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Chapter 62F: Implications for FY 2023 and Future Fiscal Years

Background

Chapter 62F of the Massachusetts General Laws establishes a limit on annual state tax revenue collections. The law, passed by an initiative petition in 1986, created a process by which actual tax collections are compared to an allowable tax revenue threshold, adjusted annually on the basis of wage and salary growth in the Commonwealth. If actual collections exceed the allowable threshold, the excess revenue is returned to eligible income tax filers in amounts proportionate to filers' income taxes paid in the most recent tax year.

Implementation of Chapter 62F in Fiscal Year 2022

As MTF previously reported, between 2002 and 2021, wage and salary growth in the Commonwealth consistently outperformed state tax collections by an average of $4 billion, keeping the state significantly below the allowable tax threshold. However, unprecedented revenue growth over the last two fiscal years led to actual collections exceeding the allowable tax revenue threshold for the first time in 35 years in Fiscal Year (FY) 2022.

The table below demonstrates that while wages and salaries grew by an average rate of 5.7 percent between calendar years 2019 to 2021, actual state tax collections grew by 20.7 percent, leading to excess revenue of $2.941 billion. Beginning on November 1, 2022, eligible income tax filers began to receive tax refunds equal to the amount of excess revenue.

Calculation of FY 2022 Excess Tax Revenue

Wage & Salary Growth (2019 – 2022)	**5.7%**	
	FY 2021	**FY 2022**
Allowable Tax Revenue	$36,790	$38,871
Actual Tax Revenue	$34,656	$41,813
Difference	**($2,134)**	**$2,941**
	$ in millions	

The implementation of Chapter 62F had an immediate impact on budget and policy decisions during the final months of FY 2022; delaying the passage of a supplemental budget to close the books on the fiscal year and deploy additional federal resources, and halting discussions on a comprehensive tax reform package.

FY 2023 Allowable Tax Revenue Threshold

To project the potential impacts of Chapter 62F in FY 2023 and beyond, this brief analyzes how the allowable revenue threshold is impacted by various levels of wage and salary growth. It then assesses state tax revenue collections to date and offers a range of likely scenarios to compare actual revenue collections to the allowable threshold.

Under Chapter 62F, the allowable tax revenue threshold for a fiscal year is calculated by multiplying the prior year's threshold by the 3-year average growth rate of wages and salaries in the state.

To estimate the allowable revenue threshold in FY 2023, it is first necessary to project the average growth rate of wages and salaries between 2020 and 2022. Exact wage and salary data for calendar year 2022 is not yet available from the federal Bureau of Economic Analysis[1].

Therefore, the table below calculates the average growth rate of wages and salaries between 2020 and 2022 under three scenarios: (1) wages and salaries increase in calendar year 2022 by 4.58 percent, the 10-year average rate of growth between 2011 and 2021, excluding outliers; (2) wages and salaries in calendar year 2022 increase by 8.17 percent, the midpoint between the 10-year average and 11.76, the annual growth rate in calendar year 2021 and a 10-year high; and (3) wages and salaries increase in calendar year 2022 by 11.76 percent, the same level of growth experienced in calendar year 2021.

Estimated Average Wage & Salary Growth 2020 - 2022[2]

Calendar Year	Scenario 1	Scenario 2	Scenario 3
2019	5.92%	5.92%	5.92%
2020	-0.71%	-0.71%	-0.71%
2021	11.76%	11.76%	11.76%
2022	***4.58%***	***8.17%***	***11.76%***
Average Growth Rate 2020 - 2022	**5.21%**	**6.41%**	**7.60%**

Applying the three-year average growth rate calculated under each of these scenarios to the FY 2022 allowable tax revenue threshold increases the threshold in FY 2023 by at least a margin of $2 billion.

[1] Section 2 of Chapter 62F of the Massachusetts General Laws requires the use of wage and salary data as compiled by the Bureau of Economic Analysis of the United States Department of Commerce.

[2] Wage and salary data for calendar years 2019-2021 from the State Auditor's report, *Determination of Whether Net State Tax Revenues Exceeded Allowable State Tax Revenues* (issued September 15, 2022).

Calculation of FY 2023 Allowable Revenue Threshold			
	Scenario 1	**Scenario 2**	**Scenario 3**
FY 2022 Allowable Tax Revenue	$38,871	$38,871	$38,871
Average Wage & Salary Growth Rate (2020-2022)	5.21%	6.41%	7.60%
FY 2023 Allowable Tax Revenue	**$40,897**	**$41,362**	**$41,827**
Increase in Threshold over FY 2022	**$2,026**	**$2,491**	**$2,956**
$ in millions			

It is important to clarify that the establishment of the allowable tax revenue threshold under Chapter 62F is based solely on the prior year threshold and wage and salary growth. Its calculation is entirely separate from the annual consensus revenue process that takes place at the beginning of the state budget development process and is not impacted by larger fiscal trends or actual state tax collections.

FY 2023 Actual State Tax Revenue Collections

State tax revenues are defined in Chapter 62F as all state taxes collected by the Department of Revenue (DOR) and six other state agencies: the Massachusetts Gaming Commission, the Massachusetts State Lottery, the Massachusetts State Athletic Commission, the Division of Insurance, the Office of the Secretary of the Commonwealth, and the Department of Unemployment Assistance.

The original benchmark for state tax collections by DOR in FY 2023 was $39.618 billion. As of December, collections were performing $1.1 billion ahead of the year-to-date benchmark. In recognition of the current year-to-date surplus, the recently announced consensus revenue agreement increased the FY 2023 benchmark by $151 million, to $39.768 billion. Additional details regarding this adjustment can be found in MTF's report on the consensus revenue agreement. Notably, the benchmark for state tax collections by DOR in FY 2023 remains $1.3 billion less than total collections in FY 2022.

Benchmarks for state tax collections by the six non-DOR agencies do not exist; however, historic trends offer insight into FY 2023. From FY 2011 to FY 2022, collections by non-DOR agencies grew at an average annual rate of 17.4 percent. In FY 2022, state tax collections by non-DOR agencies were $549 million.

The table below offers three reasonable scenarios for FY 2023 state tax revenue collections, as defined by Chapter 62F: (1) DOR collected state taxes come in at the revised FY 2023 benchmark; (2) DOR collected state taxes outperform the revised benchmark by the current margin of $1.1 billion; and (3) DOR collected state taxes match FY 2022 collections at $41.105 billion. In each scenario, the amount of revenue collected by non-DOR agencies is held constant and is equal to prior year collections increased by the average annual growth rate of 17.4 percent.

Estimated FY 2023 Actual State Tax Revenue Collections			
	Scenario 1 – Meet Benchmark	**Scenario 2 - Benchmark + $1.1B**	**Scenario 3 - Benchmark + $1.3B**
FY 2023 DOR State Tax Collections	$39,768	$40,855	$41,105
FY 2023 Non-DOR State Tax Collections	$644	$644	$644
Total State Tax Collections	**$40,412**	**$41,499**	**$41,749**
State Tax Collections in Excess of FY 2023 Benchmark	**$0**	**$1,087**	**$1,337**
$ in millions			

FY 2023 Allowable Revenue Threshold v. Actual Revenue Collections

Having established reasonable estimates for the FY 2023 allowable revenue threshold and actual state tax revenue collections, it is possible to assess if or when the Commonwealth is likely to collect excess tax revenues under Chapter 62F.

FY 2023 Allowable v. Actual Revenue Collections				
		Allowable Tax Revenue Threshold		
Actual Revenue Collections		5.21% Growth	6.41% Growth	7.60% Growth
	Meet Benchmark ($40.412B)	**-$485**	**-$950**	**-$1,415**
	Exceed Benchmark by $1.1B ($41.499B)	$602	$137	**-$328**
	Exceed Benchmark by $1.3B ($41.749B)	$852	$387	**-$78**
$ in millions				

The bolded and shaded figures above identify the circumstances under which state tax revenues do not exceed the estimated allowable revenue thresholds, as well as the margin between actual and allowable revenues.

If FY 2023 state tax revenues collected by DOR meet the revised benchmark and non-DOR state taxes increase by 17.4 percent, they are not expected to surpass the allowable revenue threshold at any projected level of growth. However, if actual state tax collections exceed benchmark by the current margin of $1.1 billion and wage and salary growth is modest at a three-year average rate of 5.21 percent, actual revenue collections could exceed the allowable tax revenue threshold by $602 million.

At this stage in the fiscal year, it is difficult to conclude if actual state tax collections will exceed the allowable threshold, and the calculation of excess state tax revenues will ultimately be determined by the State Auditor in September 2023. However, this array of scenarios offers a helpful rubric against which to measure wage and salary growth in calendar year 2022 and actual state tax revenue collections in FY 2023.

Considerations for FY 2024

State tax revenue collections in FY 2024 will be significantly impacted by the new 4 percent surtax on taxpayer income above $1 million. The introduction of this revenue, which DOR estimates will come in between $1.445 and $1.766 billion in FY 2024, will undoubtedly impact whether state tax collections approach or exceed the allowable tax revenue threshold under Chapter 62F. While it is far too early to predict whether or not the state will collect excess revenue, expanding on our analysis for FY 2023 can provide some useful guideposts.

Increasing the allowable revenue threshold projections for FY 2023 by the same average wage and salary growth rates referenced above, results in a minimum increase to the allowable revenue threshold for FY 2024 of $2.1 billion.

Estimate of FY 2024 Allowable Tax Revenue Threshold

	Scenario 1	Scenario 2	Scenario 3
FY 2023 Allowable Tax Revenue Threshold	$40,897	$41,362	$41,827
Average Wage & Salary Growth Rate (2021-2023)	5.21%	6.41%	7.60%
FY 2024 Allowable Tax Revenue	**$43,028**	**$44,013**	**$45,006**
Increase in Threshold over FY 2023	**$2,131**	**$2,651**	**$3,179**

$ in millions

The consensus revenue agreement announced this week established an FY 2024 consensus tax revenue estimate of $40.410 billion. If revenue collections in FY 2024 meet benchmark, surtax revenue collections would need to approach $2 billion to reach the most conservative allowable revenue threshold estimate in FY 2024.

Future Concerns

In FY 2023 and beyond, several factors are likely to impact the collection of excess tax revenues, and the triggering of Chapter 62F:

- *Wage and Salary Growth* – Between 2002 and 2021, wage and salary growth consistently outpaced growth in state tax collections. To recapture that trend and ensure that the allowable revenue threshold increases commensurate with state tax collections, efforts to support businesses and incentivize increased wages and salaries should be prioritized.
- *Actual State Tax Collections* – The consensus revenue agreement announced earlier this week increased the FY 2023 tax revenue benchmark by $151 million, and established an

FY 2024 tax revenue benchmark of $40.410 billion. Under current projections, if state tax collections meet benchmark in either fiscal year, it appears unlikely that they would exceed the allowable revenue threshold under Chapter 62F. But, if state tax revenue collections outperform expectations, as they did in FY 2021 and FY 2022, it remains possible that excess revenues are collected and returned to taxpayers.

- *Income Surtax* – State tax revenue collections in FY 2023 and FY 2024 will be effected by the implementation of the new 4 percent income surtax. While DOR estimates that surtax collections will be between $1.445 and $1.766 billion in FY 2024, the exact impact of the surtax will be difficult to measure in the early years of implementation. However, it is worth noting that periods of slow or stagnant wage and salary growth, coupled with large collections of new revenue, may result in a triggering of Chapter 62F.
- *Pass-Through Entity Excise* – In 2021, in response to the $10K cap on the federal state and local tax (SALT) deduction, Massachusetts enacted a new excise permitting certain types of businesses to pay income taxes at the entity-level and then claim a state tax deduction equal to 90 percent of the excise. This new law provided a federal tax benefit to many filers, and a temporary bump in state non-withheld income tax collections in FY 2022. It is unclear when the tax credits accumulated in FY 2022 and the first half of FY 2023 will be claimed, but the potential exists for future refunds to diminish excess revenues collected to date in FY 2023.

Conclusion

The generation of $2.941 billion in excess state tax revenue in FY 2022 is a clear indication of the strong fiscal state of the Commonwealth and the extraordinary pace of tax collections in the past two years. According to our analysis, it is by no means certain that the state will trigger the provisions of Chapter 62F in FY 2023 or FY 2024, even after accounting for new surtax revenue. However, the scope of the recent 62F rebates underlines the capacity and need for ongoing tax relief. Commonsense tax adjustments that improve Massachusetts' ability to attract and retain a diverse and highly-skilled workforce, as well as ease cost burdens on low-income and working families should remain a priority for the Administration and the Legislature this legislative session.