TESTIMONY
OF
MICHAEL J. ALLEN, ASSOCIATE COMMISSIONER FOR TAX POLICY
DEPARTMENT OF ADMINISTRATIVE & FINANCIAL SERVICES

Before the Joint Standing Committee on Appropriations and Financial Affairs

Date: December 7, 2021

December 1, 2021 REVENUE FORECASTING COMMITTEE REPORT

Senator Breen, Representative Pierce, and Members of the Joint Standing Committee on Appropriations and Financial Affairs – good morning, I am Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services and the outgoing Chair of the Revenue Forecasting Committee (RFC). Before I begin summarizing the revenue forecast, I would like the other members of the RFC that are attending to introduce themselves.

The Revenue Forecasting Committee (RFC) has concluded its fall forecasting exercise in order to incorporate the new economic forecast released by the Consensus Economic Forecasting Commission (CEFC) on November 1, 2021 and to provide the Governor and Legislature with a new revenue forecast by the statutorily required date of December 1, 2021.

In its December 2021 update, the RFC has revised General Fund (GF) revenue forecasts upward by $822.2 million for the FY22/23 biennium, an increase of 9.7% over our previous forecast. After increasing by 13.9% in FY21, the forecasted rate of year-over-year growth for General Fund revenue in FY22 is now 2.3%, followed by growth of 1.8% for FY23. In addition, Highway Fund revenues were increased by $4.0 million for FY22 and by $1.9 million for FY23 for a total increase of $5.9 million (0.9%) for the FY22/23 biennium. The forecasted rate of year-over-year growth for Highway Fund revenue for FY22 is 0.2% and for FY23 is 1.1%.

As the table below demonstrates, FY22/23 GF revenues are not only forecasted to be 9.8% higher relative to our May 1, 2021 forecast, but also to our pre-pandemic March 1, 2020 forecast. Percentage adjustments of this magnitude have not been seen since the late 1990's.

General Fund Summary

	FY21	FY22	FY23	FY24	FY25
March 2020 Forecast	$4,070,279,515	$4,174,531,432	$4,317,597,709		
Annual % Growth	2.5%	2.6%	3.4%		
May 2021 Forecast Adjusted [1]	$4,520,591,145	$4,179,154,919	$4,325,387,503	$4,484,402,527	$4,628,688,473
Annual % Growth	13.9%	-7.6%	3.5%	3.7%	3.2%
Net Increase (Decrease)	$0	$443,172,347	$379,073,003	$401,908,593	$419,689,617
Dec 2021 Forecast	$4,520,591,145	$4,622,327,266	$4,704,460,506	$4,886,311,120	$5,048,378,090
Annual % Growth	13.9%	2.3%	1.8%	3.9%	3.3%
Change $ from March 2020 RFC	$450,311,629	$447,795,834	$386,862,797	na	na
Change % from March 2020 RFC	11.1%	10.7%	9.0%	na	na

1/ Reflects FY21 actual revenue and revenue changes enacted subsequent to the May 2021 Forecast

Once again almost all the FY22 and FY23 net increases are attributable to the sales and use and individual income tax revenue lines. In the case of the sales and use tax, the $209.0 million upward adjustment in FY22 reflects a positive variance of $92.5 million through October and preliminary November receipts that pointed to a monthly positive variance of approximately $20 million. While the sales tax forecast assumes year-over-year growth will slow starting in calendar year 2022, the CEFC's economic forecast estimates Maine households will experience income growth capable of sustaining the current level of spending on taxable goods and services. Most (55-60 percent) of the annual adjustments are from higher levels of the non-auto related portion of the sales tax base taxed at the general rate of 5.5%; in other words, taxable durable and nondurable goods. Lodging and prepared foods represent most of the remaining annual increases. After FY22, annual sales tax growth is forecasted to be between 2.7 and 3.1 percent, reflecting higher inflation and a gradual shift back to in person non-taxable services as consumers adjust their mix of spending to where it was pre-pandemic.

Changes to the General Fund individual income tax are primarily the result of the 2020 tax year being stronger than previously forecasted, revenue performance through the first 10 months of tax year 2021 indicating that tax year 2021 will grow by more than previously forecasted, and more optimistic assumptions of wage and salary growth over the remainder of the forecast period. The November CEFC forecast assumes that wages and salaries will increase 5.5% during CY21, 5.0% per year for the CY22-CY24 period, and 4% in CY25. The wages and salaries forecast results in an increase in forecasted individual income tax liability of $39 million in tax year 2021, $60 million in tax year 2022, $84 million in tax year 2023, and approximately $110 million in tax years 2024 and 2025. Stronger growth in capital gains realizations increases 2021 tax liability by $64 million but has limited impact relative to the May forecast after 2021 as projected decreases in capital gains realizations eventually reduces tax liability. The revenue increase in FY22 is larger than the later years partly because of timing in receipts. The new forecast assumes some shifting of income into tax year 2021 and out of future tax years to avoid potential tax increases at the federal level. This behavior by high-income taxpayers will boost FY22 revenues at the expense of future fiscal years. If Congress passes a significant tax package prior to the end of calendar year 2021 it's entirely possible that the income shifting may be larger than we are currently estimating and the FY22 individual income tax forecast will need to be adjusted up in the March 1, 2022 revenue forecast.

The corporate income tax line has been growing at unusually high year-over-year rates for the last 18 months. Last fiscal year corporate income tax receipts increased by 31.5 percent, and through the first 4 months of FY22 they have increased by 70.5 percent. Other states with a corporate income tax structure like ours and the federal government have experienced similar growth rates. In the latest revenue forecast the RFC increased the corporate income tax forecast by $70 million in the FY22/23 biennium and by $101.5 million in the FY24/25 biennium. Until more detailed information provided on income tax returns is received and analyzed, we can only postulate why corporate income tax revenues have been so high. Three possible explanations that have been discussed are; (1) corporate profits, particularly for larger companies, are much stronger than previously estimated, (2) the unique aspects of the pandemic economy have interacted with key provisions of the 2017 federal tax reform act (TCJA) to increase revenue, and (3) corporations in reaction to tax changes being discussed in Congress are shifting income into 2021 to avoid potential future tax increases.

Over the last two years both the CEFC and RFC have made unusually large adjustments to their previous forecasts as both forecasting groups, along with other economic and revenue forecasters, have tried to understand and adjust to changing health and economic conditions caused by the historic global pandemic. In addition, the fiscal and monetary response by Congress and the Federal Reserve System is the largest as a percentage of GDP since the Great Depression and has included tax and expenditure programs unique to the economic dislocations caused by the pandemic induced recession.

The significant revenue increases estimated in this forecast represent the latest thinking by economic forecasters on the trajectory of the U.S. and Maine economies over the next four years. As the last couple of weeks have shown, the historic COVID-19 pandemic remains highly uncertain, and variants can appear unexpectedly and spread across the globe quickly. Most of the short-term risk to the current revenue forecast is positive, while ongoing issues (inflation, stock and real estate market valuations, supply chain and labor force constraints etc.) facing the economy make the FY23-25 portions of the forecast volatile and susceptible to significant downside risk. The short time horizon between this forecast exercise and the next one in early CY22 doesn't provide a lot of time for many of the global challenges to be resolved, which means the long-term part of this forecast will remain uncertain until late next year.

That concludes my summary of the November RFC meeting. We welcome any questions you may have.