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MTF Bulletin

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MTF Conference Committee Preview: Fiscal Approach to Surtax Revenue

The Fiscal Year (FY) 2024 Budget will define how Massachusetts collects, tracks, and manages revenue from the new 4 percent surtax on income over \$1 million, passed by voters in November 2022. In January, the Massachusetts Taxpayers Foundation (MTF) proposed a fiscal approach for surtax revenues that prioritized transparency and sustainability. These principles were largely reflected in the budgets passed by the House and Senate, and MTF urges budget negotiators to maintain them in the final policy put before Governor Healey.

This bulletin provides a brief background on the income surtax and MTF's initial recommendations, compares the House and Senate proposals, and makes specific policy recommendations for the final budget.

Background

Soon after the income surtax went into effect on January 1, 2023, MTF released several recommendations regarding how the new revenues should be treated in FY 2023, FY 2024 and future years. In the near term, MTF recommended the following:

- No use of income surtax revenues in FY 2023;
- A cap on the use of surtax revenues in FY 2024;
- Separate income surtax revenues from other tax revenues;
- Split the use of surtax revenues evenly between transportation and education.

As part of the FY 2024 consensus revenue agreement, the Healey administration, House, and Senate budget leaders agreed to not use surtax revenues in FY 2023 and to cap the use of those revenues at \$1 billion in FY 2024, consistent with MTF's recommendations. However, critical details were left to be resolved as part of the budget process.

Governor Healey Proposal

The Healey-Driscoll administration's budget proposed a straightforward process to collect and spend surtax revenues:

- Deposit all surtax revenues into a new Education and Transportation Trust Fund, with collections subject to certification from the Department of Revenue and the Comptroller;

- Cap annual surtax revenue used to support ongoing expenditures in each fiscal year; beginning in FY 2026, the cap would be established by a formula based on historic collection trends;
- Maintain a balance in the Education and Transportation Trust Fund equal to one-third of the annual spending cap. A two-thirds vote of the House and Senate would be required to spend out of the reserve balance;
- Limit the use of funds in excess of the reserve balance requirement to one-time education and transportation expenditures;
- All surtax appropriations are made in a separate section of the budget (Section 2F).

In addition to these surtax provisions, Governor Healey also proposed exempting surtax revenues from the state's 62F tax limit calculation.

House & Senate Proposals Compared

The House and Senate followed a similar approach to the Governor, including: identical certification processes, annual limits on surtax spending for ongoing expenditures, the creation of a reserve fund, and allowing excess revenue collections to be used for one-time initiatives and capital needs. In addition, the House and Senate agree that surtax revenues will not be included in the 62F calculation.

However, the House and Senate differ from the Governor, and from each other, in four ways:

- **Number of new trust funds** – The House and Senate both divide surtax collections among three separate trust funds. One to be used for ongoing spending, one for one-time uses, and one as a reserve to be used only when revenues fall dramatically.
- **Level of surtax reserves** – The Governor proposed a minimum reserve balance of one-third of the annual spending threshold, while the House and Senate set that figure as the maximum balance.
- **Use of excess surtax funds** – Like the Governor, the Senate requires that funds over the annual spending threshold, and not kept in reserve, be used for one-time projects and capital investments. The House leaves the requirement much more open ended, with no requirement that the uses be one time.
- **Calculation of annual spending limit** – Like the Governor, the Senate proposes that starting in FY 2027, the annual spending limit be determined by a formula, while the House proposes that the limit be determined each year by the administration, House, and Senate; similar to the consensus revenue process.

Finalizing the Surtax Approach

It is clear that the final budget will dedicate surtax revenue collections to separate funds, establish an annual spending cap and require funds be kept in reserve. It is also apparent that all surtax spending in FY 2024 will be included in a new budget section, Section 2F. These are all strong policies that promote transparency. In addition, MTF strongly recommends the following:

- Surtax reserves be subject to a minimum, not a maximum level. The House and Senate should adopt Governor Healey's proposal to keep surtax reserves at a minimum of 33 percent of the annual spending limit.
- Surtax spending over the annual threshold should be limited to one-time uses.
- The annual surtax spending limit should initially be based on historic growth of income subject to the surtax. This formula could be subject to periodic review from administration, House and Senate budget leaders.
- Surtax collections should be included in the state's 62F tax limit calculation.