State Treasurer Andrew Sidamon-Eristoff

Treasury and Interdepartmental Testimony

Assembly Budget Committee

May 7, 2014

Chairman Schaer, Budget Officer O'Scanlon, and members of the Assembly Budget Committee. I am pleased to appear before you today.

I am joined today by Charlene Holzbauer, Director of the Office of Management and Budget, and Dr. Charles Steindel, Treasury's Chief Economist, as well as many Division Directors and senior staff from the Treasurer's Office. I am also joined by the chief executive officers of some of Treasury's "in-but-not-of" agencies.

The stated focus of today's hearing was to have been the Governor's combined $6.8 billion Fiscal Year 2015 budget for the Department of the Treasury, the in-but-not of agencies, and the State's interdepartmental accounts. Although we are prepared to address any questions you may have with respect to those proposed expenditures, I hope you will not object to my taking a few minutes at the outset to speak to the fiscal developments of the last week.

On Monday, April 28, we announced that, based on available information to date, gross income, sales and corporate tax revenues for April would fall short of budgeted projections by approximately $600 million. We further announced a reduction in projected net revenue for the current fiscal year of $807 million, 2.5 percent less than anticipated as of the Governor's Fiscal Year 2015 budget message. Approximately $700 million or 85 percent of the net reduction in projected Fiscal Year 2014 revenues is attributable to the Gross Income Tax. Of course, the final tabulation for April is not yet in, and will be affected by the precise allocation of revenues between April and May. Per standard practice, I will provide a complete revenue update for both Fiscal Year 2014 and Fiscal Year 2015 at my next appearance before this committee.

What happened? Although it will take some time to clarify the specifics, it appears that we and many other states with similar economic and tax policy profiles broadly under-estimated the impact that the scheduled imposition of higher federal income taxes at the end of calendar year 2012 (Washington's so-called "fiscal cliff") had on taxpayer behavior, particularly high-income taxpayers who have the flexibility to plan and manage the realization of non-wage income such as dividend distributions and capital gains.

With respect to projecting April 2014 receipts, the consensus view --- apparently shared by our colleagues in the Office of Legislative Services and many other states --- was that, as expected, high income taxpayers did in fact accelerate income into the end of calendar year 2012, boosting April 2013 receipts, but that the exceptionally strong stock market gains of calendar 2013 --- with the Dow up 26 percent, the S&P up more than 29 percent, and the Nasdaq up nearly 40 percent --- would more than make up for any acceleration. Moreover, our statistical models suggested that there would be more capital gains realizations in 2013 than 2012, despite the "fiscal cliff" dynamic.

Obviously, we were wrong.

Was this a surprise? Yes. As you would anticipate, we track the various components of the Gross Income Tax --- withholding tax payments, quarterly estimated tax payments, and April final payments (consisting of final settlements and payments made in conjunction with requests for extensions) very closely throughout the fiscal year. This year, withholding tax payments and estimated tax payments have largely tracked our expectations, so the most significant outstanding variable entering the final stages of this year's annual tax filing season was receipts from April final payments, particularly physical checks mailed with high-income taxpayers' requests for filing extensions. Historically, solid estimated tax payments have tended to correlate with strong final payments, so we had reasonable basis to anticipate that April final payments would track expectations.

As it happened, withholding and estimated tax receipts this April once again met our expectations, but final payments have been a significant disappointment, with receipts tracking about 27.6 percent below expectations. Instead of receiving $1.976 billion, we received $1.431 billion in final payments through April 30 this year, or $545 million less than anticipated. This became apparent over the course of a handful of days as we processed check payments mailed on the April 15 mailing deadline (but received some days thereafter).

Understanding what this 27.6 percent variance in April final payments means requires some context. In recent years, final payments have accounted for at least 11.7 percent of annual Gross Income Tax. By themselves, they account for about 4.5 percent of State revenue and constitute the 4th largest State revenue source. So, clearly, a variance of this size has significant fiscal implications.

But this variance also raises some important tax policy considerations. The plain fact is that a relative handful of very high income taxpayers account for the bulk of final payment revenues, particularly payments made in conjunction with requests for filing extensions. Historically, these taxpayers' taxable income has exhibited a high degree of variability, at least some of which is a function of their flexibility to engage in tax planning. Every state with an income tax is obliged to deal with the resulting unpredictability and volatility in revenues, but New Jersey faces a particular challenge as a function of its extremely progressive Gross Income Tax rate structure. As we noted, in recent years just 400 taxpayers have accounted for almost 10 percent of our income tax revenue, while the top one percent accounted for almost 40 percent and the top 10 percent have accounted for approximately 70 percent.

It may come as cold comfort to note that many other states are also experiencing a shortfall against final payment expectations. Press reports indicate that Arkansas, California, Connecticut, Delaware. Kansas, Massachusetts, Michigan, Missouri, North Carolina, Pennsylvania, Tennessee, West Virginia, and Wisconsin have all experienced shortfalls; many others have shared information with us privately and will likely make some form of public disclosure in the coming weeks.

Having quantified the challenge, it is now our moral and Constitutional obligation to identify and implement solutions. We have just seven weeks and a lot of work ahead.

To set the stage, I must repeat what I said last week: the State will take any and all actions necessary to offset the reduction in anticipated revenues and finish both Fiscal Year 2014 and Fiscal Year 2015 with unrestricted fund balances of at least $300 million as anticipated in the Governor's Fiscal Year 2015 Budget Message, including the identification of additional lapses and savings opportunities, as well as the exercise of the full range and scope of the Governor's executive authority, including but not limited to reserving and/or impounding budgeted appropriations.

As I announced last week, I will provide a detailed description of the specific actions we are taking or proposing to take with respect to the Governor's proposed Fiscal Year 2015 budget, together with related adjustments to Fiscal Year 2014, when I appear before this budget committee later this month.

In the interim, of course, we are already at work identifying, scoring and evaluating Fiscal Year 2014 options for the Governor's consideration. Although the Governor has not yet made his final decisions, I will acknowledge that, with just seven weeks left in the current fiscal year and the bulk of State spending for the year already behind us, we face incredibly difficult choices. The limited areas of significant spending that remain impact nearly every New Jerseyan: payments for Medicaid services including managed care; hospitals, nursing homes and other health care providers; school aid, state colleges and universities, and student assistance; health benefits for teachers and state employees; the State retirement system; and more. As the Governor has said, everything must be on the table.

We appreciate that the weeks ahead will be extremely challenging and that different stakeholders will advance competing and often conflicting views and priorities. We hope and expect that the budget committees and the Legislature as a whole will play an active and constructive role as partners in meeting this challenge. But I must assure you and our fellow New Jerseyans: No matter what, New Jersey will meet this challenge and emerge the stronger for it. We have no choice.

Thank you for giving me this opportunity to speak to the immediate fiscal challenge before us. Despite my rather sobering remarks, I remain ready for, and would welcome, a discussion of the work of the Department of the Treasury's dedicated employees who work to deliver a broad range of important services to State government and the public. Of course, I will also be pleased to relinquish the floor to my esteemed colleagues from the in-but-not-of agencies, as I know they are also anxious to share their work and answer your questions.