Massachusetts Taxpayers Foundation

333 Washington Street | Suite 853 | Boston, MA 02108 | 617.720.1000
www.masstaxpayers.com

MTF Bulletin

April 26, 2024

FY 2024 Fiscal Update

Two weeks ago, the House Ways and Means Committee released its budget proposal for Fiscal Year (FY) 2025. While the budget development process for the upcoming fiscal year will consume much of the attention in the coming weeks, the FY 2024 fiscal picture remains unclear and will require careful monitoring.

Over the first eight months of FY 2024, revenue collections have consistently fallen below expectations, and currently stand $4 million below collections from the year before. While the Healey administration took action early in the year to reduce revenue benchmarks and close a $1 billion revenue shortfall, there remains a high degree of uncertainty heading into the final quarter of the fiscal year. April is typically the largest month for state revenue collections and its performance compared to benchmark will have an outsize impact on the state's financial position.

To provide an update on the state's fiscal picture for FY 2024, this brief examines revenue collection trends to date, reviews the actions already taken by the Healey administration to offset revenue losses, and evaluates how three different April revenue scenarios may impact the balance of the state budget. It concludes with a review of the supplemental spending under consideration by the Legislature and how it may impact the availability of one-time state resources previously set aside in the Transitional Escrow Fund.

FY 2024 Tax Revenue Collection Trends

In January, after six straight months of below benchmark revenue collections, the Healey administration downgraded the tax revenue benchmark for FY 2024 by $1 billion, from $40.41 billion to $39.41 billion (excluding surtax revenue).[1] Because this downgrade took place halfway through the fiscal year, this brief will review tax revenue collection trends in two parts:

- First, it will assess collections from July to December 2023; highlighting the factors that contributed to the $1 billion revenue downgrade and the steps taken by the Healey administration to proactively address the revenue shortfall.
- Second, it will evaluate trends from January to March 2024; assessing revenue collections compared to the updated and lowered benchmarks.

July 2023 – December 2023

During the first six months of FY 2024, state tax revenue collections totaled $17.869 billion, $769 million (4.1 percent) below the year-to-date benchmark and $60 million (0.3 percent) ahead of FY 2023.

[1] In January, the Healey administration downgraded the FY 2024 revenue benchmark from $40.41 billion to $39.41 billion, excluding revenues related to the 4 percent surtax on income over $1 million. After taking into account the fiscal impact of the tax relief package, expected FY 2024 revenue collections total $38.83 billion.

Collections failed to meet benchmark across all categories, with the exception of withholding income; however the increase over benchmark in that category was marginal, at only 0.2 percent.

FY 2024 Revenue Collections July – December v. Benchmark and FY 2023

	FY 2023 YTD Actuals	FY 2024 YTD Actuals	FY 2024 v. FY 2023 YTD	FY 2024 YTD Benchmark	Year to Date v. BM
Withholding	$8,017	$8,524	$507	$8,506	$18
Non-Withholding	**$1,662**	**$1,562**	**-$100**	**$1,846**	**-$284**
Sales	$4,719	$4,662	-$57	$4,844	-$182
Corporate/Business	$1,947	$1,845	-$102	$1,984	-$139
Other	$1,464	$1,277	-$187	$1,460	-$183
Total	**$17,809**	**$17,869**	**$60**	**$18,640**	**-$769**

$ in millions

In recognition of this below benchmark performance, in early January the Healey administration announced a $1 billion tax revenue shortfall for FY 2024 and downgraded the revenue benchmark from $40.41 billion to $39.41 billion (excluding surtax revenues). At the time, no further adjustments were made to the benchmarks for individual tax categories, and so the administration identified solutions to close a $1 billion gap in resources available for budgeted spending; including $625 million in non-tax revenues and $375 million in net spending reductions. For more detailed information on the Governor's actions to close the revenue shortfall, read MTF's analysis here.

However, a $1 billion revenue downgrade does not translate to a $1 billion budget gap. Due to a number of factors – including the dedication of some capital gains tax collections to the Stabilization Fund, as well as sales tax collections to the MBTA and School Building Authority (SBA) – a $1 billion downgrade in revenue expectations may have a significantly reduced impact on the resources available to support budgeted spending. For example, while total tax revenue collections in FY 2023 came in $605 million below benchmark, the estimated budget impact was only $177 million.[2]

Following the announcement of the $1 billion revenue downgrade in January, the Department of Revenue (DOR) released updated benchmarks for the individual tax categories. Using that information, we estimate that the budget impact of the downgrade is a loss of approximately $875 million in resources. Therefore, by proactively solving for a $1 billion revenue shortfall, the Healey administration provided a cushion of approximately $130 million heading into the second half of the fiscal year.

FY 2024 Revenue Shortfall & Solutions in January

FY 2024 Tax Revenue Downgrade	**-$1,000.0**
FY 2024 Revenue Downgrade Solutions	**$1,004.0**
Unanticipated Non-Tax Revenues	*$626.0*
Net Spending Reductions	*$378.0*
Estimated Budget Impact of Revenue Downgrade	**-$876.8**
Positive Impact of Revenue Solutions	**$127.2**

$ in millions

[2] In FY 2023, below benchmark revenue performance was primarily driven by lower than anticipated capital gains tax revenue collections. As a result, the statutorily required transfer to the Stabilization Fund of above-threshold capital gains collections was reduced by nearly $700 million.

January – March 2024

Since the downward adjustment to the FY 2024 revenue benchmarks in January, tax collections have continued to stagnate. Through March, revenue collections total $27.531 billion; $145 million (0.5 percent) behind the updated year-to-date benchmark and $4 million (0.01 percent) below collections in FY 2023.

However, while year-to-date collection trends continue to disappoint, March revenue collections exceeded expectations for the first time this fiscal year. In that month, revenues totaled $4.065 billion; $129 million (3.3 percent) higher than the monthly benchmark and $182 million (4.7 percent) above March of 2023.

FY 2024 Revenue Collections Through March v. Benchmark and FY 2023

	FY 2023 YTD Actuals	FY 2024 YTD Actuals	FY 2024 v. FY 2023 YTD	FY 2024 YTD Benchmark	Year to Date v. BM
Withholding	$12,544	$13,515	$971	$13,230	$285
Non-Withholding	**$2,465**	**$1,989**	**-$476**	**$2,397**	**-$408**
Sales	$6,970	$6,913	-$57	$6,947	-$34
Corporate/Business	$3,401	$3,254	-$147	$3,236	$18
Other	$2,156	$1,860	-$296	$1,866	-$6
Total	**$27,536**	**$27,531**	**-$5**	**$27,676**	**-$145**

$ in millions

As demonstrated by the table below, in combination with the $127 million in savings from the administration's revenue gap-closing actions in January, the net position of state tax revenue collections is only slightly behind the updated benchmark (-$18 million).

Estimated Net Position of State Tax Revenue Collections v. Benchmark

FY 2024 Revised Revenue Benchmark	$40,410
Below Benchmark Revenue YTD (January - March)	($145)
Carry Forward Savings from January Actions	$127
Net State Tax Revenues Collections v. Benchmark	**($18)**

$ in millions

The tenuous position of revenue collections compared to benchmark at this point in the fiscal year places an even greater importance on the month of April. Historically, April has represented the single largest month for state tax revenues, comprising approximately 12 percent of total revenue collections in FY 2023.

Looking Ahead to April Revenues

In this section, this brief presents three possible scenarios for April revenues and evaluates what they would mean for the balance of the state budget. While tax collections above or below benchmark do not translate directly to an equal "budget surplus" or "budget deficit," they are one of the most important factors in assessing the resources that are available to support spending.

In the table below, MTF estimates total FY 2024 state tax revenue collections based on three possible scenarios for April revenue collections:

1. April revenues meet the monthly benchmark.
2. April revenues fall below the monthly benchmark by $500 million.

3. April revenues exceed the monthly benchmark by $500 million.

Assuming that revenues in the final two months of the fiscal year (May and June) meet benchmark, these three scenarios demonstrate a range of possibilities in which total FY 2024 tax revenue collections could fall short of the annual benchmark by $645 million or exceed expectations by up to $355 million.

MTF Estimated FY 2024 State Tax Revenue Collections

	Scenario 1 – Meet BM	Scenario 2 – Fall Below by $500M	Scenario 3 – Exceed by $500M
FY 2024 Revenue Benchmark	$39,833	$39,833	$39,833
April Revenues v. Benchmark	$0	($500)	$500
FY 2024 Estimated Revenue Collections	$39,688	$39,188	$40,188
Estimated Revenues v. Benchmark	**($145)**	**($645)**	**$355**

$ in millions

However, while these scenarios illustrate where total tax revenue collections may land compared to benchmark, further analysis is required to estimate how these different outcomes would impact the resources available to support the state budget. Two factors in particular complicate the relationship between tax revenue collections and the balance of the state budget: income surtax revenues and capital gains taxes.

Income Surtax Revenues

According to the process created in the FY 2024 GAA to collect, track, and spend surtax revenue; these resources may only be used to support education and transportation investments; and therefore must be set aside from any assessment of tax revenue available to support general budgeted spending.

In FY 2024, DOR projects income surtax collections between $1.6 and $2.1 billion, significantly higher than the $1 billion spending threshold for surtax revenue established by policymakers last year and reflected in the FY 2024 benchmark. All surtax revenue collections above $1 billion must be deducted from total tax revenues to determine the resources available to support budgeted spending.

If surtax revenue collections meet the lower-limit of DOR’s projection for FY 2024 of $1.578 billion, the resources available to support budgeted spending would be further reduced by nearly $600 million.

Estimated FY 2024 Surtax Revenue Collections

FY 2024 Surtax Revenue Spending Cap	$1,000
DOR Projected Surtax Revenues (lower-limit)	$1,578
Estimated Above Cap Surtax Revenues	**$578**

$ in millions

Capital Gains Taxes

In addition to income surtax revenues, the other category of state tax collections that will have the largest impact on the resources available for the state budget will be capital gains. Capital gains tax revenues comprise approximately 40 percent of the non-withheld income tax category, and any collections above a certain threshold ($1.48 billion in FY 2024) are automatically transferred into the Stabilization Fund and other reserves. In FY 2024, state budget writers originally anticipated total capital gains collections of $2.06 billion; which would result in a reserve deposit of $583 million.

Through March, non-withheld income tax collections are trailing benchmark by 17 percent; by far the largest contributor to below benchmark revenue performance to date. Based on this trend, if total capital gains collections come in below expectations, the state reserve transfer may be reduced. A reduction to this planned deposit would have a positive impact on the resources available to support state budget spending.

In the table below, the same three scenarios for April revenue collections introduced above are repeated; and then further adjustments are made to reflect the impacts of surtax revenue collections above $1 billion and reduced capital gains tax collections. Accounting for these factors allows us to produce a range of reasonable estimates for the on-budget impact of different revenue situations.

MTF Estimated Budget Impact of FY 2024 Revenue Collections

	Scenario 1 – Meet BM	**Scenario 2 – Fall Below by $500M**	**Scenario 3 – Exceed by $500M**
FY 2024 Revenue Benchmark	$39,833	$39,833	$39,833
April Revenues v. Benchmark	$0	($500)	$500
FY 2024 Estimated Revenue Collections	$39,688	$39,188	$40,188
Estimated Revenues v. Benchmark	**($145)**	**($645)**	**$355**
Surtax Collections over $1 billion	-$578.00	-$578.00	-$578.00
Capital Gains Transfer Downgrade	$96.86	$122.66	$71.07
Estimated on Budget Revenue Shortfall	**($626.14)**	**($1,100.34)**	**($151.93)**

$ in millions

In even the most optimistic scenario presented – that April revenue collections exceed the monthly benchmark by $500 million – if surtax revenues meet DOR's low-point projection, and capital gains tax revenues decrease, the state budget would still be facing a revenue shortfall of approximately $152 million. If April revenue collections miss the monthly benchmark by $500 million, that revenue gap may grow as large as $1.1 billion.

Additionally, while income surtax revenues and capital gains tax collections will have a significant impact on the state's fiscal position, there are a number of other factors that will impact the state's ability to end the fiscal year in balance, including: supplemental spending obligations, unanticipated non-tax revenues, and the availability of one-time resources.

Other Factors Impacting the Balance of the State Budget

- **Supplemental Spending Obligations (*Emergency Assistance*)** – Throughout the fiscal year, spending assumptions increase or decrease based on new demands, updated utilization trends, and other developments. In FY 2024, the largest driver of increased spending has been the state's Emergency Assistance (EA) shelter system, which has seen an influx of more than 7,500 families being housed in shelters, hotels, and motels across the state. To date, the state has spent $504 million on the EA housing assistance program[3] and the administration anticipates the need for an additional $224 million. In January, the Governor filed a supplemental budget to address this

[3] Biweekly report on the Emergency Housing Assistance Program, April 8, 2024.

deficiency, and the House and Senate each passed their own versions of the spending bill. Each of the three proposals relied on resources previously set aside in the Transitional Escrow Fund to support spending. Earlier this week, budget writers announced an agreement to use $251 million from the Transitional Escrow fund to cover these costs, meaning EA will not affect the state's ability to balance the budget in FY 2024.

Emergency Assistance Supplemental Spending Proposals for FY 2024

	Governor	House	Senate	Compromise
FY 2024 EA Supplemental Spending	$215	$245	$225	$251
Transitional Escrow Offset	($215)	($245)	($225)	($251)

$ in millions

- **Supplemental Spending Obligations *(Other)* -** In March, the Governor filed a second supplemental budget to address $535 million in other expected deficiencies; the net cost of which is $88 million after accounting for offsetting federal revenues that support the spending. Notable spending from the second bill includes $228 million for the Home and Community-Based Healthcare workforce, $29 million for Income-Eligible childcare services, and $20 million for Victims of Crime Act (VOCA) services. The House and Senate have not yet taken action on this spending bill.

Healey Administration March Supplemental Budget

Gross Supplemental Spending	$535
Non-Tax Revenue Offsets	$446
Net Supplemental Spending	**$89**

$ in millions

- **Unanticipated Non-Tax Revenues** – In addition to tax revenue, state budget spending is supported by thousands of individual non-tax revenue sources. These non-tax revenues include reimbursements from the federal government, as well as departmental revenues like fees and recoupments. In January, the Healey administration identified $625 million in non-tax revenue solutions to address a portion of the $1 billion revenue shortfall; and the administration identified an additional $446 million in non-tax revenues to support the spending proposed in the March supplemental budget. Additional federal or departmental revenue sources may be identified to help close the books on FY 2024, including federal American Rescue Plan or state surplus funds that were previously appropriated but have not been spent.

- **One-Time Resources** – The proposal to support the EA shelter system approved this week by the Legislature, as well as the administration's supplemental spending bill from March, would allow for spending to be supported by one-time resources previously set aside in the Transitional Escrow Fund. The Transitional Escrow Fund started FY 2024 with a balance of $1.073 billion; however, as the table below demonstrates, those resources could quickly be depleted in support of various housing and healthcare-related priorities. Ultimately, policymakers will need to weigh the costs and benefits of using these one-time resources to support specific program investments or maintaining a balance in the fund to safeguard against a potential revenue shortfall. However, using one-time surplus funds to balance the current year budget, without a plan in place to fund the shelter system for FY 2025, would simply shift a large budget gap into next year.

Transitional Escrow Fund Spending, Administration v. Legislature

	Governor	House	Senate	Compromise
FY 2024 Starting Balance	**$1,073**	**$1,073**	**$1,073**	**$1,073**
EA Proposal for FY 2024	*$215*	*$245*	*$225*	*$251*
EA Proposal for FY 2025	*$498*	*$0*	*$600*	*$175*
Other Housing	*$160*	*$0*	*$10*	*$0*
HHS Critical Workforce Reserve	*$200*	*$0*	*$0*	*$0*
Subtotal Spending	**$1,073**	**$245**	**$835**	**$426**
Remaining Balance	**$0**	**$828**	**$238**	**$647**

$ in millions

Putting it all Together

State tax revenue collections throughout FY 2024 have consistently lagged behind expectations. Over the first six months of the fiscal year, revenues had fallen below the year-to-date benchmark by $770 million; and as a result, in January the Healey administration downgraded the revenue benchmark by $1 billion and announced a series of solutions to solve for that revenue gap. Since January, revenues have continued to stagnate, placing even greater importance on the month of April.

This brief outlined three potential scenarios for April revenue collections to demonstrate how they may impact performance compared to benchmark and the resources available to support state budget spending. Under even the most optimistic scenario (April revenues exceed the monthly benchmark by $500 million), after several key factors – like income surtax revenues and capital gains taxes – are taken into consideration, the state may still face a revenue gap of approximately $150 million.

Additionally, to close the books on FY 2024, the Healey administration will need to balance supplemental spending obligations, unanticipated non-tax revenues, and the use of one-time resources. The evolving Emergency Assistance Shelter System crisis, other unexpected spending needs, and the availability of unused or recouped federal and surplus funds may further complicate and impact this process.

As policymakers look ahead to the final months of the fiscal year, they should remain mindful of the following realities:

- **Data on the impact of the income surtax remains limited.** The current revenue benchmark reflects a $1 billion assumption for surtax revenue collections, and there is no data available from DOR to assess how surtax collections to date compare to that threshold. Any surtax revenues above $1 billion must be deducted from the resources available to support budgeted spending and are automatically diverted to two new Education and Transportation Trust Funds.
- **One-time resources are finite.** The Administration, House, and Senate have all proposed using resources from the Transitional Escrow Fund to support supplemental spending needs, particularly the EA shelter system. While these needs may be critical, to the extent that they will be ongoing, supporting them with one-time resources creates a structural budget imbalance over time. Combining one-time supports with long-term policy solutions to control cost-growth is critical.