NJ ASSEMBLY BUDGET COMMITTEE
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State Treasurer Elizabeth Maher Muoio
Testimony as Prepared for Delivery

Good afternoon, Chairwoman Pintor Marin, Vice Chair Burzichelli, Budget Officer DiMaio, members of the committee. Thank you for the opportunity to come before you today to discuss Governor Murphy's proposed Fiscal Year 2020 Budget.

I'd like to once again start by introducing my colleagues here at the table with me - Deputy Treasurer Catherine Brennan, Acting Director of the Office of Management and Budget (OMB) David Ridolfino, OMB Deputy Director Lynn Azarchi, and the Director of the Office of Revenue and Economic Analysis (OREA) Martin Poethke.

I'd like to personally thank each of them, as well as my front office, and the staff of OMB and OREA, many of whom have joined us here today, for their tireless dedication in putting this budget together.

This time around was very different from last year when we had to unveil a proposed budget less than two months after taking office. For FY20, we had the benefit of being involved from day one. Many people would probably be surprised to know that the planning process begins not too long after the current budget is signed into law.

So while the process was vastly different this year for myself and my immediate staff, one thing remained constant - I am fortunate to be surrounded by a team of truly dedicated and experienced professionals within our department.

While the introduction of this budget is a critical step in this journey, there is still much more to be done before reaching final enactment. There will be numerous hearings and many productive discussions between now and the end of June. While many of the moving parts may change, this budget is built on four strong pillars that everyone should embrace – pillars that will strengthen our foundation for the years ahead.

Number one is smart, strategic, sustainable savings. This budget includes $1.1 billion in sustainable savings, including nearly $800 million in public employee health benefit savings and $200 million in departmental savings.

Number two – this budget is built on fiscal responsibility with an eye towards restoring our creditworthiness:

- It boosts our surplus to three percent of our total budget, including back-to-back billion dollar projected surpluses for the first time in memory;
- It continues to identify reliable, recurring revenue sources while reducing our reliance on one-shot revenues; and
- It includes another record pension payment to put us further on the path to full ARC funding;

Number three – this budget continues to invest in our shared priorities:

- boosting the General Fund subsidy to NJ TRANSIT by $100 million for an historic total of $407.5 million;

- increasing funding for Pre K expansion and K through 12 education under the new school funding formula;
- targeting increased higher education funding towards degree completion; and
- reducing Clean Energy Fund diversions to further secure New Jersey's place as a leader in renewable energy; and
- entirely eliminating the diversion of Affordable Housing Trust funds.

Number four – this budget continues to build on our goal of tax fairness by asking the most fortunate among us to pay a little more in order to help support these investments and meet our growing structural obligations.

Last year, the Governor and Legislature laid the foundation for a stronger and fairer New Jersey. This year, we are building on that goal by laying out a blueprint to help grow our middle class.

So let me begin by first providing you with an update on our revised projections for the major revenues for the current fiscal year – FY19.

FY 2019 REVENUE UPDATE

For the current fiscal year, we have revised our forecast for total revenues upward by $327.3 million for a total of $37.738 billion, which is a modest increase of less than one percent from the amount certified last summer. In a nutshell, robust growth in corporate tax revenue is exceeding downward adjustments in the Gross Income Tax (GIT) and the Sales Tax.

The most compelling revenue performance in FY19 has been the **Corporation Business Tax (CBT)**. Through the end of February, the CBT is up 95.6 percent. As a result, we have increased the CBT forecast by $662.4 million to a total of $3.7 billion for FY19, the highest total ever for this tax revenue.

While the full picture will not be clear until the fall, when corporations' returns for 2018 will have been processed, there are some things we do know for certain right now. Growth is being driven by a combination of factors, chief among them: the 2.5 percent State CBT surtax on earnings over $1 million and the expansion of the tax base due to federal tax law changes.

We currently estimate that one-third of this corporate revenue growth, about $516.8 million, is comprised of one-time, non-recurring revenues that will evaporate next year, including: certain statutory revenues such as deemed repatriated dividends and tax amnesty, a large, unexpected one-time payment, one-time tax planning behavior, and lastly, catch-up tax payments resulting from the retroactive implementation of the surtax.

The smaller CBT on Banks and Financial Institutions is also significantly out-performing expectations. As a result, we have raised the forecast for this revenue as well to $328.6 million, an increase of $125.9 million above the certified level.

Combined, these corporation tax revenues are now projected to grow by $1.569 billion over last year, accounting for 80 percent of the State's total projected revenue growth between FY18 and FY19. While this growth may sound extraordinary, FY19's remarkable corporate tax revenue surge will stand as a temporary, one-year high water mark – and not a sustainable solution to the numerous budget challenges we face in the near future.

In contrast to robust corporate revenues, the **Sales Tax** forecast for FY19 has been reduced by $78.6 million, to $10.057 billion. Year-to-date trends have been slightly below forecast, due largely to slowed implementation of collections from online remote sellers related to the U.S. Supreme Court's *"Wayfair"* ruling last June. Last summer's certified Sales Tax forecast included $212 million from these remote sellers. However, collections did not begin until October and many vendors were also granted up to a 180-day postponement as authorized under the law. As a result, we have collected just $53 million from remote sellers so far this year and we now project a total of $130 million from this source by the end of FY19.

Now let me turn to the most challenging forecast in FY19 - **the Gross Income Tax**. As we have reported, GIT collections for December fell 35 percent below the prior December; and January collections fell by 4.8 percent over last January.

This notable two-month dip in the GIT constricted year-to-date growth in total major revenues to a modest 3.7 percent through the end of February. However, we believe actual underlying growth is stronger than these numbers indicate. Two distinct factors combined to inflate FY18's revenue numbers, making this year's growth appear misleadingly low.

First, in December of 2017, the State received an estimated $253.0 million from the one-time repatriation of deferred compensation for hedge fund managers, prompted by the sunset of a 2008 federal tax law.

Second, State revenue collections also benefitted from about $150.0 million in April prepayments as many taxpayers rushed to take advantage of the uncapped federal SALT (State and Local Tax) deduction one last time before it was capped by the feds. I discussed these payments in my testimony this time last year and I will expand on this a little more in a minute.

Combined, these two factors artificially boosted December 2017 and January 2018 GIT by an estimated $403.0 million. As a result, last year we cautioned against overstating what appeared to be 9.3 percent growth in the total major revenues at the time. You may recall there were some optimistic claims of a potential billion dollar revenue windfall for FY18 based on that mid-year growth rate – a windfall that did not materialize.

This year we are urging caution when it comes to jumping to negative conclusions and projecting dire shortfalls before we have a clear picture of April revenue collections. When we factor out the $403.0 million brought in by the one-time repatriation of hedge fund compensation and the prepayment of April 2018 Gross Income Taxes from the FY18 base, we get a more realistic underlying growth rate for the major revenues of 6.0 percent year-to-date through February.

Furthermore, we have compelling reason to believe that the recent two-month dip in GIT collections during December and January - a pattern that has been reported in a number of states - is largely attributable to a significant shift in historical tax planning behavior due to changes under the federal Tax Cut and Jobs Act that was enacted in December 2017.

Here is the reason why.

For many decades, high-income taxpayers had an annual incentive to accelerate substantial state tax payments into December to take advantage of the uncapped federal SALT deduction, which is the deduction for State and Local Taxes. The value of these deductions could equal six figures for certain taxpayers, resulting in tens of thousands of dollars in federal tax savings. As a result, between 50 percent and 60 percent of total December and January estimated payments were typically prepaid around December 31 for <u>federal tax planning purposes</u>.

In December of 2017 this prepayment behavior jumped to 72 percent as taxpayers attempted to take advantage of the uncapped SALT deduction one last time before it expired. In 2018, with the federal SALT deduction capped at $10,000, the incentive to accelerate State tax payments vanished and the December 31 prepayments plummeted to about 19 percent, a drop of nearly $900 million in one year. While roughly half of this drop was made up by estimated payments at the end of this January, we believe taxpayers are now waiting until April to fully reconcile their 2018 tax liabilities, making up much of the remaining shortfall.

It is worth noting that this particular tax planning behavioral change has never happened before. Since the inception of the Gross Income Tax in New Jersey, there had always been an uncapped federal SALT deduction – until last year, that is. So there is no prior year in history to serve as a model for what we, and some other states, are currently experiencing.

Therefore we are taking a cautious approach to the revised GIT forecast, and reducing our GIT projection by $415.1 million from the amount certified last summer, to a total of $15.563 billion. It should be noted that part of this decline is due to a technical shift of $177 million from the GIT to the CBT as a result of an accounting reformulation of certain partnership payments. The remaining $238.1 million reduction is a prudent hedge against the weak December performance.

Last among the State's largest major tax revenues I'd like to discuss is the **Petroleum Products Gross Receipts Tax** (PPGRT). We have increased our FY19 forecast for this tax by $105.8 million over the certified June forecast for a total projection of $1.466 billion. Most of this money is transferred to Capital Reserves to support critical Transportation Trust Fund projects throughout our State.

Our revenue projections include the 4.3 cent rate increase announced last August, which went into effect on October 1st. As you are aware, the statutory formula directs us to annually assess this revenue stream to determine if a recalculation of the PPGRT rate is warranted based on fuel consumption data and revenue collections compared to the 2016 base year. This is done to ensure that the TTF program can support $2 billion in crucial road and bridge construction projects each year. As required by law, we will revisit these revenue collections in August to determine if the rate should be recalculated either upward or downward.

As members of this committee, you are very familiar with how important April tax payments are. In about six weeks we will have a much better idea if this April's receipts will confirm our belief that changes in historical tax planning behavior are largely responsible for the recent collection patterns we have seen.

While there are always ups and downs, we have many reasons to remain confident about FY19 revenues. There are no economic indicators suggesting that the GIT should decline in FY19. In fact, the economy is performing well:

- State nominal GDP (Gross Domestic Product) is projected to grow by at least 4 percent in 2018;

- Employment increased by nearly 40,000 jobs;
- Wages were up over 3 percent -- including 5.1 percent growth in employee withholding receipts;
- Personal income was up 3.6 percent; and
- The Congressional Budget Office projects U.S. capital gains to have jumped by 21 percent last year.

All in all, 2018 was a good year for New Jerseyans. With that said, let me now turn to our forecast for FY 2020 revenues.

FY 2020 Revenue Forecast

As I mentioned a few moments ago, revenue growth into FY20 will be severely curtailed by significant one-time, non-recurring revenues received in FY19. In addition to the estimated $516.8 million in non-recurring corporate revenues, there is an additional estimated $295.7 million in non-recurring revenue among the other major tax streams, most notably from tax amnesty receipts under the GIT and Sales Tax, and the final expiration of the Estate Tax. In total, there is an estimated $812.5 million in one-time revenues for FY19 that must be factored out of our base when projecting FY20 revenues.

As a result, while we could typically expect aggregate revenues to increase between three and four percent in a normal year with moderate economic growth, the estimated net growth in FY20 is only 1.4 percent due to the loss of these non-recurring revenues.

In order to meet our growing structural obligations and fund the crucial investments needed to move New Jersey forward in a fair and equitable manner, the Governor is proposing several new tax policy changes that will generate an additional $558 million in FY20.

The majority of this new revenue would be derived by taking the 10.75 percent tax rate that was enacted last year on income over $5 million and extending it to all taxable income over $1.0 million. This proposal will raise an estimated $447 million in FY20 to help support crucial investments in many of our shared priorities, particularly education funding and property tax relief.

What this means is that the vast majority of millionaires will pay roughly two cents more on every dollar over $1 million. As the Governor has repeatedly said, this is about tax fairness - asking a little more from those among us who have realized the greatest financial rewards from all that our state has to offer.

Additionally, the Governor's budget proposal also includes several other new revenue initiatives.

With everyone still firmly committed to the long-awaited passage and legalization of recreational adult-use cannabis, we estimate that the $42 per ounce tax specified in the most recent version of legislation will produce an estimated $60 million in the second half of the fiscal year if sales begin in January of 2020. As a quick aside, we estimate there will be $21 million in administrative costs to get the program up and running in its first year, meaning net revenue from legalization is estimated at $39 million.

The Governor is also proposing a Corporate Responsibility Fee that would levy a $150 per employee assessment on companies that employ 50 or more people who are covered by Medicaid. Similar to a policy instituted in Massachusetts, this proposal would primarily impact larger corporations in New Jersey. The Department of Human Services estimates that there are roughly 200,000 Medicaid beneficiaries employed by these companies. Those employees bring with them 250,000 spouses and dependents, for a total of 450,000 individuals, which equates to roughly 25 percent of New Jersey's total Medicaid population. The annual cost to New Jersey for each person on Medicaid is roughly $2,500, which means we are paying $1.1 billion for this population. The fee we are proposing would only generate roughly $30 million to help partially offset these costs. Ultimately, this proposal is intended to encourage employers to provide health benefits and reduce the reliance on government-subsidized, taxpayer-funded healthcare.

Additionally, the Governor's budget includes a proposed increase in the assessment on opioid drug manufacturers and distributors that will yield an estimated $21.5 million in revenue. This fee, which will ultimately require legislation, will help fund the continued, concerted effort to combat the opioid crisis in our state.

Again, these four tax policy proposals will add $558 million to revenues in FY20, partially offsetting the significant impact of the loss of $812.5 million in non-recurring revenues.

In total, our **Gross Income Tax** revenue projection for FY20 is $16.639 billion, an increase of 6.9 percent over the current fiscal year. Steady underlying growth, plus the expanded millionaire's tax, is expected to yield an additional $1.077 billion over FY19. Our FY20 projection also includes the second of three planned increases in the Earned Income Tax Credit, providing an additional $30.2 million in tax relief for working families in New Jersey who need it most.

Moving on to the **Sales Tax**, we are projecting $10.456 billion in revenue for FY20, which represents four percent growth over FY19. A full year of collections from online remote sellers is expected to yield an additional $60 million for an estimated annual total of about $190 million for FY20.

Our **CBT** projection, however, is expected to decline 13.3 percent from our revised FY19 forecast of $3.7 billion to an estimated total of $3.217 billion from FY20. This is due to the significant amount of non-recurring revenue that I mentioned earlier, which has boosted FY19 collections to peak level.

For FY20, we are projecting a modest growth in revenues of $1.498 billion from the **Petroleum Products Gross Receipts Tax**. While consumption is likely to decline somewhat further, with the 4.3 cent rate increase in effect for an entire 12-month cycle, we are cautiously optimistic that total revenues will remain stable. As I said earlier, this will be revisited in August as required by law, but no rate change is assumed in the current projection.

All told, total revenues in FY20 are projected to yield $38.833 billion, a $1.095 billion increase over FY19, and growth of a modest 2.9 percent overall.

Last, but certainly not least, I want to touch on something I mentioned last year. I cannot stress enough the importance of building up our surplus. We cannot simply treat it as an "extra" pot of money available to be raided. Our surplus is the only safety net we have in the event of an emergency, including situations we are all too familiar with, such as the increasing severity of storms, and the potential for a severe economic downturn or recession.

It's important to remember that the states that recovered quickest from the last recession were those with the healthiest surpluses. Today the national state surplus average is roughly 10 percent of their respective budgets. At $1.2 billion, our proposed surplus, while substantially increased from what we inherited, still only represents about three percent of our budget. In order to be on par with the national average, we would need a surplus of roughly $3.9 billion - $2.7 billion more than what we're scoring in the Governor's proposed budget. We have a long way to go to get to that level – one that is adequate enough to support our fiscal needs in the event of an economic downturn, which is something the ratings agencies look favorably upon as an indicator of sound financial management.

We are on the right path. We are committed to continuing to pursue the type of smart, strategic initiatives that helped produce $1.1 billion in savings for this budget. I want to thank the team in my office and in Treasury's various divisions, in particular, for their dedication to this effort. We conducted a holistic review of how health benefits are delivered, taking a look at things with fresh eyes, and pursuing efficiencies and savings wherever they may be had, working in tandem with the Governor's Health Benefits Review Task Force and members of the Legislature in many cases.

I think we can all agree that the years of kicking the can down the road are over. For the second year in a row, the Governor's proposed budget tackles many long-standing and long-ignored challenges head on. It marks a significant departure from recent years. As the Governor stated in his budget message, he knows this will not be the budget he ultimately signs. We look forward to working together with our partners in the Legislature to continue fine-tuning it in the coming months.

As I said before, this budget is built on four solid pillars – fiscal responsibility, sustainable savings, continued investments and tax fairness. At the end of the day, I think these are principles we can all be proud of. Thank you and I look forward to taking your questions.

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