REVENUE ESTIMATES

While high-income individuals and corporate profits outperformed expectations from Governor's Budget, the boost is expected to be temporary and revenues will be lower beyond the forecast window. From 2017-18 through 2019-20, the May Revision revenues have increased by approximately $3.2 billion before accounting for transfers. The changes in the three largest tax sources are:

- Personal income tax revenues are revised upwards almost $1.9 billion due to the strong stock market in 2019, which results in substantially higher capital gains in 2019 and 2020. In addition, personal income tax withholding was increased by $500 million in 2019 due to the expected number of Initial Public Offerings (IPOs) of stock in large California-based companies.
- Sales tax receipts are down by $360 million due mainly to a downgrade in the forecast for investment by businesses, as the expected boost from the federal tax cut did not materialize.
- Corporation tax revenues are up over $1.7 billion based on corporate tax receipts received through April. The stronger receipts are a result of shifting of income from 2017 to 2018 and other one-time payments such as revenues from repatriation of foreign earnings associated with the federal tax changes in late 2017.

After accounting for transfers, which includes loan repayments as well as automatic and discretionary transfers to the Rainy Day Fund, General Fund revenues at the May

Revision forecast are higher than the Governor's Budget by over $1.1 billion in 2018-19 and almost $1.2 billion in 2019-20.

The General Fund Revenue Forecast table compares the revenue forecasts by source in the Governor's Budget to the May Revision. Total May Revision revenues, including transfers, is projected to be $138 billion in 2018-19 and $143.8 billion in 2019-20.

2019-20 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change From Governor's Budget Forecast	
Fiscal 17-18				
Personal Income Tax	$94,272	$93,776	-$495	-0.5%
Sales & Use Tax	25,006	24,974	-32	-0.1%
Corporation Tax	12,156	12,313	156	1.3%
Insurance Tax	2,569	2,569	0	0.0%
Alcoholic Beverage	376	376	0	0.0%
Cigarette	65	65	0	0.0%
Pooled Money Interest	250	250	0	0.0%
Other Revenues	1,170	1,171	1	0.1%
Subtotal	$135,865	$135,494	-$370	-0.3%
Transfers[1/]	-4,369	-4,378	-9	0.2%
Total	**$131,495**	**$131,116**	**-$378**	-0.3%
Fiscal 18-19				
Personal Income Tax	$97,720	$98,304	$584	0.6%
Sales & Use Tax	26,244	26,100	-144	-0.5%
Corporation Tax	12,330	13,774	1,444	11.7%
Insurance Tax	2,606	2,643	37	1.4%
Alcoholic Beverage	382	381	-1	-0.3%
Cigarette	65	63	-1	-2.0%
Pooled Money Interest	554	602	48	8.7%
Other Revenues	1,088	1,045	-42	-3.9%
Subtotal	$140,988	$142,912	$1,925	1.4%
Transfers[1/]	-4,042	-4,866	-824	20.4%
Total	**$136,945**	**$138,046**	**$1,101**	0.8%
Fiscal 19-20				
Personal Income Tax	$100,547	$102,333	$1,786	1.8%
Sales & Use Tax	27,424	27,241	-184	-0.7%
Corporation Tax	13,125	13,233	108	0.8%
Insurance Tax	2,830	2,868	39	1.4%
Alcoholic Beverage	389	386	-3	-0.7%
Cigarette	63	62	-1	-2.0%
Pooled Money Interest	655	602	-53	-8.1%
Other Revenues	1,079	1,108	29	2.7%
Subtotal	$146,112	$147,833	$1,721	1.2%
Transfers[1/]	-3,494	-3,995	-501	14.3%
Total	**$142,618**	**$143,839**	**$1,221**	0.9%
Three-Year Total			**$1,943**	

Note: Numbers may not add due to rounding.

[1/] Includes transfers to Budget Stabilization Account each year.

LONG-TERM FORECAST

The May Revision economic forecast reflects slower U.S. real gross domestic product growth of 2.3 percent in 2019 and 2.1 percent in 2020, down from 2.9 percent in 2018. The projected average growth rate starting in 2021 then continues to fall below 2 percent, with more of the growth accruing to lower-wage workers who pay less in taxes. While the forecast does not project a recession, the risks to the outlook are now higher, as discussed in the Economic Outlook Chapter.

The Long-Term Revenue Forecast table below shows the forecast for the largest three sources of General Fund revenues from 2017-18 through 2022-23. Total General Fund revenues from these sources is expected to grow from $131.1 billion in 2017-18 to $151.8 billion in 2022-23. The average year-over-year growth rate over this period is 3 percent.

Long-Term Revenue Forecast — Three Largest Sources
(General Fund Revenue — Dollars in Billions)

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Average Year-Over-Year Growth
Personal Income Tax	$93.8	$98.3	$102.3	$103.8	$106.3	$107.6	2.8%
Sales and Use Tax	$25.0	$26.1	$27.2	$28.1	$28.8	$29.6	3.4%
Corporation Tax	$12.3	$13.8	$13.2	$13.7	$14.2	$14.7	3.7%
Total	**$131.1**	**$138.2**	**$142.8**	**$145.5**	**$149.3**	**$151.8**	3.0%
Growth	10.0%	5.4%	3.4%	1.9%	2.6%	1.7%	

Note: Numbers may not add due to rounding.

EARNED INCOME TAX CREDIT

The 2015 Budget enacted the state's first-ever Earned Income Tax Credit to help the poorest working families in California. The EITC was expanded as part of the 2017 and 2018 Budgets, and is expected to provide $400 million of credits to around 2 million households in 2018.

The May Revision proposes to rename the credit the California EITC, a cost-of-living refund, and to significantly expand the credit. The newly expanded credit will be available to roughly 3 million households in total, and will approximately triple the amount of credits provided from $400 million to about $1.2 billion. The expansion will:

- Provide a $1,000 credit for every family that otherwise qualifies for the credit and has at least one child under the age of 6.
- Increase the maximum eligible earned income to $30,000 so that those working up to full-time at the 2022 minimum wage of $15 per hour will be eligible for the credit.
- Change the structure of the credit so that it phases out more gradually, providing a more substantial credit for many eligible families.

The May Revision includes $18.7 million in 2019-20 for the Franchise Tax Board to develop and administer a program to give California EITC recipients the option to receive a portion of their EITC as monthly advance payments rather than as a lump sum at the end of the year when they file their taxes. The program is targeted to begin in 2021 and is contingent upon a Department of Finance determination that the monthly advance EITC payments will not affect taxpayer's eligibility for any income-based federal or state programs.

To pay for the entire California EITC program, the May Revision proposes conforming to a number of federal tax provisions mainly impacting business income. The provisions included are those that would constitute good tax policy or that would confer a significant administrative benefit to California taxpayers or the Franchise Tax Board. These provisions include small business accounting simplicity, limitations on employer deductibility of some fringe benefits, and limitations on the amount of non-corporate business losses that can be used to offset non-business income. The May Revision also proposes to partially conform to the federal provisions on deferred and reduced capital gains for investments in the California Opportunity Zones designated in 2018. Eligible investments include green technology and affordable housing, with criteria chosen to allow incentives to be layered with Infill Infrastructure Grants to incentivize housing. These conformity provisions are expected to generate $200 million in 2018-19, $1.7 billion in 2019-20, and then about $1.4 billion annually on an ongoing basis. The revenue estimates for these conformity provisions are subject to a high level of uncertainty as it is difficult to anticipate taxpayer behavior in response to changes such as these.

SMALL BUSINESS TAX CODE STREAMLINING

In addition to conforming to federal tax provision on accounting rules, the May Revision includes statutory changes to help businesses and individuals by expediting certain tax appeals.

Current law requires the Office of Tax Appeals to decide appeals using panels of three Administrative Law judges. The proposed statutory changes allow tax appeals to be decided by one judge, if the appellants opt-in. The appeals must involve franchise income tax matters of less than $5,000, or business tax matters of less than $50,000. The business tax appellant must also have less than $20 million in gross annual sales.

PERSONAL INCOME TAX

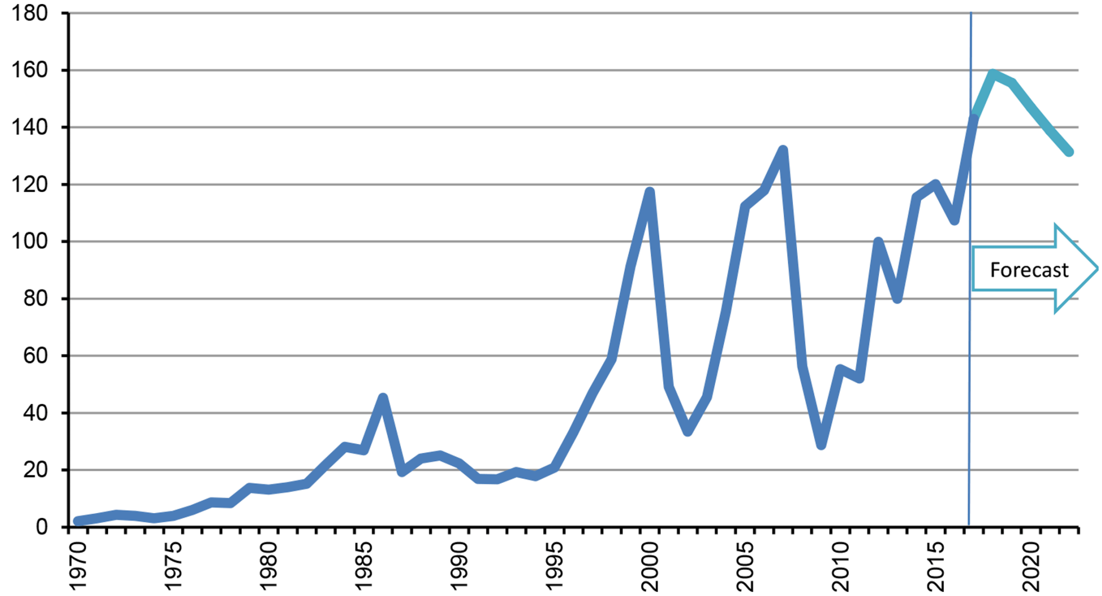
Compared to the Governor's Budget forecast, the personal income tax forecast is lower by $495 million in 2017-18, and higher by $584 million in 2018-19 and $1.8 billion in 2019-20. Over the three-year period, the personal income tax forecast reflects a total increase of $1.9 billion.

Despite the stock market plunge in December 2018 that saw the S&P 500 index decline by 20 percent to 2,351 from its high of 2,930 in September, stock market values fully recovered, with the S&P 500 back above 2,900 and well above the Governor's Budget forecast. The forecast assumes the S&P 500 will be at 2,905 in the second quarter of 2019, up from 2,677 at the Governor's Budget, and then grow at 0.5 percent annually for the following years. This improved market forecast leads to an increase in the forecast for capital gains realizations from $138 billion to $156 billion in 2019 (see figure with Capital Gains Realizations), and from $131 billion to $147 billion in 2020. Capital gains realizations in 2018 were revised higher from $153 billion to $159 billion. Capital gains realizations for 2017 were revised higher from $142 billion to $143 billion, based on new Franchise Tax Board taxpayer data for 2017. Capital gains realizations are forecast to return to a normal level of 4.5 percent of personal income by 2022, one year later than the assumption in the Governor's Budget.

Forecasting revenues associated with capital gains is subject to significant uncertainty because realizations are heavily dependent upon stock market performance and when taxpayers choose to buy or sell stock. Any sustained decline in the stock market below the May Revision forecast is likely to reduce capital gains realizations below the forecast.

The personal income tax forecast includes Propositions 30 and 55 revenues, which are estimated at $8.9 billion in 2018-19 and $8.9 billion in 2019-20. These estimates are higher than the Governor's Budget by $175 million and $278 million, respectively, due to higher capital gains realizations.

Capital Gains Realizations
(Dollars in Billions)



New tax return data for 2017 reflected a distribution of income that was less skewed toward the upper income levels than expected at the Governor's Budget, leading to a lower effective tax rate and offsetting some of the revenue gain from higher capital gains realizations. For example, the effective tax rate on capital gains realizations for Proposition 2 was calculated at 0.4 percentage point lower in 2017 compared to the Governor's Budget. Still, the highest-income Californians continue to pay a very large share of the state's personal income tax. For the 2017 tax year, the top one percent of income earners paid over 47 percent of personal income taxes. This percentage has been greater than 40 percent for 13 of the last 14 years. The top 0.1 percent of income earners — approximately 17,000— paid around 27 percent of personal income taxes—$22 billion.

SALES AND USE TAX

The sales tax forecast is lower by $144 million in 2018-19 and $184 million in 2019-20, due primarily to the expected growth for taxable capital investments in the state being revised down from 6.3 percent to 5.1 percent in 2019, and from 4.4 percent to 3.5 percent in 2020. Taxable sales are expected to grow at 4.9 percent in 2018-19 and 4.4 percent in 2019-20, which is below the Governor's Budget by 0.6 percentage point in 2018-19 and by 0.3 percentage point in 2019-20. Lower sales of cannabis reduced the forecast from the Governor's Budget by $70 million through 2019-20 and higher use of the manufacturing exemption reduced the forecast from the Governor's Budget by $58 million through fiscal year 2019-20.

The U.S. Supreme Court's ruling in *Wayfair v. South Dakota* in June 2018 gives states more authority to require out-of-state sellers to collect use tax. Chapter 5, Statutes of 2019 (AB 147) clarified the economic nexus thresholds that California will use to determine if out-of-state retailers are required to remit use tax to California, effective April 1, 2019. Additionally, AB 147 requires marketplace facilitators to collect and remit sales and use tax on behalf of their marketplace sellers, effective October 1, 2019. The *Wayfair* decision and AB 147 are expected to increase sales and use tax revenues by $174 million in 2018-19 and $616 million in 2019-20, a decrease of $45 million in 2018-19 and an increase of $62 million in 2019-20 from the Governor's Budget. The decrease in 2018-19 is due to a lower estimate of compliance among marketplace sellers due to the *Wayfair* decision prior to the October 1, 2019 effective date in AB 147 that requires marketplace facilitators to collect and remit sales and use tax for their marketplace sellers. The May Revision proposes that CDTFA limit the look-back to 3 years of back taxes, and this is consistent with the revenue forecast. This will be codified with statutory amendments.

MENSTRUAL PRODUCTS AND DIAPERS SALES TAX EXEMPTION

The May Revision proposes to exempt menstrual products and children's diapers from sales taxation beginning January 1, 2020. This exemption reduces General Fund revenues by $17.5 million in 2019-20 and $35 million each year thereafter. Total state and local revenue losses are $38 million 2019-20 and $76 million for the following full years. This tax exemption sunsets on December 31, 2021.

CORPORATION TAX

The corporation tax forecast is higher by $156 million in 2017-18, $1.4 billion in 2018-19, and $108 million in 2019-20. Tax return data for 2017 indicated that corporations left an additional $900 million on account with FTB rather than taking a refund, resulting in a large one-time gain to the forecast. While tax return data for the 2017 tax year also reflected lower liability than forecast at the Governor's Budget, tax payments related to 2018 liability were unusually strong. April final return payments and extension payments in 2019 were up more than 58 percent over 2018 levels. As a result, the forecast assumes that corporations shifted a larger share of their income—5 percent versus 1 percent—from 2017 to 2018 in response to the federal tax law change that reduced corporate tax rates in 2018. In addition, some of the unusual strength in 2018 tax year payments was assumed to be due to one-time payments such as the expected repatriation of overseas profits due to tax law changes.

INSURANCE TAX

The insurance tax forecast is higher by $37 million in 2018-19 and $39 million in 2019-20 due to moderately higher forecast for insurance tax liabilities.

LOAN REPAYMENTS TO SPECIAL FUNDS

The May Revision reflects the repayment of loans to special funds of $171 million and $942 million in 2018-19 and 2019-20, respectively, which eliminates all outstanding loans from special funds.

PROPERTY TAX

The property tax is a local revenue source; however, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools generally offset General Fund expenditures.

Preliminary data show statewide property tax revenues increased 6.1 percent in 2018-19, which is slightly higher than the 6-percent growth rate anticipated at the Governor’s Budget. Property tax revenues are expected to grow 6.5 percent in 2019-20. Approximately 42 percent ($31 billion) of 2019-20 property tax revenues will go to K-14 schools. While this amount includes $2.1 billion that schools are expected to receive in 2019-20 due to the dissolution of redevelopment agencies, it excludes the $9.1 billion shifted from schools to cities and counties to replace Vehicle License Fee (VLF) revenue losses stemming from the reduced VLF rate of 0.65 percent.