Testimony prepared for presentation to the
Senate Budget & Appropriations Committee
David Drescher
Office of Legislative Services
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Good morning Chairman Sarlo and members of the committee.

After the Governor's Budget Message each year, the Office of Legislative Services (OLS) prepares an independent analysis of the major tax revenues available for appropriation for the balance of the current fiscal year as well as next fiscal year.

You have been provided a copy of our **Tax and Revenue Outlook** containing our revised revenue estimates for the current Fiscal Year (FY) 2018, as well as our preliminary revenue projections for FY 2019. This report was prepared by the Revenue, Finance, and Appropriations Section of OLS in collaboration with the Legislative Budget and Finance Office.

Although this is my first year presenting to you, our methodology remains consistent. We rely on a review of recent State revenue collections, historical revenue patterns, revisions to State and federal law, a variety of economic data and forecasts, revenue trends in other states, as well as our professional judgment. The OLS considers a range of possibilities for each of the major taxes, and calculates the revenue outcomes that would result using various assumptions before arriving at estimates we believe reflect the most likely scenario.

In grand total, the OLS expects that the current fiscal year revenue collections will outpace the targets used to develop the budget by about $750 million. Economic trends and recently enacted State and federal policy changes, when combined with several additional policy changes proposed by the Governor, lead the OLS to project total revenues will grow approximately 5% in FY 2019. The difference between our grand total revenue estimates and those presented in the Governor's Budget Message are extremely small – inclusive of both years, the difference is approximately ¼ of one percent of total State revenues. This similarity masks some differences in our estimates for some specific revenues – in particular, our higher estimates for the Gross Income Tax and lower estimates for several other taxes suggest a greater proportion of overall revenue that would be constitutionally dedicated to property tax relief, therefore offering the Legislature less flexibility in choosing spending priorities for the next budget.

I will begin the discussion on specific taxes with our largest single revenue, the **Gross Income Tax (GIT)**. The GIT has grown steadily for the past seven years, averaging about 4.4% growth over that period. The OLS forecasts accelerated growth for FY 2018 and FY 2019, at approximately 8% per year, but these estimates are substantially influenced by changes in the behavior of high-income taxpayers related to federal and State tax policy changes. The current fiscal year is boosted by one-time payments related to the expiration of one provision of federal law dating back to 2008. We also assume that some taxpayers initially delayed capital gains from 2016 into 2017 and 2018 in anticipation of federal tax cuts. Another possibility to consider is that some taxpayers may have accelerated gains from tax year 2018 into 2017 to avoid a possible increase in the State GIT rate. These one-time events make the "April Surprise" particularly difficult to predict this year. Withholding receipts, which are typically less influenced by tax planning, have risen approximately 5.5% year-to-date, and we expect this trend to continue. In total, the FY 2018 OLS forecast of $15.1 billion is $159 million above the Executive estimate.

In FY 2019, we expect the underlying positive trends in GIT collections to continue, though the aforementioned one-time effects seen in FY 2018 will not repeat. The GIT estimate includes several of the Governor's proposed changes in the tax code, including an increase in the top marginal rate for income over $1 million, an increase in the property tax deduction cap, an increase in the Earned Income Tax Credit (EITC), and a new child and dependent care tax credit. The Executive estimates that these changes will collectively increase collections by $642 million, which we temporarily accept for purposes of today's revenue forecast. As we analyze legislation seeking to effect the tax policy changes, we will provide you with our independent assessment of the magnitude of the proposed tax policy changes. I should emphasize that GIT revenue is fairly volatile from year to year, and as previously indicated, is quite dependent on tax planning decisions of high-income taxpayers and the performance of financial markets. Our growth estimates assume that trends of the past several years will continue, but if the past month's decline in stock markets extends into a major correction of asset prices, actual collections in the coming fiscal year may fall below our predictions.

I'll move on to the **Corporation Business Tax (CBT)**. Our office has suggested for many years that the CBT is extremely difficult to forecast. Collections typically include both payments and refunds from multiple tax years and are influenced by corporate accounting practices that are largely invisible to us. The recent federal tax reform law will affect corporate behavior and CBT collections in a variety of ways that we cannot aggregate into a single net impact on the CBT. The Executive anticipates that FY 2018 CBT collections will be $175.3 million less than the budget's certified forecast, but still 2.7% more than the prior year's collections. In FY 2019, the Executive believes that revenues will grow by more than 10%, to $2.4 billion, after including $110 million from proposed tax law changes. Given unusually weak performance in February and March, the OLS projects that current year collections will fall below FY 2017 totals, $151 million less than the Executive estimate. Our FY 2019 projection assumes underlying growth of approximately 3.5%, which when combined with the Governor's revenue initiatives produces $2.23 billion, $208 million less than the Executive prediction.

Unlike the GIT and the CBT, the **Sales and Use Tax** is a fairly stable and predictable source of revenue – and at this time the OLS and Executive agree on likely collections for both FY 2018 and FY 2019. Collections to date in FY 2018 have grown more slowly than the certified revenue estimate would predict, causing us to lower our forecast by $159 million. Growth in the sales tax, while still positive, is less than it would otherwise be because of the reduction in the sales tax rate under P.L.2016, c.57. The Governor proposes restoring the rate to 7%, while also expanding the tax base in several ways, which the Executive expects will collectively produce an additional $648 million in FY 2019. When combined with our expectation of about 3% growth in tax revenue, we expect revenue to reach about $10.4 billion in FY 2019.

As you all know, chapter 57 changed more than only the sales tax, bringing me to two other revenue sources that were significantly affected – inheritance taxes and gas taxes. The law provided for a two-step elimination of the estate tax, which had historically provided about half of the revenue reported as **inheritance taxes.** Actual collections data thus far in FY 2018 suggest that the Executive as well as the OLS had underestimated the rate at which estate tax revenues would fall. The Executive has revised its forecast downward, from $746 million to $610 million. With the benefit of additional months of data, the OLS has set its expectation for the current year lower still, at $583 million. We concur with the Executive's prediction that collections will fall further in FY 2019, coming to the same estimate of $466 million.

Revenue from the **Petroleum Products Gross Receipts Tax** (PPGRT) has grown substantially as a result of chapter 57, and those revenues are now constitutionally dedicated for transportation trust fund purposes. These revenues are allocated between what is identified in the budget as "Capital Reserves" for dedicated transportation projects, and the General Fund for the support of transportation debt service. Year-to-date performance of the PPGRT has caused the Executive and the OLS to revise FY 2018 forecasts downward from the original certified estimate – the Executive by $45 million and the OLS (with the benefit of additional months of data) by $133 million. The lack of historical data on collections under the current structure of the tax makes it difficult to project future collections – consequently, we have chosen to project the same collections in FY 2019 as in FY 2018.

Finally, I will highlight a relatively minor tax in which the Executive and OLS estimates diverge notably. Compared to the Governor, the OLS expects slower growth in the **Realty Transfer Fee** and a slight decline in the separate assessment on properties valued over $1 million, forecasting $37 million less in FY 2018 and $40 million less in FY 2019 from the combination of the two taxes. This cautious stance reflects slightly weaker year-to-date performance than originally assumed, as well as a lower growth rate expected in the out-year. Our assumptions of slowing growth are largely guided by rising mortgage interest rates, the tightening supply of homes available for purchase, and certain effects of recently enacted federal tax changes.

The Tax and Revenue Outlook before you expands upon the points I have summarized and discusses the major tax revenue sources in greater detail. In addition, the OLS is projecting small upward and downward differences relative to the Executive for a few of the other major taxes and those can also be found in our report. As always, the projections we are providing to you today are subject to revision when we come back before you at the final budget hearing in May, after important April tax collections are recorded.

And now, we would be pleased to answer your questions.