $3.647 billion. MTF uses a different monthly estimation methodology than the Massachusetts Department of Revenue. Figures in $ millions.

Appendix II

Capital Gains Tax Revenue Was Likely to Underperform Before COVID-19

Tax revenue generated from realized capital gains is both very difficult to predict and a volatile component of the state's tax system. The Commonwealth offsets a portion of the risk associated with this tax type by imposing a revenue volatility cap that requires capital gains tax revenue above a statutory threshold be deposited in the state's "rainy day" fund, the Commonwealth Stabilization Fund (CSF).

In fiscal 2020, the capital gains tax revenue estimate was revised to $1.815 billion as part of the consensus tax revenue agreement between the Baker Administration and legislature. This amount exceeds the $1.26 billion statutory threshold by approximately $555 million, which is currently slated for deposit in the CSF.

One proxy measure with some value as a proxy is capital gains distributions from mutual funds. Each year, mutual funds distribute their gains to investors and typically represent taxable income, though exceptions apply. As depicted in Figure 2, capital gains tax collections tend to align with the number of funds with "large" capital gains distributions (those that represent more than 10 percent of the Net Asset Value of the fund).[6]

If this pattern holds again in fiscal 2020, it implies capital gains tax revenue of approximately $1.313 billion, just $52 million above the statutory threshold. This is significant because it would wipe away most of the deposit to the CSF. More importantly, however, it reduces the total tax revenue base for fiscal 2021 tax growth forecasts by $503 million.

[6] Data as published at Cap Gains Valet for 2019.

FY	Large Cap Gains Distributions	Cap Gains Tax Revenue
2015	517	1,680.0
2016	391	1,416.0
2017	116	1,184.8
2018	346	1,686.9
2019	539	2,050.2
2020	203	*1,312.6*

Figures in $ millions. FY20 is an estimated value.

Figure A-1: Large capital gains distributions compared to capital gains tax revenue, FY15-20E

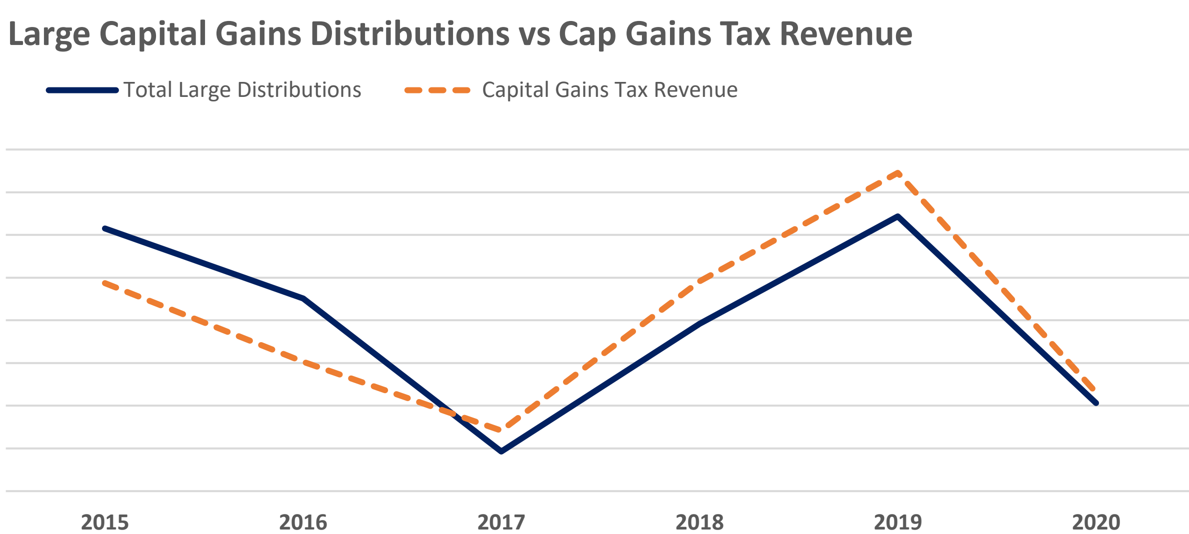

Figure A-2: A normalized comparison of large capital gains distributions suggests a strong correlation with capital gains tax collections, FY15-FY20E. Large capital gains data per Cap Gains Valet. Capital gains tax collections per MA DOR.

About the Massachusetts Taxpayers Foundation

The Massachusetts Taxpayers Foundation (MTF) is a non-partisan research organization that serves as an independent source of information for the Commonwealth's decision-makers.

Founded in 1932, MTF's mission is to provide accurate, unbiased research with balanced, thoughtful recommendations that strengthen the state's finances and economy in order to foster the long-term wellbeing of the Commonwealth.

MTF contributes to the public policymaking process in several key ways, including an annual forecast of tax revenue provided as part of the state's consensus tax revenue deliberations, budget planning and tracking, policy research on major issues such as transportation financing, the opioid epidemic, the income surtax, and migration trends, and supporting policymakers and opinion leaders with high quality analysis.