

REVENUE ESTIMATES

The economic picture nationally and in California is less positive than when the Governor's Budget forecast was finalized in November 2021, driven by the disruption caused by the Ukraine-Russia war, elevated inflation that is more persistent and has led to tighter monetary policy, and a stock market that has declined significantly. Nonetheless, tax receipts for the three largest tax sources have come in \$33.9 billion higher than projected through April. And while the economic forecast has been downgraded somewhat since the Governor's Budget in real (inflation-adjusted) terms, these developments have been generally positive for the revenue forecast, as the higher level of inflation leads to higher income and prices, translating to higher levels of tax liability and revenue. Thus, all three major revenue sources are expected to show significant increases over the multiyear period relative to the Governor's Budget forecast. Risks to the economic forecast, however, have been heightened, as discussed in the Economic Outlook Chapter.

The changes in the three largest tax sources over the budget window (2020-21 through 2022-23) are:

- Personal income tax revenues are higher by over \$23 billion due largely to very strong tax receipts related to the 2021 tax year and a significantly upgraded forecast for nominal (not adjusted for inflation) wage growth in 2022 and 2023.
- Sales tax revenues have been revised upward by almost \$3.7 billion due to strong tax receipts and a higher inflation forecast.

REVENUE ESTIMATES

- Corporation tax revenues are up \$28.1 billion based on very strong cash receipts, stronger corporate profits in 2021 than projected at Governor's Budget, and stronger participation in the pass-through entities (PTE) elective tax.

After accounting for transfers, which includes loan repayments as well as deposits into the Rainy Day Fund, baseline General Fund revenues at the May Revision exceed the Governor's Budget forecast by \$54.6 billion over the budget window: \$442 million in 2020-21, \$30.3 billion in 2021-22, and \$23.9 billion in 2022-23. Other Revenues includes \$1.1 billion in federal cost recovery for 2021-22 and \$6.7 billion for 2022-23.

The PTE tax, enacted as part of the 2021 Budget Act as a way to help California business owners mitigate the impact of the federal limit on state and local tax deductions on federal tax returns, has proved more popular than anticipated. Actual receipts through April 2022, which are related to the 2021 tax year, came in at \$14.9 billion, over 60 percent higher than the \$9.1 billion projected at Governor's Budget. In addition to the higher usage of the elective tax, payments came in sooner than anticipated. It is uncertain how much of the roughly \$14 billion in tax credits related to the 2021 tax year that are expected to be generated from this tax have actually been reflected in reduced personal income tax payments received so far. The May Revision forecast assumes that 50 percent, or \$7 billion, of the credits will result in higher refunds on October 2022 personal income tax extension returns. The combination of higher participation and modified assumptions regarding the timing of the effects of the tax lead to a net increase in revenue, relative to the Governor's Budget, of \$5.9 billion in 2021-22 and \$700 million in 2022-23. Over the following three fiscal years combined, the modified assumptions regarding the PTE tax reduce General Fund revenues by \$5.3 billion relative to the Governor's Budget.

The General Fund Revenue Forecast table compares the Governor's Budget and May Revision revenue forecasts.

2022-23 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	2022-23 Governor's Budget	May Revision	Change From Governor's Budget Forecast	
Fiscal 2020-21: Final				
Personal Income Tax	\$128,226	\$128,856	\$630	0.5%
Sales & Use Tax	29,066	29,073	7	0.0%
Corporation Tax	22,793	22,591	-202	-0.9%
Insurance Tax	3,139	3,139	0	0.0%
Alcoholic Beverage	415	415	0	0.0%
Cigarette	60	60	0	0.0%
Pooled Money Interest	192	192	0	0.0%
Other Revenues	2,201	2,485	284	12.9%
Subtotal	\$186,092	\$186,810	\$718	0.4%
Transfers ^{1/}	8,040	7,764	-276	-3.4%
Total	\$194,132	\$194,575	\$442	0.2%
Fiscal 2021-22				
Personal Income Tax	\$120,873	\$136,397	\$15,524	12.8%
Sales & Use Tax	\$30,866	\$32,750	1,884	6.1%
Corporation Tax	\$32,863	\$46,395	13,532	41.2%
Insurance Tax	\$3,448	\$3,468	19	0.6%
Alcoholic Beverage	\$423	\$430	7	1.6%
Cigarette	\$58	\$54	-4	-6.1%
Pooled Money Interest	\$182	\$237	55	30.3%
Other Revenues	\$5,116	\$3,050	-2,066	-40.4%
Subtotal	\$193,829	\$222,782	\$28,952	14.9%
Transfers ^{1/}	2,840	4,174	1,334	47.0%
Total	\$196,669	\$226,956	\$30,286	15.4%
Fiscal 2022-23				
Personal Income Tax	\$130,269	\$137,454	\$7,186	5.5%
Sales & Use Tax	\$32,208	\$33,991	1,783	5.5%
Corporation Tax	\$23,732	\$38,464	14,732	62.1%
Insurance Tax	\$3,541	\$3,667	127	3.6%
Alcoholic Beverage	\$421	\$435	14	3.3%
Cigarette	\$51	\$49	-2	-4.7%
Pooled Money Interest	\$164	\$478	314	191.5%
Other Revenues	\$7,249	\$8,428	1,179	16.3%
Subtotal	\$197,634	\$222,966	\$25,332	12.8%
Transfers ^{1/}	-1,915	-3,333	-1,418	74.0%
Total	\$195,718	\$219,632	\$23,914	12.2%
Three-Year Total			\$54,642	

Totals may not add because of rounding.
^{1/}Includes transfers to Budget Stabilization Account for each year.

LONG-TERM FORECAST

The Long-Term Revenue Forecast table below shows the forecast for the largest three sources of General Fund revenues from 2020-21 through 2025-26. Assuming continued steady economic growth, total General Fund revenues from these sources are projected to increase from \$180.5 billion in 2020-21 to \$232.1 billion in 2025-26. The

majority of the increase occurs in 2021-22, reflecting the surge in revenues related to the 2021 tax year.

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

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	Average Year-Over-Year Growth
Personal Income Tax	\$128.9	\$136.4	\$137.5	\$143.8	\$148.9	\$156.2	3.9%
Sales and Use Tax	\$29.1	\$32.7	\$34.0	\$35.1	\$36.2	\$37.3	5.2%
Corporation Tax	\$22.6	\$46.4	\$38.5	\$42.0	\$45.4	\$38.6	18.1%
Total	\$180.5	\$215.5	\$209.9	\$220.9	\$230.6	\$232.2	5.4%
Growth	29.5%	19.4%	-2.6%	5.3%	4.4%	0.7%	

Note: Numbers may not add due to rounding. The PTE elective tax is artificially deflating personal income tax revenues from 2021-22 through 2025-26 and artificially inflating corporation tax revenues for the same years.

Note: Average year-over-year growth is calculated from 2020-21 to 2025-26 and therefore excludes the 29.5% growth from 2019-20 to 2020-21. Average year-over-year growth from 2019-20 to 2025-26 is 9.4%.

Source: California Department of Finance, May Revision Forecast

REVENUE PROPOSALS

The May Revision includes several proposals included in the Governor's Budget that have not yet been enacted. These proposals include the following:

- Index the \$1,000 Young Child Tax Credit (YCTC) amount to inflation. The estimate for this proposal has been updated from a loss of \$19 million in 2022-23 in the Governor's Budget to a loss of \$14 million for the May Revision.
- Allow the YCTC to be claimed by households with zero income. The estimate for this proposal has been updated from a loss of \$24 million in 2022-23 in the Governor's Budget to a loss of \$55 million for the May Revision.
- Create a \$1,000 credit for young adults who have come through the foster care system, at a cost of roughly \$20 million ongoing.
- Tax payment flexibility for low- and moderate-income households. The revenue loss for this proposal was not available for the Governor's Budget. The revenue loss at the May Revision is estimated at \$100 million for 2021-22 and \$60 million for 2022-23.

In addition, the May Revision also proposes the following:

- An extension of the California Competes (CalCompetes) Tax Credit Program through the 2027-28 fiscal year at the current level of \$180 million in credit allocations per year to ensure program continuity. The CalCompetes extension—and an associated proposed second year of the CalCompetes grant program—is discussed in the Economic Growth, Job Creation, and Expanded Opportunity Chapter.
- An expansion of the conformity to the federal tax treatment of the Paycheck Protection Program (PPP) to include loans provided after March 30, 2021. The PPP conformity expansion is discussed in the Economic Growth, Job Creation, and Expanded Opportunity Chapter.
- A technical fix to the two Main Street Tax Credits to help taxpayers who reserved credits claim those credits against income tax. The Main Street Credits fix is discussed in the Economic Growth, Job Creation, and Expanded Opportunity Chapter.
- An expansion of the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) program by \$15 million from 2022-23 through 2024-25 dedicated to equipment purchases related to the extraction or processing of lithium, as well as equipment purchases related to manufacturing with lithium, with additional costs to backfill local revenues consistent with the base program.
- A tax on lithium extraction. This tax is discussed in the Climate Change Chapter.
- As part of the broad-based relief package, a 12-month pause, effective October 1, 2022, on the General Fund (3.9375-percent rate) portion of the sales tax rate on diesel. This tax reduction is discussed in the Broad Based Relief Chapter.

These new proposals are expected to reduce General Fund revenue by \$160 million in 2021-22 and by \$487 million in 2022-23.

The Governor's Budget included two tax credits to help California transition to a more resilient climate future. The first was a new credit for companies investing in activities and technologies that mitigate climate change and are headquartered in California. The second was a credit for those that opt in to develop green energy technologies. Both of these credits have been converted to a grant program administered by the California Energy Commission. This grant program is discussed in the Climate Change Chapter.

PERSONAL INCOME TAX

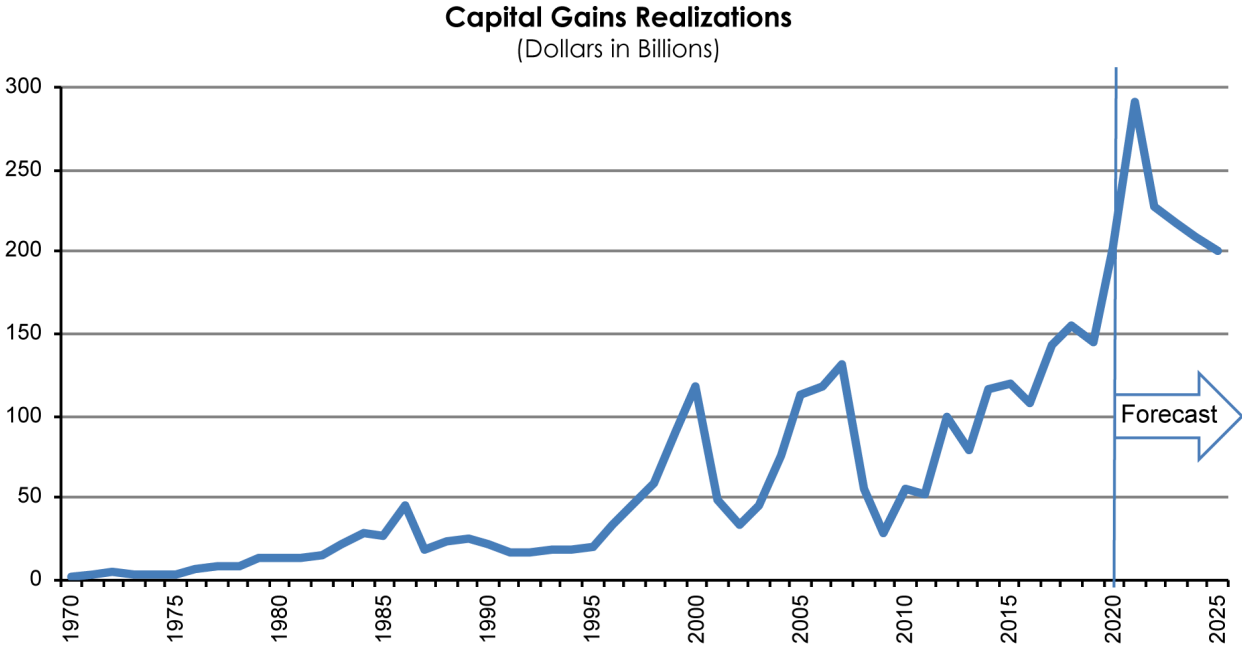
Compared to the Governor's Budget forecast, the personal income tax forecast is higher by \$630 million in 2020-21, \$15.5 billion in 2021-22, and \$7.2 billion in 2022-23. Over the three-year period, the personal income tax forecast reflects a total increase of \$23.3 billion. These figures include revenue losses from credit usage related to the pass-through-entities (PTE) elective tax of \$16.2 billion in 2021-22 and \$15 billion in 2022-23, which is an increase of \$2.1 billion and \$5.3 billion, respectively, over the Governor's Budget forecast.

Due to stronger wage growth for employees, as well as lower unemployment than forecast in the Governor's Budget, taxable wages have been revised higher, which positively impacts personal income tax wage withholding receipts. Typically, wages comprise around 55 percent to 60 percent of all personal income tax receipts. Taxable wage growth was revised from 9.2 percent to 12.4 percent in 2021, from 7.5 percent growth to 9.7 percent in 2022, and from 6 percent to 7 percent in 2023.

Personal income tax wage withholding receipts were very strong in 2021, with 20.2-percent year-over-year growth, compared to 16-percent growth estimated in the Governor's Budget. The difference between the 20.2-percent growth in withholding and the 12.4-percent growth in taxable wages reflects a larger share of the wage gains going to high-income earners with higher effective tax rates. Growth has moderated in the first four months of 2022, with withholding cash receipts growing about 7 percent year over year. As a result, withholding growth in 2022 has been revised to 7 percent compared to 7.6 percent in the Governor's Budget. Withholding growth is expected to be 7 percent in 2022, 2.7 percentage points lower than the expected growth in wages. Wage withholding growing slower than wages implies that a larger share of the wage growth is attributed to lower income taxpayers. This is consistent with the forecast that lower-wage sectors will comprise a larger share of the wage gains than higher-wage sectors.

Tax data for 2020 capital gains realizations reflected strong year-over-year growth of 40 percent to \$202 billion. Given the strong year for the stock market in 2021, along with strong cash receipts related to tax year 2021 that were significantly above the Governor's Budget forecast, the forecast for capital gains realizations in 2021 was revised substantially higher, increasing from \$245 billion to \$291 billion. (See figure on Capital Gains Realizations.) This level is equal to 9.7 percent of personal income, which is the highest level of capital gains realizations as a share of the economy ever recorded except for 2000, when capital gains realizations were 10.4 percent of personal

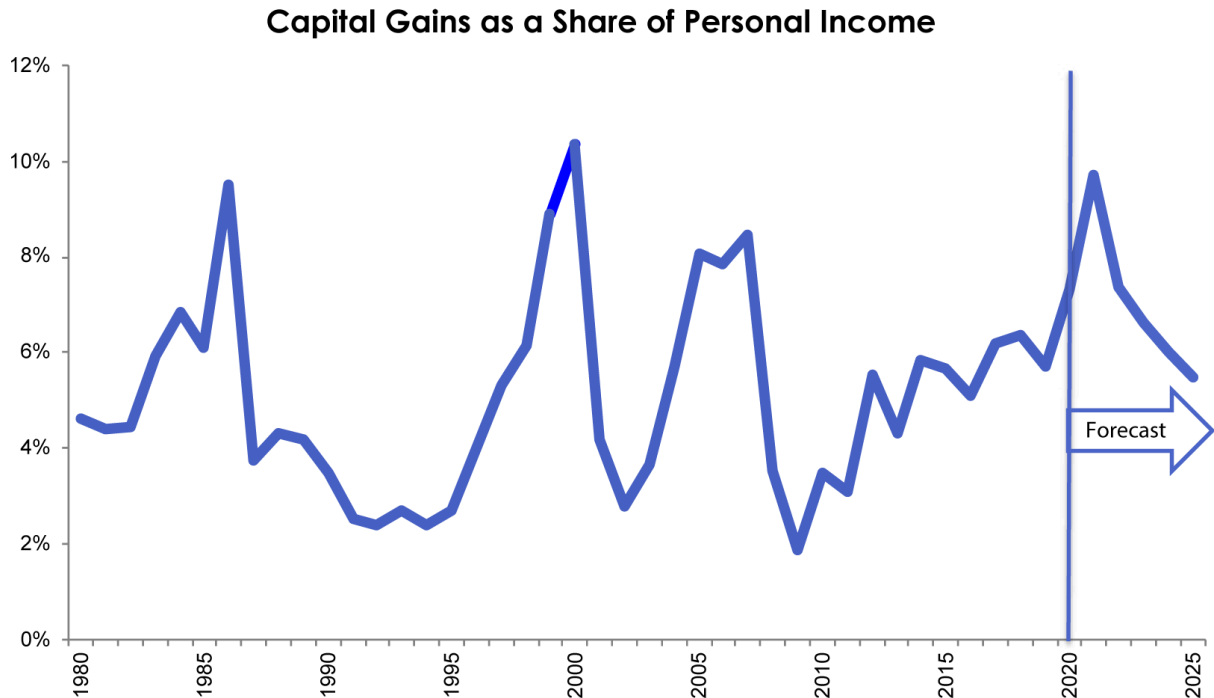
income. The Capital Gains Realizations as a Share of Personal Income figure shows the ratio of capital gains realizations to California Personal Income since 1980.



The S&P 500 has been in and out of correction territory (falling at least 10 percent below its most recent high) since late February. Accordingly, the S&P 500 is projected to average 4,244 in the third quarter of 2022, a significant downgrade from the Governor's Budget, which assumed that the S&P 500 would be at 4,716 in the third quarter of 2022, or nearly 11 percent higher. Further, the Nasdaq has declined more significantly, trading at 12,626 when the May Revision forecast was finalized—an over 21-percent decline from its peak levels in late November 2021 when the Governor's Budget was finalized.

Due to the stock market decline in early 2022, capital gains realizations are forecast to decline year-over-year to \$227 billion in 2022. While this represents a 22-percent year-over-year decline, this level is only slightly below the Governor's Budget forecast of \$232 billion for that year. Beginning in 2023, the stock market is assumed to experience below-average growth. Capital gains realizations are forecast to decline about 4 percent per year and are assumed to reach 5 percent of personal income at \$191 billion in 2026, compared to \$183 billion in 2026 at Governor's Budget due to the lower forecasted level of personal income at Governor's Budget.

As the apparent recent surge in capital gains shows, 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. Stock market performance is inherently unpredictable. In the Great Recession,



the S&P 500 dropped by over 50 percent; in the technology-driven recession of 2001, it dropped by about 47 percent.

The personal income tax forecast includes Proposition 55 revenues, which are estimated at \$14.9 billion in 2021-22 and \$14.3 billion in 2022-23. These estimates are higher than the Governor's Budget by \$1.4 billion and \$571 million, respectively, due primarily to higher wages and capital gains realizations.

The highest-income Californians continue to pay a very large share of the state's personal income tax. For the 2020 tax year, the top one percent of income earners paid over 49 percent of personal income taxes. This percentage has been greater than 40 percent for 15 of the last 16 years.

Policy changes and updates in the personal income tax forecast relative to the Governor's Budget include the following: (1) lifting the temporary limitation on business use of net operating losses and credits one year early (see Corporation Tax); (2) PPP conformity for loans provided after March 30, 2021; (3) revised estimates for changes to the YCTC proposed at Governor's Budget; (4) incorporation of the fiscal estimate related to the Tax Payment Flexibility Program proposed at Governor's Budget; and (5) conversion of the Innovation Headquarters Credit and the Green Energy Tax Credit proposed at Governor's Budget to a grant program. In sum, these policy changes reduce personal income tax revenues by \$275 million in 2021-22 and \$36 million in 2022-23.

SALES AND USE TAX

The sales tax forecast is higher by \$1.9 billion in 2021-22 and \$1.8 billion in 2022-23 relative to the Governor's Budget forecast. Taxable sales are expected to increase by 15.8 percent in 2021-22 and a further 5.3 percent in 2022-23. In the Governor's Budget, taxable sales were expected to grow 9 percent in 2021-22 and decline by 3.7 percent in 2022-23.

Taxable consumer spending is expected to be higher than Governor's Budget by 5 percent in 2021-22 and by 9.2 percent in 2022-23, due primarily to higher inflation and a slower shift of spending patterns back to services from taxable goods. Taxable sales remained strong throughout the pandemic, due in large part to a shift in consumer spending from services to durable goods, which are more likely to be taxed. Of the industries that generate significant taxable consumer sales, non-store retailers, building material and garden improvement stores, and new car dealers have seen strong sales due to the pandemic. This spending shift is expected to unwind from 2022 to 2025 as spending habits are assumed to normalize, leading taxable consumer spending to stay relatively flat at 2022 levels.

Taxable capital investment, which has benefitted in recent quarters from strong inventory investment and inflation, is expected to be greater than Governor's Budget by 5 percent in 2021-22 and 3.1 percent in 2022-23. Beginning in 2023-24, investment growth is assumed to moderate due to higher borrowing costs resulting from the Federal Reserve increasing interest rates.

The May Revision sales tax forecast reflects two proposed policy changes: exempt diesel fuel from the General Fund (3.9375 percent) portion of the sales tax from October 1, 2022 to September 30, 2023; and increase the California Alternative Energy Advanced Transportation Financing Authority's \$100 million sales tax exclusion program by \$15 million per year for 2022-23 through 2024-25 for lithium-related projects, with additional costs to backfill local revenues consistent with the base program. These two policy changes are expected to decrease sales tax revenue by \$328 million in 2022-23.

CORPORATION TAX

The corporation tax forecast is lower by \$202 million in 2020-21, higher by \$13.5 billion in 2021-22, and higher by \$14.7 billion in 2022-23 relative to the Governor's Budget forecast. Roughly half of these gains result from higher PTE elective tax payments—\$8 billion and \$6 billion in 2021-22 and 2022-23, respectively. In response to strong cash

receipts since the Governor's Budget that were about \$10 billion above forecast through April 2022, corporate profit growth in 2021 was revised substantially higher from 15 percent to 41 percent. The forecast assumes that corporate profits will increase roughly in line with nominal GDP in subsequent years.

The 2020 Budget Act temporarily suspended net operating loss usage and limited business incentive tax credit usage for tax years 2020, 2021, and 2022. The corporation tax forecast incorporates the early action package enacted in February 2022, which ended the net operating loss and credit usage restriction one year early, allowing businesses to fully utilize their net operating losses and credits in tax year 2022.

The May Revision forecast for corporate tax revenues reflects one proposed policy change and one revised proposal: PPP conformity for loans provided after March 30, 2021 and the conversion of the Innovation Headquarters Credit and the Green Energy Tax Credit to a grant program. These two items are expected to reduce revenues by \$80 million in 2021-22 and increase revenues by \$190 million in 2022-23 relative to Governor's Budget.

INSURANCE TAX

The insurance tax forecast is higher by \$19 million in 2021-22 and by \$127 million in 2022-23 relative to the Governor's Budget forecast. Insurance tax premiums are expected to increase 6.5 percent in 2021, which is unchanged from Governor's Budget. Premiums are expected to grow 5.5 percent in 2022 and 5 percent in 2023, which are increases from the 3 percent assumed at Governor's Budget due primarily to higher inflation.

CANNABIS EXCISE TAX

Proposition 64, commonly referred to as the Adult Use of Marijuana Act, levies excise taxes on the cultivation and retail sale of both recreational and medical cannabis. The cultivation tax is paid on all recreational and medicinal cultivation of cannabis, and was increased, to adjust for inflation, to \$10.08 per ounce of flower, \$3.00 per ounce of trim, and \$1.41 per ounce of fresh cannabis plant on January 1, 2022. In addition, there is a 15-percent tax on the retail price of cannabis. Both cannabis excise taxes together generated \$770 million in 2020-21. The May Revision adjusted up the revenue from these excise taxes from \$711 million to \$809 million in 2021-22. The May Revision proposes statutory changes, effective July 1, 2022, to reform cannabis taxes with the intent to

bring more licensees and customers into the legal market, which are discussed in the General Government and Statewide Issues Chapter.

PROPERTY TAX

Although the property tax is a local revenue source, the amount of property tax generated each year has an increased impact on the state budget when Tests 2 or 3 of Proposition 98 are operative because, in those years, local property tax revenues allocated to K-14 schools offset General Fund expenditures. When Test 1 of Proposition 98 is operative, as it will be for 2022-23, property tax revenues received by K-14 schools count toward the Proposition 98 guarantee, but do not offset General Fund expenditures.

Preliminary data suggest statewide property tax revenues increased around 3.7 percent in 2021-22, which is 2.5 percentage points lower than the 6.2-percent growth rate anticipated in the Governor's Budget. Property tax revenues are expected to grow 5.9 percent in 2022-23, which is 0.2 percentage point lower than the 6.1-percent growth expected in the Governor's Budget due to home price growth slowing and data that show a much lower rate of property transfers in 2021 compared to recent years. The rate of property transfers has a large effect on property tax revenue because price reassessments for the purposes of property tax occur when property changes hands under Proposition 13. Approximately 42 percent (\$39.6 billion) of 2022-23 property tax revenues will go to K-14 schools. This includes \$2.8 billion that schools are expected to receive in 2022-23 pursuant to the dissolution of redevelopment agencies.