Revenue Estimates

General Fund revenues under the May Revision forecast will be higher than at the Governor's Budget by $2.8 billion in 2012-13 and lower by $1.3 billion in 2013-14. Figure REV-01 shows the revenue forecasts, by source, in the Governor's Budget and the May Revision. Total May Revision revenue is projected to be $98.2 billion in 2012-13 and $97.2 billion in 2013-14.

Accurately forecasting tax revenue for a large and diverse economy like California's is always a challenging task. That task has become even more challenging in recent years because of several factors. First, the economy is still recovering from the most severe recession since the Great Depression. The recovery pattern does not conform to the patterns of other recent economic recoveries. Second, the increasing concentration of income has made tax revenues dependent to a greater degree on the income and decisions of a relatively small population of taxpayers. Third, the use of tax credits and deductions has increased in unpredictable ways. Finally, recent changes to state and federal tax laws affect how much tax is owed and when taxes are paid making it increasingly difficult to make accurate predictions based on cash receipts.

Personal Income Tax (PIT) receipts for January were $4.9 billion higher than expected. At the time, it was expected that much of the additional January payments were related either to taxpayers making their 2012 tax payments related to Proposition 30 earlier than required, or to taxpayers shifting more income into 2012 due to federal tax law changes. While the issue of whether Proposition 30 revenue was shifted from April to January is no longer relevant based on cash receipts through the end of April, there is still uncertainty

Figure REV-01
2013-14 May Revision
General Fund Revenue Forecast
Baseline
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 11-12:				
Personal Income Tax	$53,836	$54,261	$425	0.8%
Sales & Use Tax	18,652	18,658	$6	0.0%
Corporation Tax	7,949	7,233	-$716	-9.0%
Insurance Tax	2,165	2,165	$0	0.0%
Vehicle License Fees	70	70	$0	0.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	346	346	$0	0.0%
Cigarette	95	95	$0	0.0%
Other revenues	2,449	2,449	$0	0.0%
Transfers	1,509	1,509	$0	0.0%
Total	**$87,071**	**$86,786**	**-285**	-0.3%
Fiscal 12-13				
Personal Income Tax	$60,647	$63,901	$3,254	5.4%
Sales & Use Tax	20,714	20,240	-$474	-2.3%
Corporation Tax	7,580	7,509	-$71	-0.9%
Insurance Tax	2,022	2,156	$134	6.6%
Vehicle License Fees	4	7	$3	75.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	320	325	$5	1.6%
Cigarette	91	91	$0	0.0%
Other revenues	2,216	2,218	$1	0.1%
Transfers	1,800	1,748	-$52	-2.9%
Total	**$95,394**	**$98,195**	**2,801**	2.9%
Change from Fiscal 11-12	$8,323	$11,409		
% Change from Fiscal 11-12	9.6%	13.1%		
Fiscal 13-14				
Personal Income Tax	$61,747	$60,827	-$920	-1.5%
Sales & Use Tax	23,264	22,983	-$281	-1.2%
Corporation Tax	9,130	8,508	-$622	-6.8%
Insurance Tax	2,198	2,200	$2	0.1%
Vehicle License Fees	0	0	$0	---
Estate Tax	0	0	$0	---
Alcoholic Beverage	326	332	$6	1.8%
Cigarette	89	89	$0	0.0%
Other revenues	1,770	1,828	$58	3.3%
Transfers	-23	468	$491	2126.9%
Total	**$98,501**	**$97,235**	**-1,266**	-1.3%
Change from Fiscal 12-13	$3,106	-$960		
% Change from Fiscal 12-13	3.3%	-1.0%		
Three-Year Total			**$1,250**	

about whether the additional cash is tied to more income shifting from 2013 to 2012 or to underlying economic strength. The May Revision assumes that the cash is attributable to both additional income shifting and modest economic growth in 2012. For 2013, however, the economic forecast has weakened.

The Governor's Budget assumed that the federal government would extend the 2-percent payroll tax holiday and that sharp across-the-board spending cuts would be avoided. The payroll tax holiday was not extended, and across-the-board spending cuts did go into effect. These developments have reduced the May Revision forecast for economic growth for 2013 and later years. For the forecast of 2013, personal income dropped over 2 percent. The wage growth forecast, a significant driver for revenue, has declined from 4.6 percent at the Governor's Budget to 4 percent at the May Revision.

The May Revision estimates that capital gains in 2012 were over $100 billion, the highest level since 2007. This is partially due to taxpayers shifting the realization of capital gains from 2013 to 2012 to minimize federal taxes. The May Revision assumes that 25 percent of capital gain realizations that would have occurred in 2013 instead occurred in 2012. The forecast assumes that capital gains will fall to $58 billion in 2013, after accounting for the shift of gains from 2013 to 2012. While this level is substantially lower than the 2012 level of capital gains, it is higher than the capital gains observed in any of the other four post-recession years. The May Revision assumes somewhat slower wage growth, due to the expiration of the 2-percent payroll tax holiday and implementation of federal spending cuts. The combination of slower economic growth and the shift of capital gains (and other income items) from 2013 into 2012 leads to a reduction in PIT liability from 2012 to 2013. Consequently, 2012-13 PIT revenue is up for the May Revision by $3.3 billion, while 2013-14 PIT revenue is down by $900 million.

While cash for PIT was up by $4.5 billion through the end of April, the May Revision forecast is $3.3 billion higher in the 2012-13 fiscal year than at the Governor's Budget. There are several reasons for this difference. Some of the additional cash, about $400 million, received for the 2012 tax year is attributable to 2011-12 and 2013-14. A lower wage forecast and higher refund forecast reduces May and June cash by $200 million. To reflect recent cash patterns, additional cash adjustments for the final two months of the fiscal year have been made, moving revenues to 2013-14.

The forecasts for both Sales and Use Tax (SUT) and Corporation Tax (CT) are reduced for the May Revision. The SUT reduction reflects weaker SUT tax receipts in recent months versus the Governor's Budget forecast. The reduction also reflects the expiration of the

2-percent payroll tax holiday and a lower forecast for wage growth. Sales tax revenue is often a leading indicator of economic conditions and has been underperforming relative to the Governor's Budget forecast. The May Revision reflects this early indicator of changing conditions. The decrease in CT revenue reflects reduced CT cash receipts for the 2012-13 fiscal year compared to the prior year. The CT forecast has also been negatively affected by an increase in refunds for prior years. The CT revenue forecast is reduced by $71 million in 2012-13 and by $622 million in 2013-14.

Job Creation and Economic Development Proposal

The May Revision proposes to modernize the state's job creation and economic development incentives. Created over 25 years ago, the Enterprise Zone program should be reshaped to meet the needs of the current economy. In its current form, it fails to encourage the creation of new jobs and instead rewards moving jobs from one place to another within the state. Additionally, the New Jobs Hiring Credit created in 2009 has not been effective at stimulating job growth. The May Revision aims to strengthen both of these programs to bolster California's business environment and reintegrate people into the workforce.

The hiring credit will be refocused to specific areas with high unemployment and poverty rates. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, and people receiving public assistance. The Enterprise Zone sales tax program will be expanded to a statewide, upfront sales tax exemption for manufacturing or biotech research and development equipment purchases. Finally, the California Competes Recruitment and Retention Fund will be created, to be administered by the Governor's Office of Business and Economic Development (GO-Biz). GO-Biz will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California.

The proposal is revenue neutral and focuses on improving the performance of those dollars already spent. It will allow California to be more effective at stimulating economic growth and creating new jobs. The program will be designed to ensure that small businesses are able to easily obtain the manufacturing sales tax exemption, and will dedicate a portion of the hiring credit and the incentive fund solely to small businesses.

Long-Term Forecast

Figure REV-02 shows the forecast for the largest three General Fund revenues from 2011-12 through 2016-17. Total General Fund revenue from these sources is expected to grow from $80.2 billion in 2011-12 to $112 billion in 2016-17. The average year-over-year growth rate over this period is 7 percent.

Figure REV-02
Long-Term Revenue Forecast - Three Largest Sources
(General Fund Revenue - Dollars in Billions)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	average year over year growth
Personal Income Tax	$54.3	$63.9	$60.8	$67.1	$71.8	$75.0	6.9%
Sales and Use Tax	$18.7	$20.2	$23.0	$24.7	$26.3	$27.0	7.7%
Corporation Tax	$7.2	$7.5	$8.5	$9.1	$9.6	$10.1	6.9%
Total	**$80.2**	**$91.7**	**$92.3**	**$100.9**	**$107.7**	**$112.0**	7.0%
Growth	--	14.3%	0.7%	9.3%	6.7%	4.0%	

Note: Numbers may not add due to rounding

The May Revision economic forecast reflects modest but steady growth over the next five years. The projected average growth rate in GDP over the next five years is 2.7 percent, a slightly slower rate than normal for an economic expansion.

The total revenue generated by these three sources has grown at an average annual rate of 5 percent since 1987. The relatively high average growth rate in revenue expected in the next few years reflects the passage of Proposition 30 and Proposition 39, which affect the near-term growth rates. When fully phased-in, these two provisions increase revenue by $7 billion to $8 billion per year. Also adding to the volatile year-to-year growth is the shifting of income (capital gains realizations, dividend payouts, and wages) from 2013 into 2012 due to the federal tax increases in 2013.

Personal Income Tax

Compared to the Governor's Budget, the PIT forecast is higher by $425 million in 2011-12 and $3.3 billion in 2012-13 and lower by $920 million in 2013-14. Over the entire three-year period, the PIT forecast increased by $2.8 billion. Through April, current-year

PIT receipts are up $4.5 billion from the Governor's Budget forecast. However, the revenue forecast for 2013-14 has been reduced and reflects a modestly lower forecast for wages and salaries in 2013.

April's cash receipts provide a clearer picture of 2012 tax year liability, but add a layer of difficulty in estimating 2013 tax liability. Based on these receipts and the most recent economic data, it now appears that the Governor's Budget forecast underestimated the strength of capital gains income for the 2012 tax year. Because of this, the forecast of capital gains income for 2012 has been increased from $87 billion to $104 billion. This represents a 100-percent increase over the prior year. However, capital gains income is forecast to decrease by 44 percent in 2013, due primarily to the shifting of capital gains realizations from 2013 into 2012 as a result of higher federal tax rates on capital gains income beginning in 2013. The May Revision forecast assumes that 25 percent of 2013 capital gains shifted into 2012, whereas the Governor's Budget assumed a 20-percent shift. In addition, the forecast for capital gains in 2013 and forward reflects capital gains income as a percent of personal income that is in line with historical averages.

This forecast also reflects the passage of Proposition 30 in November 2012. Proposition 30 PIT revenues are estimated at $3.2 billion in 2011-12, $4.7 billion in 2012-13, and $4.8 billion in 2013-14.

Sales and Use Tax

The Sales and Use Tax (SUT) forecast reflects a decrease of $474 million in 2012-13 and $281 million in 2013-14. This includes Proposition 30 revenues totaling $598 million in 2012-13 and $1.3 billion in 2013-14.

For the current year, the decline in the SUT forecast is attributed to lower than estimated cash receipts through March, the expiration of the payroll tax holiday, and the expected slower growth in wages. Overall weakness in the forecast continues through 2013-14.

Corporation Tax

The Corporation Tax (CT) forecast reflects a decrease of $71 million in 2012-13 and $622 million in 2013-14.

The May Revision economic forecast for national corporate profits projects growth of 6.8 percent in 2012, and 1 percent in 2013. The year-over-year increases in California taxable profits are estimated at 0.8 percent in 2012-13, and 1.2 percent in 2013-14. However, the modest growth in estimated taxable profits for California corporations does not translate to increased CT revenues. This is due largely to outflows in the current and budget years from the resolution of disputes between taxpayers and the state. Recent tax changes allowing increased usage of credits, as well as recently enacted legislation allowing the sharing of credits among members of the same unitary group, and allowing the elective use of single sales factor apportionment also contributed to this divergence between corporate profits and tax receipts. Additionally, temporary limitations on the use of tax credits and net operating losses that were enacted in 2008 and 2010 have ended as of the 2010 and 2012 tax years respectively, further reducing taxes from corporations.

This forecast also reflects the passage of Proposition 39 in November 2012. Proposition 39 revenues are estimated at $453 million in 2012-13 and $928 million in 2013-14.

Insurance Tax

The Insurance Tax forecast reflects an increase of $134 million in 2012-13 and $2 million in 2013-14. The revenue changes are due in large part to a delay in refunds paid pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case.

Estate Tax

The federal Estate Tax, to which the state's pick-up tax is tied, was reinstated in January 2013 for deaths on or after January 1, 2013. The new federal Estate Tax operates in such a way as to effectively eliminate the state pick-up estate tax.

Property Tax

The property tax forecast reflects an increase of $2.7 billion compared to the Governor's Budget. Revenues are projected to increase 1.3 percent in 2012-13 and 2.8 percent in 2013-14. The base 1-percent rate is expected to generate roughly $50.9 billion in revenue in 2013-14, of which roughly half ($27.2 billion) will go to K-14 schools. The $27.2 billion figure does not include additional property tax revenue that schools are expected to receive in 2013-14 from the former redevelopment agencies.

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