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MTF Bulletin

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Fiscal Year 2025 Budget: A Closer Look

Revenue & Resources in the Governor's Budget

On January 24th, the Healey administration filed its budget proposal for Fiscal Year (FY) 2025. The $58.13 billion spending plan is supported by tax, departmental, and federal revenues, as well as the use of trust fund resources built up in recent years.

The revenue foundation for Governor Healey's budget is the $40.2 billion consensus tax revenue figure agreed to by administration, House, and Senate budget leaders in January. In addition, her budget assumes $14.3 billion in federal reimbursements, $9.3 billion from non-tax departmental revenues, and $565 million in one-time trusts. Within this revenue blueprint resides about $300 million in new revenue initiatives either proposed or assumed in the Governor's budget.

FY 2025 Governor's Budget Revenue Summary

	FY 2025 - Governor
Consensus Tax Revenues	**$40,202**
Workforce Training Trust Fund	-$27
School Building Authority	-$1,305
MBTA	-$1,465
Pension Fund	-$4,500
Capital Gains Transfer	-$138
Pre-Budget Transfers	**-$7,436**
CR Taxes Remaining for Budget	**$32,766**
Income Surtax Revenues	**$1,300**
Revenue Initiatives	**$310**
Tax Amnesty Program	$75
Online Lottery	$75
Tax Fairness & Modernization	$60
Gaming Fund Consolidation	$100
Baseline Non-Tax Revenues	**$23,378**
One-Time Resources	**$565**
High-Quality Early Education & Care Fund	$265
Student Opportunity Act Investment Fund	$300
Settlements and Judgements	$50
Revenues Available for Budget	**$58,369**

$ in millions

This Brief examines the resource assumptions and proposals in the Governor's budget. It looks at how the recent slowdown in tax revenue growth in FY 2024 impacts available resources for FY 2025, and explores the revenue initiatives put forward by the Governor that are now under consideration by the House and Senate.

FY 2025 Tax Revenues

The FY 2025 consensus tax revenue figure was established just as it became apparent that FY 2024 collections were unlikely to meet original projections. The same day budget leaders agreed on a consensus revenue figure for FY 2025, the Healey administration downgraded FY 2024 tax revenue expectations by $1 billion to $39.41 billion, which becomes $38.83 billion after accounting for the fiscal impacts of tax relief.

The FY 2025 consensus tax revenue figure is $40.2 billion, not including assumed surtax collections. This assumes 3.5 percent tax revenue growth over FY 2024, after adjusting for tax relief.

FY 2025 Consensus Revenue Agreement (without Surtax)

	FY 2024 Projection	FY 2025 Est.	v. FY 2024 Proj. $	v. FY 2024 Proj. %	FY 2025 Capital Gains	Over CG Threshold
Tax Revenue Comparison	$39,410	$40,202	$792	2.0%	$2,077	$513
Adjusted for Tax Relief	*$38,833*	*$40,202*	*$1,369*	*3.5%*		

$ in millions

Since the establishment of the FY 2025 revenue figure, tax collections have fallen $275 million below the revised FY 2024 tax estimate. If collections were to remain $275 million below benchmark, revenue growth of 4.3 percent would be necessary to reach the FY 2025 revenue target.

The amount of tax revenue available to support budget spending is significantly less than the $40.2 billion consensus revenue figure because a significant share (19 percent) of tax collections are automatically diverted towards other obligations. Once these diversions are accounted for, $32.39 billion remains for Governor Healey's budget; this amount available for budget spending is actually less than the tax revenue available to budget-makers during the FY 2024 budget development process.

FY 2024 & FY 2025 Tax Revenues Available for Budget

	FY 2024	FY 2025	Change
Consensus revenue	**$40,410**	**$40,202**	**-$208**
Cap. Gains transfer	-$584	-$513	$71
Workforce Training	-$27	-$27	$0
SBA	-$1,303	-$1,305	-$2
MBA	-$1,463	-$1,465	-$2
Pension	-$4,105	-$4,500	-$395
Taxes remaining for budget	**$32,928**	**$32,392**	**-$536**

$ in millions

The FY 2025 budget also caps income surtax spending at $1.3 billion, $300 million more than the $1 billion cap in place for FY 2024. As noted by MTF here, the surtax cap is not a projection of likely surtax revenue collections, but rather a reasonable level of ongoing surtax-supported spending to build into the budget. However, in FY 2024, the Department of Revenue (DOR) simply added the $1 billion surtax cap to the consensus revenue figure. If DOR adopts the same approach in FY 2025, the surtax adjusted revenue target will be $41.5 billion.

Non-Tax Revenues

Governor Healey's budget relies on a further $23.38 billion in baseline federal and state non-tax revenues, meaning revenues generated without new revenue initiatives. Unlike taxes, these revenues have grown significantly from FY 2024 GAA assumptions. The Governor's FY 2025 budget includes $956.5 million in additional federal and departmental revenues, growth of 4.3 percent over the budget signed last August.

Baseline FY 2025 Nontax Revenues v. FY 2024 GAA

	FY 2024 GAA	FY 2025 Gov.	$ Growth	% Growth
Federal	$13,735.3	$14,301.5	$566.2	4.1%
Departmental & Transfers	$8,687.1	$9,077.2	$390.1	4.5%
Total	**$22,422.5**	**$23,378.8**	**$956.3**	**4.3%**

$ in millions

Federal reimbursements related to Medicaid are by far the largest source of non-tax revenues, and they comprise 52.8 percent of all non-tax revenues in the FY 2025 budget. Medicaid revenues are projected to grow by about $350 million in FY 2025, comprising a little over 1/3 of total non-tax revenue growth. Revenue projections within other notable categories of non-tax revenue vary greatly compared to FY 2024 GAA expectations.

Comparison of Major Non-Tax Revenue Sources v. FY 2024 GAA

	FY 2024 GAA	FY 2025 Gov.	$ Growth	% Growth
Medicaid	$12,013.8	$12,362.8	$349.0	2.9%
MassHealth Drug Rebates	$1,622.9	$1,686.4	$63.5	3.9%
Lottery	$1,216.4	$1,452.4	$236.0	19.4%
General Fund Interest	$200.0	$400.0	$200.0	100.0%
Tobacco Settlement	$247.0	$256.8	$9.8	4.0%
Gaming	$240.3	$279.5	$39.2	16.3%
Marijuana Fees & Licensing	$28.8	$21.5	-$7.3	-25.3%
Other non-tax revenues	***$6,853.3***	***$6,919.4***	***NA***	***NA***
Total	**$22,422.5**	**$23,378.8**	**$890.2**	**4.0%**

$ in million

More than 90 percent of total non-tax revenue growth is explained by looking at several major sources included in the table above. Aside from Medicaid, a significant increase in expected General Fund interest revenue and projected growth in Lottery revenue are the largest drivers of non-tax revenue growth. The totals above do not reflect revenue associated with online lottery or increased gaming revenue related to a policy proposal included by the Governor.

The assumed growth in Lottery is partially due to a doubling in the Lottery's advertising budget proposed by the administration, from $5 million to $10 million. Through January, Lottery profits in FY 2024 were slightly below the pace of collections in FY 2023.

Proposed Revenue Initiatives

Governor Healey's budget uses $1.25 billion in revenue initiatives to balance the budget. The majority of these resources ($1.12 billion) are one-time, meaning they will not recur in FY 2026 and will therefore need to be replaced by new revenue or reduced spending in the future.

One-time Revenues

Four one-time revenue strategies provide $1.12 billion for Governor Healey's budget:

Capital Gains Threshold Diversion ($375 million) – The largest one-time revenue utilized in the Governor's budget is the diversion of $375 million in projected capital gains tax revenue from the Stabilization Fund to the General Fund. In 2010, the state put in place a law which dedicates all capital gains tax collections above a sustainable threshold to the Stabilization Fund and other reserves.

In FY 2025, the capital gains threshold is $1.56 billion, and $2.073 billion in revenue is expected. Without any policy change, this would mean that $461.7 million would be deposited automatically into the Stabilization Fund, while $51.3 million would be divided between the state's pension and retiree health benefit trust funds.

Governor Healey proposes changing this distributions as follows:

Healey Administration Distribution of Above Threshold Capital Gains

	Current Law	Share	Gov. Budget Proposal	Gov. Budget Share (FY 2026)
Stabilization Fund	$461.7	90%	$96.6	70%
Pension Fund	$25.7	5%	$13.8	10%
Retiree Health Benefits	$25.7	5%	$13.8	10%
Disaster Resiliency	$0.0	0%	$13.8	10%
General Fund	$0.0	0%	$375.0	0%
Total	**$513.0**	**100%**	**$513.0**	**100%**

$ in millions

The diversion of revenue to the General Fund would be one-time, but the administration also proposes permanently reducing the Stabilization Fund share of excess capital gains to 70 percent of any overage and dividing the remaining amount between the pension, retiree health benefit funds as well as a new fund dedicated to disaster relief and resiliency efforts.

The state has diverted capital gains revenues to the General Fund in the past. In fact, the policy put in place in 2010 was not consistently adopted until several years later, after state finances had more fully recovered from the Great Recession. The last time the state altered the capital gains diversion was in the FY 2018 budget. Following three consecutive years of capital gains diversions, the state's bond rating was downgraded by S&P in 2017.

Pandemic Trust Funds ($565 million) – The Healey administration's budget also uses $565 billion in trust fund resources to support early education and K-12 spending. During the pandemic, when state tax collections grew by more than $10 billion in a two-year period, the state created two policy-specific trust funds with excess resources: the High-Quality Early Education and Care Affordability Fund and the Student Opportunity Act Investment Fund. The Healey administration's budget draws from both funds.

Trust Fund Use in the Healey Administration Budget

	Original Balance	Used In FY 2024	Used in FY 2025 Gov.	Remaining Balance
High-Quality Early Education and Care Affordability Fund	$490.0	$225.0	$265.0	$0.0
Student Opportunity Act Investment Fund	$500.0	$0.0	$300.0	$200.0
Total	**$990.0**	**$225.0**	**$565.0**	**$200.0**

$ in millions

Governor Healey proposes leaving $200 million in the SOA trust fund for use in future years, but fully depletes the early education trust fund. In FY 2024 and in Governor Healey's FY 2025 proposal, trust fund resources are instrumental in ongoing support of child care operational grants.

Gaming Fund Diversion ($100 million) – The Healey administration proposes a one-time redistribution of gaming revenues, diverting $100 million to the budget from gaming funds that are not part of the appropriations process. When the state's casino gaming law was passed in 2011, it divided ongoing gaming tax revenues between twelve different funds, five of which are subject to appropriation in the annual budget. Governor Healey proposes upping the share of gaming revenue to these budgeted funds to 91.5 percent of all revenues from their typical share of 63 percent. This shift increases budgeted revenues by $100 million. Several off-budget gaming funds have built-up significant balances in recent years. For example, a fund dedicated to community mitigation began FY 2023 with a balance of $39.6 million and ended FY 2023 with a balance of $52.2 million.

Tax Amnesty ($75 million) – The Governor's budget authorizes the Department of Revenue to offer a tax amnesty program in the coming year. Under the proposal, DOR would determine the specifics of the program, but it would run for 60 days and apply to returns due within the last four years. Under tax amnesty programs, filers can voluntarily pay outstanding tax liabilities without the payment of penalties. Tax amnesty programs are common during challenging budget years; the last such program was offered in 2016 and generated $138 million in additional tax revenue.

Ongoing Revenue Initiatives

The administration's budget also proposes two ongoing revenue initiatives expected to generate $135 million in FY 2025:

Online Lottery ($75 million) – The Governor's budget proposes legalizing online or app-based lottery, with the assumption that it will generate $75 million in revenue in the first year of implementation. The administration's proposal is very similar to online lottery initiatives the House has included in prior budgets and economic development legislation. Unlike the House, the administration does not dedicate online lottery revenue to a specific use.

Accurate revenue estimates for online lottery are challenging, given the interaction with the traditional lottery, sports betting and casinos, and those challenges are heightened in the first year of implementation. The administration is using a much more conservative revenue estimate – $75 million – for first year revenues than the $200 million assumption cited by the House in the FY 2024 budget.

Tax Expenditures & DOR Modernization ($60 million) – The administration relies on $60 million in increased tax revenue due to the elimination of two tax expenditures and investments in enhanced enforcement at DOR. The Governor's budget would eliminate an existing tax deduction for interest and dividends earned on savings accounts in in-state banks ($3 million in revenue) and a sales tax exemption for publications of non-profit entities ($24.1 million in revenue). The remaining $32.9 million in revenue would be generated through enhanced audit and enforcement practices.

Putting It All Together

Governor Healey's budget proposal for FY 2025 includes $58.33 billion in total spending, including funds set aside to cover anticipated costs, like collective bargaining agreements. After accounting for the impacts of tax relief, this requires a $1.7 billion increase in resources over FY 2024 to balance the budget. A combination of non-tax revenue assumptions, surtax spending growth and one-time resources, and other initiatives enabled the administration to submit a balanced budget.

Revenue Sources for New Spending in Governor Healey's Budget

New spending	**-$1,691.3**
Tax revenue difference	-$536.0
Increased surtax	$300.0
Increased baseline non-tax	$956.3
Trust funds (net)	$340.0
Capital gains diversion	$375.0
Gaming diversion	$100.0
Online gaming & DOR	$135.0
Tax amnesty	$75.0
Total revenue solutions	**$1,745.3**

$ in millions

Key Takeaways for the House and Senate

Governor Healey's budget demonstrates the challenge confronting budget-writers as they develop the FY 2025 spending plan: the consensus tax estimate will not support new spending and so other resources or spending reductions will be necessary to balance the budget. The revenue blueprint outlined by the administration will require the House and Senate to answer several challenging revenue questions:

- **Will the Legislature adopt the proposal to divert excess capital gains revenue to the budget?**
  The riskiest revenue initiative in the administration's budget is the use of $375 million in expected excess capital gains revenue. The risk is twofold: first, capital gains collections have declined sharply in recent years and it is far from certain how much the state will collect in the coming year. Second, credit rating agencies have reacted negatively to this tactic in the past.

  While the capital gains diversion carries risk, it should not be rejected out of hand. The budget language that effectuates the proposal makes explicit that the diversion will only occur if other revenues are not sufficient and by limiting the diversion to $375 million, the proposal still assumes a net deposit in the Stabilization Fund. Both of these elements of the proposal should be retained if the capital gains proposal is included in the House or Senate budgets.

- **What level of one-time resources will be included in the House and Senate budgets?**
  The $1.1 billion in one-time revenues relied upon in Governor Healey's budget is the biggest such figure since before the pandemic. Using one-time resources to maintain a sustainable level of spending during a time of tax revenue volatility is appropriate, but it is imperative that the House and Senate adhere to two critical guidelines in any use of one-timers:
  1. *Do not use any more than the $1.1 billion proposed by Governor Healey;*
  2. *Do not draw down the balance of the Stabilization Fund.*

  The future course of revenue collections is unclear and the FY 2025 budget needs to be adaptable to a fiscal situation that could either improve or worsen. Adding additional one-timers to the budget will increase the state's structural deficit in FY 2026 while limiting the state's options to close any future deficit. Protecting the balance of the Stabilization Fund and limiting new spending growth are essential for developing a budget that is guarded against future uncertainty.

- **Will the House and Senate introduce any major new revenue initiatives?**
  As highlighted in this brief, Governor Healey has put forward a number of revenue and resource initiatives for the Legislature to consider. If the House or Senate reject these proposals or differ in revenue assumptions, they will need to propose alternative revenues or savings to balance the budget.

  One strategy the House and Senate have used in the past is to assume some level of unexpended appropriations – or 'reversions' – to offset new spending. The problem with assuming significant reversions is that it limits the tools the state has to balance the budget once the year starts. In FY 2023, unbudgeted reversions were one of the primary strategies the administration used to mitigate the impact of below benchmark tax collections.

  The House and Senate could also increase the use of trust fund resources, including using the Transitional Escrow Fund which was created with the FY 2022 surplus. The Healey administration has proposed using the remainder of the TEF to cover FY 2024 and FY 2025 costs of the Emergency Assistance program. Should the Legislature divert these resources to the budget, they will increase next year's budget gap and will need to find another solution for EA in the coming months.