



April 16, 2020

## COVID-19 Impact: What MTF's Tax Forecast Means for MBTA, MSBA, "Rainy Day" Fund, and Pension Contribution

### KEY TAKEAWAYS OF THIS ANALYSIS:

- Tax revenue available for the budget will plummet approximately **\$3.9 billion or 15 percent** below the consensus tax revenue estimate for fiscal 2021 using the new MTF tax forecast adjusted for dedicated tax revenue.
- The MTF forecast implies that dedicated sales tax revenue for the Massachusetts School Building Authority will **fall to \$802 million, a decrease of \$174 million or 18 percent** to compared to the original consensus tax revenue agreement.
  - The forecast suggests MSBA will receive about the same amount of money in fiscal 2021 as they received in fiscal 2016.
- The MBTA will **lose approximately \$53 million** in dedicated tax revenue compared to the original consensus estimate and will receive the statutory minimum amount of \$1.083 billion absent other policy changes.
- Capital gains tax revenue will fall below the revenue volatility cap, **eliminating an anticipated \$271 million transfer** to the state's "rainy day" fund and long-term liabilities trust fund.
- The MTF tax projection implies total budgeted tax revenue of **\$24.8 billion**, or **about \$1 billion less than was available to budget writers in fiscal 2018.**

## INTRODUCTION

### Revised MTF Tax Forecast for Fiscal 2021

On January 13, 2020, executive and legislative leaders announced a consensus tax revenue forecast of \$31.151 billion for state fiscal year 2021, which begins July 1, 2020.<sup>1</sup> This amount was to serve as basis for the budget development process for the upcoming fiscal year's general appropriations act. As MTF has previously identified, the consensus tax revenue figure may have been overly optimistic at the time of the agreement.<sup>2</sup> The rapid and devastating impact of the COVID-19 pandemic on the state's economy since January makes the consensus tax revenue figure even more optimistic and thus unrealistic.

On April 14, 2020, MTF released a new fiscal 2021 tax revenue projection of \$26.756 billion, a decrease of \$4.4 billion or 14.1 percent compared to the consensus tax revenue estimate.<sup>3</sup> The forecast assumes income tax collections will fall short of the previous estimate by \$2 billion, an 11 percent decrease, while sales tax revenue will fall \$1.5 billion, an incredible 20 percent below expectations as a result of curtailed economic activity caused by the public health crisis. MTF further projects that capital gains tax revenue will fall to \$1.1 billion, or \$477 million less than the \$1.59 billion assumed in the consensus agreement.

After adjusting for tax revenues earmarked for specific purposes and the annual contribution to the state pension system, remaining tax revenue will total \$21.7 billion, a decrease of \$3.9 billion or 15 percent below the consensus agreement. This policy brief summarizes the impact of MTF's revised fiscal 2021 tax projection on the annual budget development process for the Massachusetts School Building Authority, the MBTA, the state's "rainy day" fund, and the potential impact on the annual contribution to the state pension system. These figures are depicted in Appendix I.

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<sup>1</sup> [Heffernan, Rodrigues, Michlewitz Announce Consensus Revenue Forecast of \\$31.151 B for Fiscal Year 2021](#), Executive Office for Administration and Finance, Senate Ways and Means Committee, House Ways and Means Committee. January 13, 2020.

<sup>2</sup> For more information, see [Further Analysis: Closing the Gap on Fiscal 2021](#), Massachusetts Taxpayers Foundation, March 11, 2020.

<sup>3</sup> For more information, see [FY2021 Tax Revenue Forecast – COVID-19 Pandemic](#), Massachusetts Taxpayers Foundation, April 14, 2020. This forecast was presented at the [Virtual Economic Roundtable](#) hosted by the Senate & House Chairs of Ways & Means and the Secretary of Administration & Finance on April 14, 2020.



## DEDICATED TAX REVENUE

### School Construction and Repair

The Massachusetts School Building Authority (MSBA) provides financial support to school districts across the Commonwealth for new school construction and renovation projects. Since its formation in 2004, MSBA has provided \$13.9 billion in grants for school construction and repairs.<sup>4</sup> There are more than 300 projects currently in the MSBA Capital Pipeline and more than 300 projects in the Accelerated Repair Program pipeline to make major facility improvements.<sup>5</sup>

MSBA leverages dedicated sales tax revenue to provide this support equal to a one percent statewide sales tax on regular retail sales and motor vehicles (excludes meals). Since its inception in 2005, this revenue stream has been relatively stable, experiencing only one fiscal year with a year-over-year decline (fiscal 2010). Through 2019 (the last year of actuals data), the trend revenue growth was 4 percent annually.

### MSBA Dedicated Sales Tax Revenue Growth vs Trend

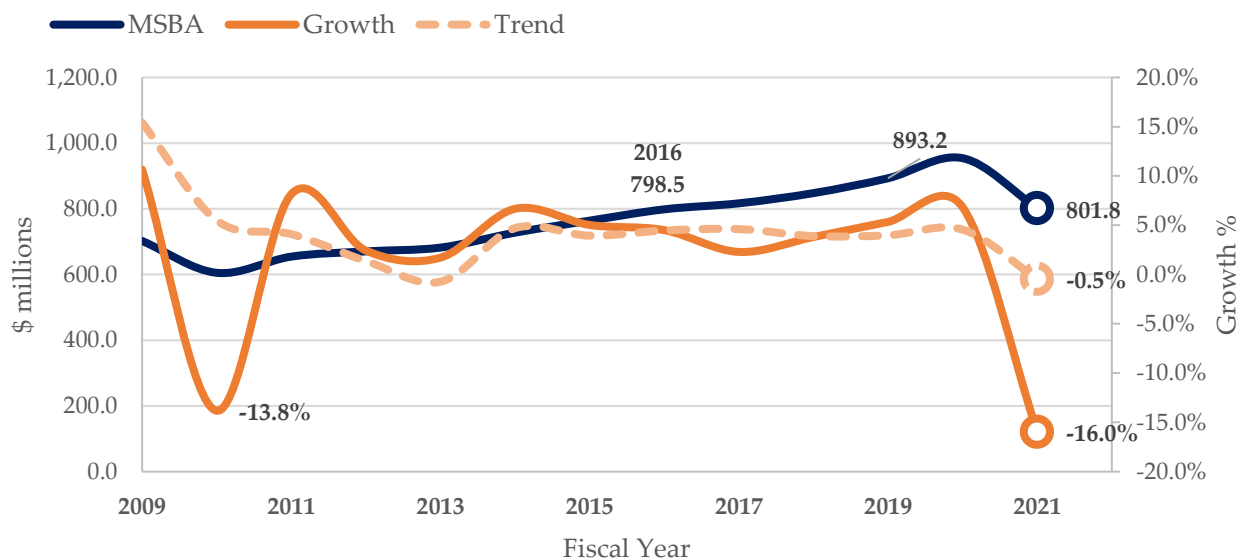


Figure 1: MSBA Dedicated Sales Tax Revenue history, FY2009-2019 Actual, FY20 shown as revised benchmark estimate. FY21 using MTF tax revenue projection.

Using the MTF tax projection estimates for fiscal 2021, MTF estimates MSBA would receive approximately \$802 million, a decrease of \$174 million compared to the consensus tax revenue estimate and set MSBA revenue back to its fiscal 2016 amount.

<sup>4</sup> [MSBA Overview Slide deck](#), Massachusetts School Building Authority, October 2019. Slide 14.

<sup>5</sup> [MSBA Overview Slide deck](#), Massachusetts School Building Authority, October 2019. Slide 19.



In the short term, this decrease compared to expectations is unlikely to have a material impact on MBSA projects given the relative strength of the authority’s financial position. A lengthy economic recovery, however, may impair their capacity to support additional school construction projects until sales tax revenue rebounds.

### MBTA

The Massachusetts Bay Transportation Authority receives dedicated sales tax revenue equal to the same statewide sales tax as the MSBA. Unlike MSBA, however, the MBTA transfer includes a statutory floor that prevents precipitous drops from one fiscal year to the next as MSBA will experience.

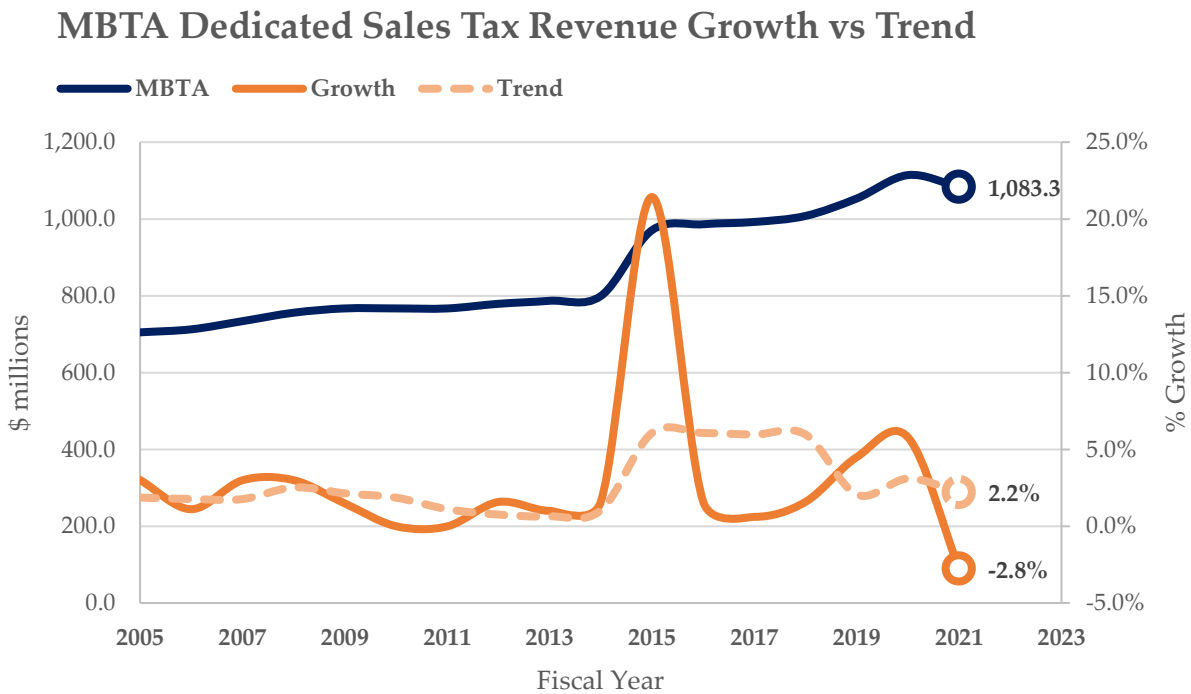


Figure 2: MBTA Dedicated Sales Tax Revenue history, FY05-2019 Actual. FY20 shown as revised benchmark estimate. FY21 using MTF tax revenue projection.

The MBTA received the statutory floor amount every year between fiscal 2012 and fiscal 2017. In fiscal 2018, the dedicated amount exceeded the floor by approximately \$1 million and has been well above the floor since that time.<sup>6</sup> The fiscal 2020 revised tax benchmark anticipates \$1.1 billion for the MBTA protected by a statutory floor of \$1.063 billion.

<sup>6</sup> Note that a statutory change reset the MBTA base amount to approximately \$971 million in fiscal 2015, causing the one-time increase in MBTA sales tax revenue depicted in Figure 2.



On March 6, 2020, the Commonwealth's Comptroller certified the MBTA base amount of \$1.083 billion for fiscal 2021, or \$53 million below the projected consensus tax revenue estimate of \$1.136 billion.<sup>7</sup>

The MBTA uses this dedicated tax revenue stream to support their capital improvement plan.

### **Revenue Volatility Cap: Excess Capital Gains**

Like many other states that rely on the personal income tax for the bulk of budgeted tax revenue, Massachusetts policymakers address the inherent volatility of this revenue stream by instituting a revenue volatility cap on capital gains tax revenue, which experiences high variability among growth rates between fiscal years. This mechanism automatically transfers capital gains tax revenue above a specified threshold to the state's "rainy day" fund, the Commonwealth Stabilization Fund.

The revenue volatility cap transferred \$1.4 billion to the Stabilization Fund in fiscal years 2018-2019, representing the major deposits that brought the total fund balance to nearly \$3.5 billion, the largest nominal fund balance in the state history.

The consensus tax revenue agreement assumed capital gains tax revenue of \$1.59 billion, or \$278 million above the threshold of \$1.3 billion. MTF's revised projection estimates capital gains tax revenue of just \$1.1 billion, which would represent the lowest capital gains tax revenue gross amount since fiscal 2012 (including fiscal 2020 at the capital gains estimate assumed in the revised tax benchmark).

After two fiscal years of sizable deposits to the "rainy day" fund, the COVID-19 pandemic will stymie executive and legislative efforts to build the state's reserves and make it more likely that policymakers will withdraw money from the fund for the first time since fiscal 2015.

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<sup>7</sup> [\*March 2020 Certification of MBTA Base Sales Tax Revenues and Dedicated Sales Tax Revenues for FY2021\*](#), Office of the Comptroller, March 6, 2020.



## **Annual Contribution to the State Pension System**

As part of the consensus tax revenue agreement, policymakers agreed to a new triennial pension funding schedule aimed at fully amortizing the Commonwealth's more than \$41 billion unfunded pension obligations by July 1, 2037. This schedule called for annual contribution increases of 9.6 percent, raising the FY2021 pension contribution to \$3.1 billion.

As decision-makers rethink the consensus tax revenue agreement, they may reevaluate the pension contribution by either extending the pension schedule beyond 2037 or implementing a "pension holiday" to reduce or eliminate the payment as a cost saving measure. Credit rating agencies routinely point to the state's unfunded pension obligation as an obstacle to improved creditworthiness. Therefore, deviating from the pension funding schedule would likely have an adverse impact on credit ratings.

## **CONCLUSION**

### **Less Budgeted Tax Revenue in Fiscal 2021 than Fiscal 2018**

The total amount of tax revenue available to budget writers after accounting for the statutory transfers to the MBTA, MSBA, and Workforce Training Trust Fund, is known as total budgeted operating tax revenue (or more simply, "budgeted tax revenue"). The MTF tax revenue projection implies budgeted tax revenue of \$24.8 billion, a decrease of \$4.2 billion or about 14 percent compared to the consensus tax revenue estimate, providing budget writers with approximately \$1 billion less in available tax revenue in fiscal 2021 than in fiscal 2018.

The COVID-19 pandemic has reshaped the state's financial picture dramatically in a very short timeframe. The unprecedented steps to curtail the spread of the virus will force big changes in public policy to deal with the crisis both in the short term and in the long run. The MTF tax projection and the ramifications of that forecast on the MBTA, MSBA, and others described here highlight the sweeping nature of those changes.



## Appendix I

<b>Fiscal 2021 Taxes Available for Budget Summary</b>				
	MTF			
	Consensus	Revised	\$ Chng	% Chng
Total Tax Revenue	31,151.0	26,756.0	-4,395.0	-14.1%
Tax Transfers				
MBTA	-1,136.0	-1,083.3	52.7	-4.6%
MSBA	-976.0	-801.8	174.2	-17.9%
Workforce Training Trust Fund	-25.0	-25.0	0.0	0.0%
<u>Subtotal, Tax Transfers</u>	<u>-2,137.0</u>	<u>-1,910.1</u>	<u>226.9</u>	<u>-10.6%</u>
<b>Total Budgeted Operating Tax Revenue</b>	<b>29,014.0</b>	<b>24,845.9</b>	<b>-4,168.1</b>	<b>-14.4%</b>
Capital Gains Tax Revenue				
Threshold	1,312.0	1,312.0	0.0	0.0%
Estimate	1,590.0	1,113.0	-477.0	-30.0%
<u>Excess Capital Gains Transfer</u>	<u>-278.0</u>	<u>0.0</u>	<u>278.0</u>	<u>-100.0%</u>
Annual Contribution to the State Pension System	-3,115.2	-3,115.2	0.0	0.0%
<b>Taxes Available for Budget</b>	<b>25,620.8</b>	<b>21,730.7</b>	<b>-3,890.1</b>	<b>-15.2%</b>

Figures in \$ millions.

Note: Capital gains tax revenue is subject to a statutory revenue volatility cap. Capital gains tax revenue above the statutory threshold amount is transferred to the Commonwealth Stabilization Fund. The consensus estimate assumed \$278 million would be transferred in fiscal 2021. MTF's revised estimate projects no excess capital gains transfer.

## **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 important 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.

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