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# *MTF Brief*

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## M.G.L.c. 62F: Tax Revenues in Excess of Allowable Amount

Two straight years of surging tax collections have put in focus M.G.L.c. 62F, a little known state law that establishes a limit on allowable tax revenues. This brief summarizes the law and assesses what it could mean for fiscal year 2022 and beyond.

### *Massachusetts General Law Chapter 62F*

In 1986 an initiative petition was passed which, among other things, put in place an annual limit on tax revenue growth. Under the law, total tax collections are compared annually to the allowable level, which is equal to the allowable level from the previous year adjusted by the three-year average growth in state wages and salaries.

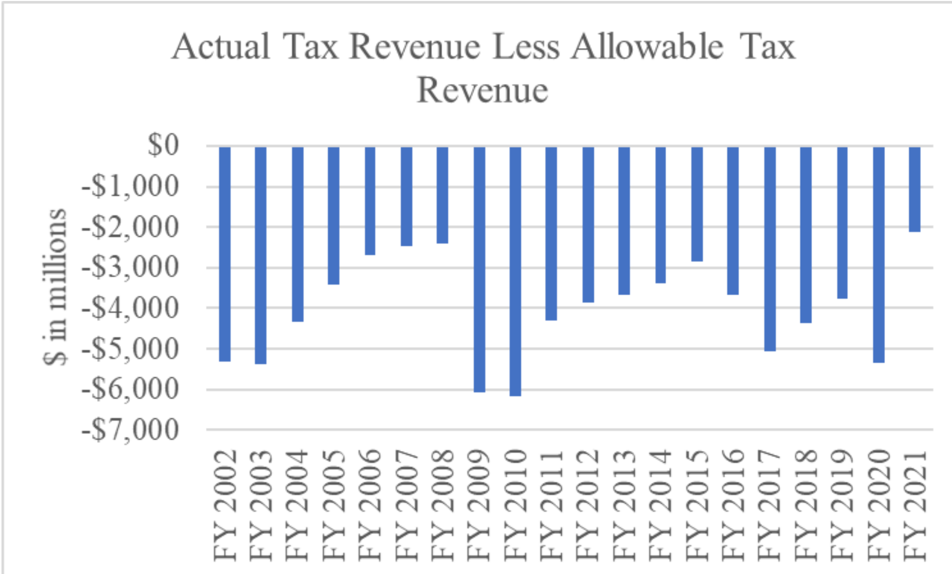
The calculation is conducted by the State Auditor each September. If tax revenues exceed the allowable level, the excess is provided to all taxpayers as an income tax credit proportionate to filers' income taxes paid in the most recent tax year.

Since the statute was put in place, tax revenues have only exceeded the allowable level in one year, 1987, when the excess was just under $30 million.

Between 2002 and 2013, the law was changed to require that excess tax revenue be calculated quarterly and excess amounts be set aside into a temporary holding fund. In 2012, this change was repealed and the current tax credit mechanism restored.

### *History of Tax Collections v. Allowable Level*

Between 2002 and 2021, wage and salary growth significantly outperformed tax collections, and as a result, collections fell at least $2.1 billion short of the tax growth limit each year. On average, the difference was $4 billion.




The strong pace of tax collections in FY 2021 reduced the gap between actual and allowable tax revenues by more than $3 billion. In FY 2022, tax collections have grown even faster and will exceed the allowable level by $2.96 billion according to the Baker administration's calculation. That calculation, which cannot be finalized until the books on FY 2022 fully close, works as follows:

*Calculation of FY 2022 Excess Tax Revenue*

| | FY 2021 | 2019-2021 Wage & Salary Growth | FY 2022 |
|---|---|---|---|
| Allowable tax revenue | $36,790 | 5.7% | $38,872 |
| Actual tax revenue | $34,656 | | *$41,835* |
| Difference | -$2,134 | | $2,963 |

*$ in millions; FY 2022 tax revenue from DOR initial analysis*

Tax revenue growth of about $7 billion, wipes away the $2.1 billion difference calculated last year, as well as $2.1 billion growth in allowable tax revenue growth, leaving an estimated $2.96 billion available to return to taxpayers. The $2.96 billion figure in the table is an estimate based on Bureau of Economic Analysis wage data and DOR tax collection estimates. The actual excess revenue figure will be calculated by the State Auditor in September.

***Impact on FY 2022 Surplus & Economic Development Legislation***

Several weeks ago, MTF estimated a $3.6 billion FY 2022 budget surplus without making an assumption on June tax collections. Based on DOR's estimate and other updated information that estimate has now grown to $4.6 billion.

*Revised FY 2022 Surplus Estimate*[1]

| Original budget tax estimate | $34,451 |
|---|---|
| January upgrade | $1,548 |
| May upgrade | $1,718 |
| Current above benchmark | $2,666 |
| **Total above benchmark** | **$5,932** |
| Dedicated to SBA/MBTA | -$120 |
| Capital gains above benchmark | -$1,200 |
| Supplemental spending to date | -$1,614 |
| Additional federal revenue | $750 |
| Outstanding deficiencies | -$23 |
| **Initial surplus** | **$3,725** |
| June revenue estimate | $834 |
| Reversion & balance estimate | $400 |
| SBA/MBTA adjustment | $80 |
| June capital gains offset | -$340 |
| Holyoke settlement | -$50 |
| **Adjusted surplus** | **$4,649** |

Using the $4.6 billion estimate, MTF assesses how $2.96 billion in tax credits would affect resources available for pending economic development legislation.

*Resources for Economic Development Assuming Credits*

| | | | | |
|---|---|---|---|---|
| **Resources** | | | | |
| Preliminary surplus | $4,649.0 | | | |
| *Excess tax revenue* | *-$2,963.0* | | | |
| Surplus remaining | *$1,686.0* | | | |
| FRF remaining | $2,266.0 | | | |
| **Total available** | **$3,952** | | | |
| **Proposed Spending** | | | | |
| | **Governor** | **House** | **Senate** | **All Spending** |
| Surplus spending | $1,688 | $1,427 | NA | *$1,686* |
| FRF spending | $2,266 | $1,427 | NA | *$2,256* |
| **Total spending** | **$3,954** | **$2,854** | **$3,002** | **$3,942** |
| **Remaining** | **-$2** | **$1,098** | **$950** | **$10** |
| *$ in millions* | | | | |

The extent of the budget surplus means that even if $2.9 billion is set credited to taxpayers, sufficient resources remain for either version of the House or Senate economic development/tax bills. However, if all spending is included in the conference report, resources get much tighter.

[1] SBA and MBTA transfer amounts are trending lower than MTF originally projected requiring an $80 million adjustment in the table. The reversion estimate remains conservative and could add to the final surplus.

***Fiscal Considerations***

State tax revenues will almost certainly exceed the current statutory cap by more than $2.5 billion, triggering the provisions of chapter 62F which provide an equal credit for taxpayers.. However, there are several important considerations for policymakers as they consider the commonwealth's fiscal picture:

- *Ongoing tax relief & rebate proposal*– in addition to the credits required by 62F, the economic development bill in Conference Committee includes a $500 million permanent tax relief plan and $500 million for one-time, middle-income tax rebates. While there are differences between the House and Senate approach, both branches have agreed that it is good policy to provide permanent tax relief that offsets housing and childcare costs, expands the EITC and improves the competitiveness of our estate law. Lawmakers must decide whether to combine the 62F credits and their proposed direct rebates that together total $3.4 billion in immediate tax relief along with the $500 million in permanent tax changes ($2.5 billion over five years), or makes adjustments to reduce the overall cost.
- *Pass-through-entity impact* – as of May, the Department of Revenue was still assuming that as much as $1.8 billion in FY 2022 tax collections was the result of timing issues related to a "pass-through-entity" tax change implemented in 2021. The change provided a federal tax benefit to many filers and increased state revenues, but implementation caused a temporary bump in non-withheld collections. There is no clear data on if or how much of these collections is likely to be given back through refunds in FY 2023, but law makers should be prepared for that possibility.
- *Fiscal Recovery Fund spending* – a large tax credit program, combined with a $3.5 to $4 billion economic development bill, will use the vast majority of remaining FRF resources. There is a benefit to spending FRF quickly, as it allows more time for programs to deploy and ensure that the state complies with federal timelines, but it limits future options to address emerging needs. The House and Senate will have to decide the proper balance between these considerations.

Lawmakers have only a few days to consider these and other factors and determine the right balance of permanent and one-time tax relief and recovery spending while maintaining the state's strong fiscal position amid a worsening economy.