REVENUE ESTIMATES

While uncertainty and risks to the U.S. and California economies have increased since the Governor's Budget was proposed, the state's economic outlook is only modestly downgraded, due largely to actual economic data coming in slightly lower than projected and tighter monetary conditions from more cautious lending in the banking sector. At the same time, tax receipts continue to come in substantially lower than projected at the Governor's Budget. Personal income tax and corporation tax receipts are down around $9 billion cumulatively in the first ten months of the 2022-23 fiscal year. However, it is important to note, cash results outside of personal income tax withholding are distorted by tax deadlines shifting to October as well as the impact of the Pass-Through Entity (PTE) Elective Tax on personal income tax payments.

The PTE Elective Tax increases payments reflected in the corporation tax and correspondingly increases personal income tax credit usage, negatively impacting personal income tax. PTE Elective Tax payments are projected to average around 9.5 percent of General Fund revenues before transfers over the budget window (fiscal years 2021-22 through 2023-24), up from 7.7 percent in the Governor's Budget. PTE Elective Tax payments and credit usage represent a substantial share of revenues and continue to make it challenging to interpret cash results for personal and corporate income taxes.

In January, the Franchise Tax Board (FTB) extended to May 15 various filing and payment deadlines for individuals and businesses in California who reside in counties impacted by winter storms between January and April, in line with tax relief announced by the Internal Revenue Service (IRS). In early March, the FTB further extended these deadlines to mid-October after the IRS announced another deadline extension in late February. Following additional disaster declarations through mid-March, the extension was granted to 55 counties comprising over 99 percent of Californians.

The Governor's Budget cashflow assumed around $21 billion in personal income and corporate tax payments shifting from January through April to May. Withholding receipts are down $2.9 billion through April, indicating genuine weakness in personal income tax trends. Gauging the magnitude of the overall shortfall is difficult since the variance in other personal and corporate income tax payments relative to the forecast may be over or understated by taxpayers' behavioral response to the delayed tax deadlines differing from the assumptions made in the Governor's Budget.

Weak cash data continues to indicate a sharp reversal of post-pandemic strength in stocks and other assets which had an outsized impact on high-income taxpayers' earnings. The revenue outlook continues to project normalization of trends following exceptionally strong revenue growth in 2020-21 and 2021-22; however, the forecast is downgraded due to lower cash receipts. Before accounting for transfers to the Budget Stabilization Account (BSA) and budget actions designed to address the budget problem, General Fund revenue is projected to be $8.4 billion lower than assumed in the Governor's Budget forecast over the budget window.

There are several risks to the forecast, including uncertainty when forecasting off the spike in revenues experienced through 2021-22, economic recession risks, and increased uncertainty from January through April's incomplete cash data for tax year 2022. The May Revision forecast assumes the delayed tax filing deadlines shift around $42 billion from January through September to October, with $28.4 billion attributed to personal income tax and $13.3 billion attributed to corporation tax. Delayed tax deadlines add significant uncertainty to the revenue forecast as projections are locked down without critical cash data usually available when finalizing the May Revision forecast. Furthermore, predicting taxpayer behavior is difficult, as there is no comparable precedent to this year's delayed deadlines in terms of scale and length of delay.

BUDGET WINDOW

The 2023-24 May Revision General Fund Revenue Forecast figure compares the revenue forecasts by source in the Governor's Budget to the May Revision forecast over the budget window:

- The personal income tax forecast is lower by $14.3 billion due to weak withholding tax receipts, downgraded wage growth, a slightly downgraded economic outlook, and higher participation in the PTE Elective Tax. Excluding the impact of the PTE Elective Tax, the personal income tax forecast is projected to be $3.2 billion lower. Offsetting these factors is an upgrade in capital gains realizations in the near term, following record-high levels in 2021.
- The corporation tax forecast is $6.2 billion higher due to upgraded PTE Elective Tax payments. Excluding PTE Elective Tax payments, corporation tax revenues are projected to be $4.3 billion lower due to weak cash payments and expectations of lower corporate profits.
- The sales tax forecast is revised upward by $100 million due largely to strong cash receipts through the first nine months of fiscal year 2022-23.
- Revenue projections for insurance tax, alcoholic beverages tax, and cigarette tax are largely unchanged from the Governor's Budget forecast while the revenue forecast for pooled money interest is $1.6 billion higher due to higher interest rates.
- The forecast for other minor and not otherwise classified revenues is $800 million lower, due largely to lower than estimated federal reimbursements of wildfire and COVID-19 Pandemic costs.

After accounting for solutions and transfers, which include loan repayments as well as automatic and discretionary transfers to the Rainy Day Fund, baseline General Fund revenues at the May Revision forecast are down $6.2 billion relative to the Governor's Budget.

The PTE Elective Tax, enacted as part of the 2021 Budget Act to help California business owners mitigate the impact of the federal limit on state and local tax deductions on federal tax returns, continues to prove more popular than anticipated. The PTE Elective Tax allows pass-through business entities to generate income tax credits for their owners by paying an elective tax at the business entity level instead of the individual level. PTE Elective Tax credit usage is assumed to be around $11.2 billion higher than assumed at Governor's Budget through 2023-24, while payments made by business entities are assumed to be over $10.5 billion higher, leading to a net loss of over $600 million. The May Revision forecast continues to assume the impact of PTE Elective Tax credit usage on personal income tax payments and refunds happens evenly throughout the year. Overall, the PTE Elective Tax continues to make it challenging to interpret cash results as the timing of its impact is uncertain; however, its uptake indicates it is likely saving California residents billions of dollars in federal taxes.

2023-24 May Revision
General Fund Revenue Forecast
Reconciliation with the 2023-24 Governor's Budget
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change From Governor's Budget	
Fiscal 2021-22 (Final)				
Personal Income Tax	$136,762	$137,144	$382	0.3%
Corporation Tax	45,298	45,128	-169	-0.4%
Sales & Use Tax	32,915	33,026	112	0.3%
Insurance Tax	3,495	3,495	0	0.0%
Alcoholic Beverage	431	431	0	0.0%
Pooled Money Interest	362	362	0	0.0%
Cigarette	54	54	0	0.0%
Other Revenues	3,851	3,861	11	0.3%
Subtotal	$223,168	$223,503	$335	0.2%
Transfer To/From BSA	-5,224	-7,065	-1,841	35.2%
Other Transfers	15,947	16,099	152	1.0%
Total	**$233,891**	**$232,537**	**-$1,354**	-0.6%
Fiscal 2022-23				
Personal Income Tax	$128,905	$122,769	-$6,136	-4.8%
Corporation Tax	38,482	42,091	3,610	9.4%
Sales & Use Tax	32,851	33,072	222	0.7%
Insurance Tax	3,641	3,673	31	0.9%
Alcoholic Beverage	436	433	-3	-0.8%
Pooled Money Interest	1,794	2,133	339	18.9%
Cigarette	49	47	-2	-3.7%
Other Revenues	4,589	2,079	-2,510	-54.7%
Subtotal	$210,746	$206,297	-$4,449	-2.1%
Transfer To/From BSA	-1,620	-544	1,076	-66.4%
Other Transfers	-359	-957	-598	166.9%
Transfer Solutions	116	334	218	187.5%
Total	**$208,883**	**$205,129**	**-$3,754**	-1.8%
Fiscal 2023-24				
Personal Income Tax	$126,695	$118,136	-$8,559	-6.8%
Corporation Tax	39,308	42,081	2,773	7.1%
Sales & Use Tax	33,599	33,366	-233	-0.7%
Insurance Tax	3,863	3,881	18	0.5%
Alcoholic Beverage	441	438	-3	-0.6%
Pooled Money Interest	1,686	2,928	1,242	73.7%
Cigarette	45	43	-1	-3.1%
Other Revenues	4,040	5,736	1,696	42.0%
Revenue Solutions	30	30	0	0.0%
Subtotal	$209,707	$206,640	-$3,067	-1.5%
Transfer To/From BSA	-911	0	911	-100.0%
Other Transfers	195	-608	-802	-412.4%
Transfer Solutions	1,183	3,022	1,839	0.0%
Total	**$210,174**	**$209,054**	**-$1,120**	-0.5%
Three-Year Total Excluding BSA and Solutions			**-$8,430**	
Three-Year Total			**-$6,228**	

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 2026-27. Total General Fund revenues from these sources are expected to decrease from $215.3 billion in 2021-22 to $193.6 billion in 2023-24 as revenue trends are projected to normalize before resuming growth through 2026-27 when revenues reach $204.8 billion. Projected revenue levels in 2026-27 are nearly 50 percent higher than in 2018-19 and imply an annual growth rate of around 5 percent from these pre-pandemic levels. Revenues are assumed to moderate to lower levels following growth of nearly 30 percent in 2020-21 and of over 19 percent in 2021-22. Year-over-year increases in revenues from these three sources in 2024-25 through 2026-27 are below historical norms largely due to capital gains declining each year from 2022 through 2026. Growth rates for the personal income tax and the corporate income tax are distorted by the PTE Elective tax in 2025-26 and 2026-27 as the PTE Elective tax is only in effect through the end of 2025.

Long-Term Revenue Forecast—Three Largest Sources

(General Fund Revenue—Dollars in Billions)

	2020-21	2021-22[e/]	2022-23[e/]	2023-24[e/]	2024-25[e/]	2025-26[e/]	2026-27[e/]
Personal Income Tax	$128.9	$137.1	$122.8	$118.2	$118.9	$127.5	$141.8
(Year-over-Year Change)	*29.4%*	*6.4%*	*-10.5%*	*-3.7%*	*0.6%*	*7.2%*	*11.2%*
Corporation Tax	$22.6	$45.1	$42.1	$42.1	$43.4	$36.4	$26.6
(Year-over-Year Change)	*61.9%*	*99.8%*	*-6.7%*	*0.0%*	*3.1%*	*-16.1%*	*-26.8%*
Sales and Use Tax	$29.1	$33.0	$33.1	$33.4	$34.4	$35.5	$36.3
(Year-over-Year Change)	*14.0%*	*13.6%*	*0.1%*	*0.9%*	*3.0%*	*3.3%*	*2.2%*
Total	**$180.5**	**$215.3**	**$197.9**	**$193.6**	**$196.7**	**$199.4**	**$204.8**
(Year-over-Year Change)	***29.8%***	***19.3%***	***-8.1%***	***-2.2%***	***1.6%***	***1.4%***	***2.7%***

[e/]Estimated

Source: California Department of Finance, 2023-24 May Revision Forecast.

PERSONAL INCOME TAX

Compared to the Governor's Budget forecast, the personal income tax forecast is higher by $382 million in 2021-22, lower by $6.1 billion in 2022-23, and lower by $8.6 billion in 2023-24. These figures include revenue losses from credit usage related to the PTE Elective Tax estimated at $19 billion in 2021-22, $18 billion in 2022-23, and $18.7 billion in 2023-24, which represent an increase over the Governor's Budget forecast of $3.5 billion, $3.9 billion, and $3.7 billion, respectively. Excluding the impact of the PTE Elective Tax, the personal income tax forecast is estimated to be higher by $3.9 billion in 2021-22, lower by $2.2 billion in 2022-23, and lower by $4.9 billion in 2023-24.

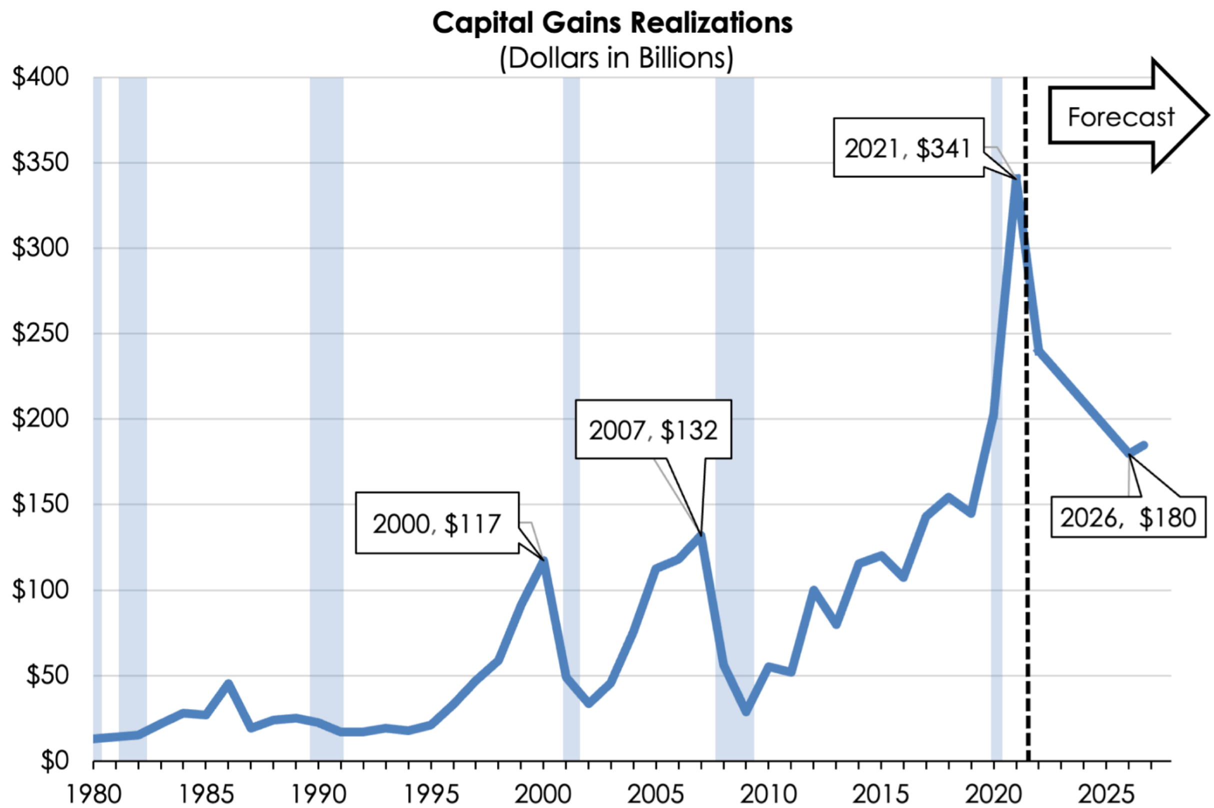
Despite continued low unemployment, taxable wages have been revised lower in the forecast, reflecting lower withholding receipts and lower economic wage growth through 2022. Typically, wages comprise around 55 percent to 60 percent of all personal income tax receipts. This share was at 56.1 percent in 2021, down from 60.4 percent in 2019 and 58.4 percent in 2020. Growth in taxable wages was revised down from 6.5 percent to 5.6 percent in 2022, from 5.1 percent to 4.7 percent in 2023, and was unchanged at 3.5 percent in 2024.

Personal income tax wage withholding receipts are projected to be $6.7 billion lower than Governor's Budget in the budget window. Withholding increased by 7 percent in 2020 and surged by another 20 percent in 2021 due largely to strong bonuses and stock-based compensation that benefitted high-income earners. This trend reversed itself in 2022 as asset prices decreased and withholding declined year-over-year by 1.2 percent. Due to weakness in cash results through April and slower projected growth for economic wages, withholding growth in 2023 has been revised down from 5 percent to 1.2 percent. The wedge between taxable wage growth and withholding growth in 2023 is consistent with expectations that lower-wage sectors will comprise a larger share of the wage gains compared to higher-wage sectors, unwinding some of the distortions and exceptional growth accruing to high-income earners from a booming stock market in 2020 and 2021.

After increasing by 16.3 percent in 2020 and by 26.9 percent in 2021, the S&P 500 ended 2022 down 19.4 percent and was in bear territory—down 20 percent or more from its previous peak—for a significant portion of 2022. As of the end of April, the S&P 500 was around 13 percent below its previous peak and the Nasdaq was still in bear territory. Stock market growth assumptions were largely unchanged from Governor's Budget as the S&P 500 tracked fairly close to forecast, coming in 1.1 percent below forecast in the fourth quarter of 2022, and just about 0.3 percent lower in the first quarter of 2023.

Capital gains realizations are revised higher from $198 billion to $240 billion for 2022 and from $174 billion to $225 billion in 2023 based on tax data reflecting higher-level capital gains realizations for 2021. Tax data for 2021 capital gains realizations are $48 billion higher than the Governor's Budget estimate, reaching a record-high level of $341 billion due to strong year-over-year growth of 67.9 percent (see figure on Capital Gains Realizations).

This level is equal to 11.3 percent of personal income—the highest proportion of capital gains realizations as a share of the economy ever recorded. Given the May Revision forecast for the stock market is fairly close to the Governor's Budget, assumed rates of decline for capital gains are fairly similar to the previous forecast. However, due to the significantly higher peak in 2021, the May Revision forecast projects higher levels of capital gains in the near term, positively impacting the forecast through 2025. In the longer run, the May Revision projects capital gains realizations to return to its historical



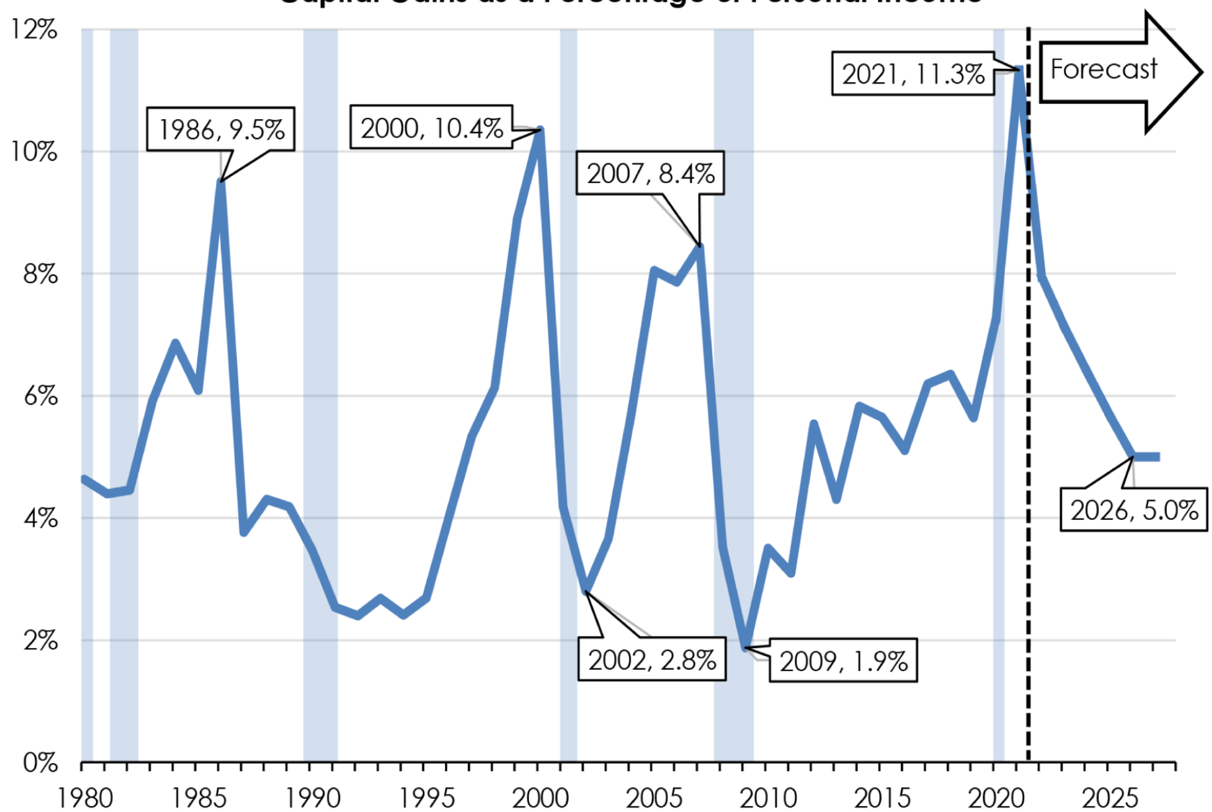
Shaded areas indicate previous U.S. recessions.
Source: California Department of Finance, 2023-24 May Revision Forecast.

share of 5 percent of personal income in 2026, one year later than projected at Governor's Budget (see figure on Capital Gains Realizations as a Percentage of Personal Income).

Forecasting revenues associated with capital gains is subject to significant uncertainty because realizations are heavily dependent on stock market performance and when taxpayers choose to buy or sell stocks. Stock market performance is inherently unpredictable but it significantly impacts high-income taxpayers' earnings. The highest-income Californians continue to pay a very large share of the state's personal income tax. For the 2021 tax year, the top one percent of income earners paid nearly 50 percent of personal income taxes, up 0.8 percentage point from 2020. This percentage has been greater than 40 percent for 17 of the last 18 years. Therefore, financial shocks to the income of a relatively small group of taxpayers can have significant impacts on revenues.

The personal income tax forecast includes Propositions 30 and 55 revenues, which are estimated at $13.2 billion in 2021-22, $10.7 billion in 2022-23, and $10.1 billion in 2023-24. These estimates are lower than the Governor's Budget by $2.7 billion, $2 billion, and $2.4 billion, respectively, due to lower personal income tax liability overall and less

Capital Gains as a Percentage of Personal Income



Shaded areas indicate previous U.S. recessions.
Source: California Department of Finance, 2023-24 May Revision Forecast.

income gains going to high-income earners compared to what was assumed at Governor's Budget.

Finally, in addition to uncertainty from the stock market, the delayed IRS deadline creates additional risk to the forecast. The May Revision forecast assumes $28.4 billion in personal income tax payments shifting from January through September to October. Delayed personal income tax payments that are now due in October for impacted taxpayers include January estimated payments, final payments, and miscellaneous payments related to tax year 2022, as well as April, June, and September estimated payments related to the current year. This represents 23 percent of personal income tax revenues projected for 2022-23 and nearly 14 percent of General Fund revenues before transfers.

CORPORATION TAX

The corporation tax forecast is lower by $169 million in 2021-22, higher by $3.6 billion in 2022-23, and higher by $2.8 billion in 2023-24. These figures include revenue gains of

$21.6 billion in 2021-22, $19.3 billion in 2022-23, and $19.3 billion in 2023-24 from PTE Elective Tax payments, which represent an increase of $1.2 billion, $5 billion, and $4.3 billion, respectively over the Governor's Budget forecast. Excluding the impact of the PTE Elective Tax, the corporation tax forecast is lower by $1.4 billion in both 2021-22 and 2022-23 and lower by $1.5 billion in 2023-24. Corporate profit growth in 2021 through 2023 was revised lower in line with downgraded expectations for nominal GDP growth.

The May Revision forecast assumes higher credit and net operating losses usage in the near term compared to Governor's Budget due to incorporation of new information from tax year 2021 data.

Due to the delayed IRS tax filing deadlines, the May Revision forecast assumes $13.3 billion in corporation tax payments shifting from January through September to October, of which $8.3 billion are PTE Elective Tax payments. Delayed payments that are now due in October for impacted taxpayers include April, June, and September estimated payments, final and extension payments normally due in April, PTE Elective Tax payments for tax year 2022 normally due in March, and PTE Elective Tax prepayments for tax year 2023 normally due in June. The total amount of corporation tax payments assumed to shift to October of $13.3 billion represents 32 percent of corporation tax revenues projected for 2022-23 and around 6 percent of General Fund revenues before transfers.

SALES AND USE TAX

The sales tax forecast is $112 million higher in 2021-22, $222 million higher in 2022-23, and $233 million lower in 2023-24. The increase in sales tax revenues attributed to 2021-22 is the result of an upward revision to total taxable sales in the second quarter of 2022. Taxable sales are expected to increase by 2.3 percent in 2022-23 and by 0.2 percent in 2023-24. In comparison, taxable sales were projected to grow by 0.4 percent in 2022-23 and by 2 percent in 2023-24 in the Governor's Budget forecast. Overall, sales tax revenues have tracked closely to the Governor's Budget forecast, with cash receipts through March up a cumulative $215 million.

Taxable consumer spending is expected to be 0.8 percent higher than projected at Governor's Budget in 2022-23 but lower by 1.6 percent in 2023-24 as spending patterns are projected to normalize and shift back from goods to services. Taxable sales were 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 saw strong sales due to the pandemic. These sectors also saw particularly high inflation in 2020-21 and 2021-22 as demand drove prices up. This trend is expected to unwind primarily in 2022-23 and 2023-24.

Taxable capital investment is expected to be lower than the Governor's Budget by 1.1 percent in 2022-23 and by 2 percent in 2023-24 due to higher actual and projected interest rates. Persistent inflation has led the Federal Reserve to raise interest rates higher than projected at the Governor's Budget.

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 suggest statewide property tax revenues increased around 7.4 percent in 2022-23, which is 1.4 percentage points higher than the 6-percent growth rate anticipated in the Governor's Budget forecast. Property tax revenues are expected to grow 4.5 percent in 2023-24, which is 0.5 percentage point lower than the 5-percent growth expected in the Governor's Budget. Strong growth in 2022-23 is likely due to home price increases that took place in 2021. A more moderate growth is expected in 2023-24 due to higher interest rates that led to lower property transfers and price declines in 2022. 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 43 percent or $40.1 billion of 2023-24 property tax revenues will go to K-14 schools. This includes $2.6 billion that schools are expected to receive in 2023-24 pursuant to the dissolution of redevelopment agencies.

REVENUE IN A RECESSION

The May Revision revenue forecast is based on a scenario that assumes continued but slowing economic growth and does not assume a recession. As discussed in the Economic Outlook Chapter, several risk factors could negatively impact the economy and lead to a recession, which could either be mild or more severe. A significant financial shock from tightening financial conditions, worsening of the recent banking crisis, persistent supply chain issues, continued elevated inflation, further stock market and asset price declines, and geopolitical turmoil are all issues that pose a risk to ongoing economic and revenue growth.

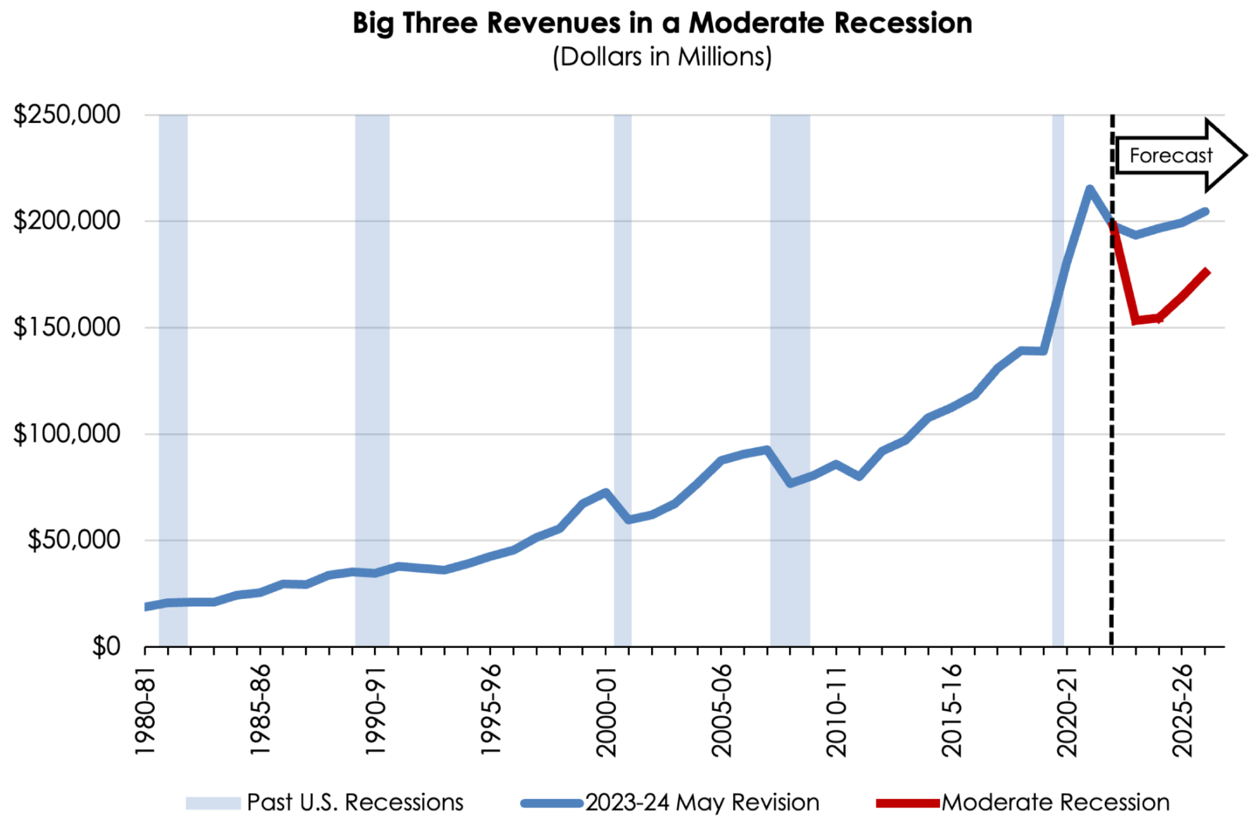
Even in a mild recession, revenue declines below the May Revision forecast could be significant. The magnitude of the revenue loss would depend upon the depth and duration of a recession, as well as its relative impact on higher-income individuals. A mild recession could lead to General Fund revenue losses of over $20 billion relative to the May Revision forecast in 2023-24. Based on a scenario that assumes a moderate recession occurring in fiscal year 2023-24 that results in a 40-percent peak-to-trough drop in the S&P 500 to around 2,900 and capital gains realizations dropping to $103 billion in 2024, the Big Three revenues would decrease by around $40 billion in 2023-24, largely driven by personal income taxes. The Big Three revenues are then projected to remain around that level in 2024-25 before bouncing back with an average growth rate of 6.7 percent in 2025-26 and 2026-27. Despite this catch-up growth, the Big Three Revenues are projected to remain around $29 billion lower than the May Revision forecast in 2026-27 (see figure on Big Three Revenues in a Moderate Recession).

TAX PROPOSALS

The May Revision maintains several proposals in the Governor's Budget. These proposals include the following:

- An extension of the Film and Television Tax Credit from 2025-26 to 2029-30 and partial refundability for credits issued through the extended program, Program 4.0.
- A requirement that income derived from an incomplete gift non-grantor trust be subject to income tax for California residents.
- Removal of the geographic requirement of the New Employment Credit for semi-conductor related businesses who compete for federal funding under the CHIPS Act.
- A requirement that the Department of Finance's Tax Expenditure Report be released by November 1 on a biennial basis instead of by September 15 every year.

The May Revision also includes tax relief to Californians who have student loans or fees discharged as part of financial relief to individuals impacted by economic disruptions



Shaded areas indicate previous U.S. recessions.
Source: California Department of Finance, 2023-24 May Revision Forecast.

and hardships from the COVID-19 Pandemic, that were part of the May 2023 budget legislation. These include the following:

- In conformity with federal law, exclusion from gross income for taxable years 2021 through 2025 of any amount of qualified student loan debt discharged under the American Rescue Plan Act due to hardship related to the COVID-19 Pandemic, including any amount discharged through the federal student loan debt relief plan.
- Exclusion from gross income for taxable years 2022 through 2026 of any amount related to the discharge of any unpaid fees due or owed by community college students through the California Community College COVID-19 Recovery Block Grant program.
- Clarification that any Higher Education Emergency Grant funds received by students in postsecondary education to support expenses and financial needs of students related to the COVID-19 Pandemic are not subject to state income taxation in taxable years 2020 through 2027. Existing federal and state law already exclude these grants from taxation as they qualify as disaster relief payments and are excluded from income pursuant to Internal Revenue Code 139, to which California conforms.