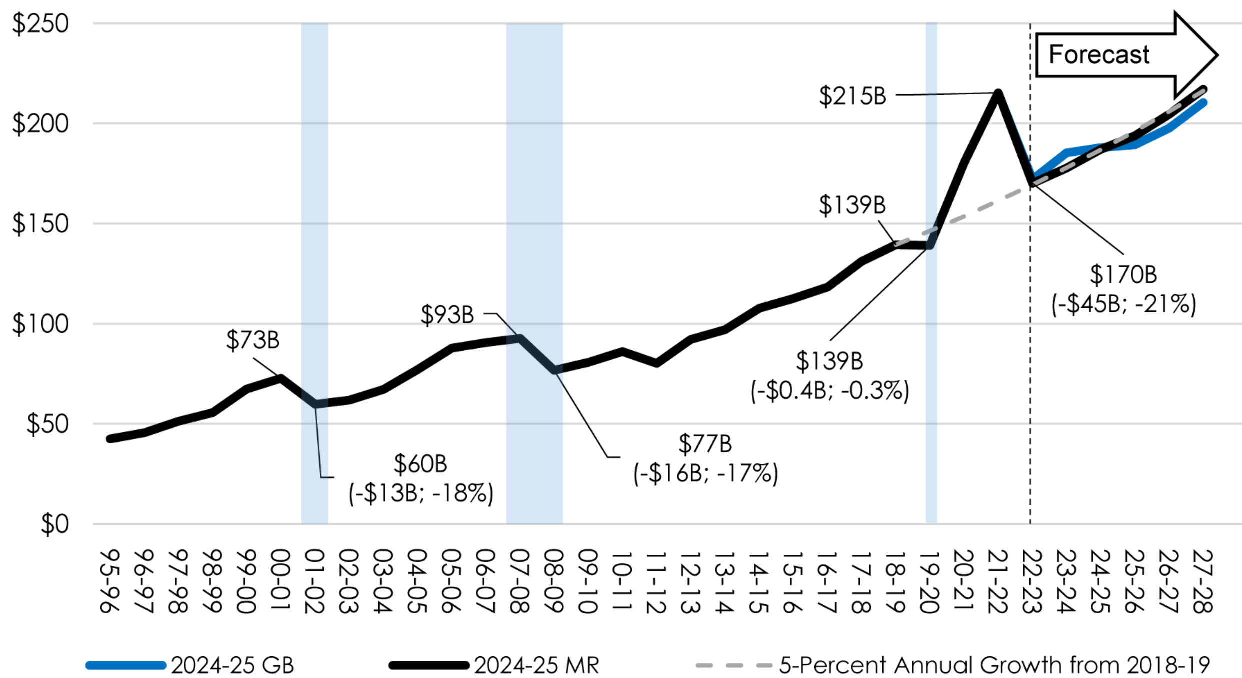
REVENUE ESTIMATES

The California and national economic pictures remain strong and resilient despite persistent inflation and elevated interest rates resulting in a slightly upgraded economic outlook compared to the Governor's Budget. Notably, the stock market has outperformed prior assumptions, exceeding its early 2022 peak in mid-January of 2024 and experiencing robust growth despite recent volatility. Nonetheless, tax receipts related to the 2023 tax year are lower than projected, with General Fund cash receipts falling short of the Governor's Budget forecast by $5.8 billion cumulatively through March, and personal income tax and corporation tax receipts adding around $600 million to the shortfall in April. These two factors, weak cash receipts related to the 2023 tax year and upgraded growth assumptions going forward, have led to downgrades to the revenue forecast in the budget window—fiscal years 2022-23 through 2024-25—followed by upward revisions in the multiyear—fiscal years 2025-26 through 2027-28.

Following the stock market run-up through the end of 2021, asset prices fell in 2022, with the S&P 500 declining by 19 percent and the NASDAQ Composite Index—which measures more than 2,500 stocks concentrated in technology companies, many of which are California-based—declining by 33 percent. As a result, the state's "Big Three" General Fund revenue sources—personal income, sales, and corporation taxes—declined by 21 percent in 2022-23 after increasing by a remarkable 55 percent from 2019-20 to 2021-22. While the stock market rebounded and recovered nearly all its losses by the end of 2023, cash receipts for the year remain weak due likely in part to increased capital loss carryovers from asset market declines in 2022. New tax year 2022 data show capital loss carryovers grew by 62 percent in 2022, exceeding the 58-percent increase in 2008 during the Great Recession.

Despite the year-over-year decrease, 2022-23 Big Three revenues are estimated to be 22 percent higher than pre-pandemic levels in 2018-19, consistent with a normal 5-percent revenue growth trajectory absent the COVID-19 surge and subsequent correction. In the forecast window, the Big Three revenues are generally projected to grow at normal historical growth rates on average as illustrated in the Big Three Revenues figure.

Big Three Revenues
(Dollars in Billions)



Projected revenue figures exclude the impact of tax policy proposals and solutions.
Shaded bars indicate previous U.S. recessions.
Source: California Department of Finance, 2024-25 May Revision Forecast.

BUDGET WINDOW

Before accounting for budget solutions and tax policy proposals, General Fund revenue is projected to be approximately $11.6 billion lower than assumed in the Governor's Budget over the budget window. While there are various changes as summarized in the 2024-25 May Revision General Fund Revenue Forecast Reconciliation with the 2024-25 Governor's Budget figure, this downgrade is driven largely by the Big Three as detailed below.

2024-25 May Revision
General Fund Revenue Forecast
Reconciliation with the 2024-25 Governor's Budget
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change From Governor's Budget	
Fiscal 2022-23 (Preliminary)				
Personal Income Tax	$101,749	$100,451	-$1,298	-1.3%
Corporation Tax	37,140	36,337	-803	-2.2%
Sales & Use Tax	33,186	33,324	137	0.4%
Insurance Tax	3,690	3,707	17	0.5%
Alcoholic Beverage	421	421	0	0.0%
Pooled Money Interest	2,391	2,391	0	0.0%
Cigarette	47	47	0	0.0%
Not Otherwise Classified Revenues	2,520	2,537	17	0.7%
Subtotal	$181,144	$179,214	-$1,930	-1.1%
Transfer To/From BSA	0	0	0	n/a
Other Transfers and Loans	-728	-670	57	-7.9%
Total	**$180,416**	**$178,544**	**-$1,873**	-1.0%
Fiscal 2023-24				
Personal Income Tax	$113,768	$111,203	-$2,565	-2.3%
Corporation Tax[1/]	36,913	33,182	-3,731	-10.1%
Sales & Use Tax	34,643	33,320	-1,323	-3.8%
Insurance Tax	3,894	3,905	12	0.3%
Alcoholic Beverage	427	417	-10	-2.4%
Pooled Money Interest	3,044	2,817	-227	-7.5%
Cigarette	43	43	-1	-1.2%
Not Otherwise Classified Revenues	3,206	3,512	306	9.5%
Tax Policy Proposals	0	100	100	n/a
Subtotal	$195,938	$188,499	-$7,439	-3.8%
Transfer To/From BSA	-1,424	-847	577	-40.5%
Transfers and Loans Solutions	0	-493	-493	n/a
Other Transfers and Loans	2,345	2,195	-150	-6.4%
Total	**$196,859**	**$189,354**	**-$7,505**	-3.8%
Fiscal 2024-25				
Personal Income Tax[1/]	$114,730	$116,176	$1,447	1.3%
Corporation Tax[1/]	38,055	36,778	-1,277	-3.4%
Sales & Use Tax[1/]	35,123	34,043	-1,080	-3.1%
Insurance Tax	4,021	4,016	-6	-0.1%
Alcoholic Beverage	433	422	-10	-2.4%
Pooled Money Interest	1,791	2,067	276	15.4%
Cigarette	42	41	-1	-1.2%
Not Otherwise Classified Revenues	6,810	4,474	-2,336	-34.3%
Tax Policy Proposals	0	116	116	n/a
Revenue Solutions	402	995	592	147.2%
Subtotal	$201,407	$199,128	-$2,280	-1.1%
Transfer To/From BSA (Solution)	12,201	3,301	-8,900	-72.9%
Non-BSA Transfers and Loans Solutions	2,504	3,904	1,400	55.9%
Other Transfers and Loans	-1,238	-909	329	-26.6%
Total	**$214,699**	**$205,249**	**-$9,450**	-4.4%
Three-Year Total Excluding Solutions and Policy Proposals			**-$11,643**	
Three-Year Total Including Solutions and Policy Proposals			**-$18,828**	

[1/] Excludes the impact of revenue solutions and tax policy proposals.

- **Revenues from the Big Three**, before accounting for budget solutions and tax policy proposals, are projected to be lower by $10.5 billion, due largely to weak cash results since the Governor's Budget. The forecast for personal income tax is revised down by $2.4 billion, corporation tax revenues are lower by $5.8 billion, and the sales tax forecast is downgraded by $2.3 billion.
- **Minor revenues**, such as insurance taxes, alcoholic beverage taxes, cigarette taxes, and interest earned on pooled money, are higher by $49 million largely due to a $48 million upgrade in the pooled money interest forecast as the $22 million upgrade in insurance tax is offset by downgrades in alcoholic beverage and cigarette taxes.
- **Other minor not otherwise classified revenues** are $2 billion lower, due largely to Federal Emergency Management Agency (FEMA) COVID-19 recovery costs reimbursement shifting from 2024-25 to 2025-26.
- **Revenue solutions** are projected to increase General Fund revenues by $995 million in 2024-25, an upgrade of $592 million relative to what was assumed in the Governor's Budget.
- **Transfers and loans solutions**, excluding transfers to the Budget Stabilization Account (BSA), are projected to increase General Fund revenues by $3.4 billion, an upgrade of $908 million relative to what was assumed in the Governor's Budget.
- **BSA transfers** are projected to increase General Fund revenues by $2.5 billion in total, a downgrade of $8.3 billion relative to the Governor's Budget. The May Revision assumes a $3.3 billion withdrawal from the BSA in 2024-25, an $8.9 billion downgrade compared to what was assumed in the Governor's Budget due to that amount shifting to 2025-26.

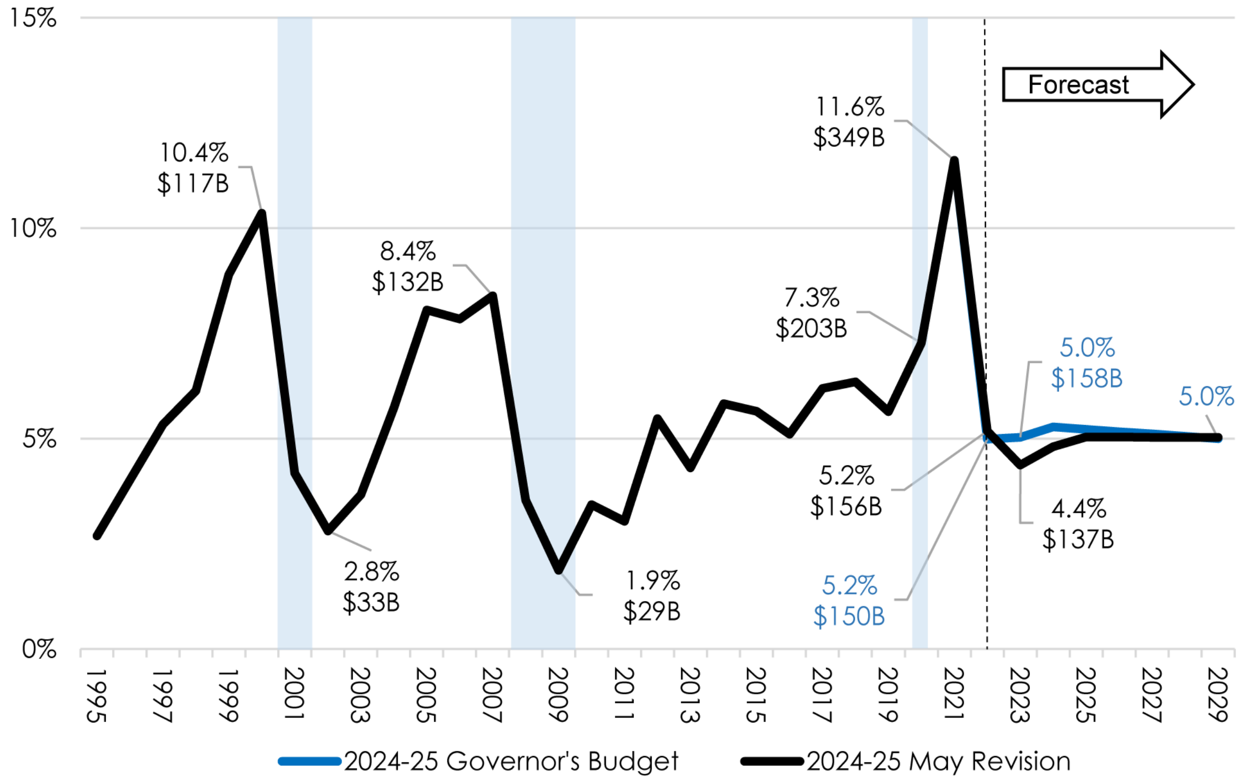
PERSONAL INCOME TAX

Before accounting for budget solutions, the personal income tax forecast is lower by $1.3 billion in 2022-23, lower by $2.6 billion in 2023-24, and higher by $1.4 billion in 2024-25 compared to the Governor's Budget forecast.

Personal income cash receipts are down approximately $3.5 billion from the Governor's Budget through April, due primarily to weak 2023 fourth quarter estimated payments, indicating weakness in 2023 tax liability. Informed by cash results through late April, capital gains realizations are projected to decline from $156 billion in 2022 to $137 billion in 2023—a $21 billion downgrade compared to the Governor's Budget's projection of

$158 billion for 2023. This is a projected 12-percent year-over-year decline in 2023 and follows a 55-percent annual contraction in 2022. In 2023, capital gains realizations' share of personal income is estimated to decline to 4.4 percent, its lowest share since 2013, as illustrated in the Capital Gains Realizations as a Share of Personal Income figure.

Capital Gains Realizations as a Share of Personal Income



Shaded bars indicate previous U.S. recessions.
Source: California Department of Finance, 2024-25 May Revision Forecast.

Reflecting gains in equity markets since the Governor's Budget and an upgraded stock market outlook, capital gains realizations are projected to increase by approximately 15 percent in 2024 and by 10 percent in 2025 when the capital gains realizations' share of personal income is projected to reach 5 percent. Capital gains realizations are assumed to largely grow in line with the economy from 2026 on; however, capital gains levels are projected to remain lower than the Governor's Budget projections due to their lower base in 2023.

Several personal income tax components are revised higher in the May Revision forecast due to the improved economic outlook, notably withholding is cumulatively above the Governor's Budget forecast by nearly $950 million through April. Growth in withholding is likely driven in part by higher levels of stock-based compensation for large technology companies. Withholding receipts increased 9.1 percent in the first four months of the year and are projected to grow 6.5 percent in 2024, leading to an upward revision of $1.1 billion in 2023-24 and $1.6 billion in 2024-25.

CORPORATION TAX

Before accounting for budget solutions and tax policy proposals, the corporation tax forecast is lower by $803 million in 2022-23, $3.7 billion in 2023-24, and $1.3 billion in 2024-25.

Corporation tax cash receipts are down $1.9 billion through April, with higher refunds accounting for $1.2 billion of the overall shortfall. Elevated corporation refunds since November are due largely to Pass-Through Entity Elective Tax (PTET) overpayments being significantly higher than assumed in the Governor's Budget, which results in downgrades in future PTET liability and payments. Updated projections for PTET explain $4.5 billion of the overall $5.8 billion budget window downgrade in corporation tax revenues excluding solutions. Conversely, lower projected PTET credit usage boosted personal income tax revenues by $4.3 billion in the budget window.

Part of the fiscal year-to-date cash shortfall is also attributed to 2023 fourth quarter estimated payments in December and final and extension payments in April, indicating weakness in baseline corporation tax revenues, which are assumed to continue to drag down revenues in the near-term. Corporation tax revenues are upgraded in the multiyear due to an improved forecast for taxable profits.

SALES AND USE TAX

Before accounting for budget solutions, the sales tax forecast is $137 million higher in 2022-23, $1.3 billion lower in 2023-24, and $1.1 billion lower in 2023-24.

Sales tax revenues are downgraded starting in 2023-24 due to lower-than-anticipated taxable sales in the second half of 2023, resulting in sales tax cash receipts falling short of projections by $1 billion cumulatively through March. Taxable sales weakness is due likely to taxable goods price growth slowing or even declining and the ongoing shift from goods to services spending. Sales tax revenues are projected to remain lower by approximately $1 billion per year through the end of the multiyear due to the lower base in 2023-24.

RISKS AND UNCERTAINTY

The May Revision revenue forecast is based on a scenario that assumes continued economic growth and does not assume a recession. Continued stock market strength and improved economic growth support the budget forecast assumptions that revenue growth will resume in 2023-24 following the steep correction in 2022-23. However, several risk factors could negatively impact the economy and state revenues going forward. For instance, a significant financial shock from tightening monetary policy, stock market and asset price volatility and declines, and geopolitical turmoil are all issues posing risk to ongoing economic and revenue growth.

Additionally, revenue forecasting is always subject to significant uncertainty, even if the underlying economy and the stock market are performing in line with expectations. This is true particularly in the personal and corporate income tax forecasts, with the reliance on a small group of high-income taxpayers as well as the timing of when assets are sold and when credits, carryover losses, and Net Operating Losses (NOLs) are used. Moreover, the tax liability of these high-income taxpayers tends to be volatile as they earn a larger share of their total income from capital gains and stock-based compensation. To illustrate, for the 2022 tax year, the top one percent of resident income earners, or about 175,000 tax returns, paid around 39 percent of resident personal income taxes—down 11 percentage points from nearly 50 percent in 2021 and its lowest share since 2009.

While the magnitude of potential revenue swings has likely declined, revenues could still end up $15 billion higher or lower in 2024-25 even if the economy and asset markets perform largely in line with expectations.

TAX PROPOSALS

The May Revision includes the following new proposals:

- **Apportionment Factor**—Clarification of existing law that when a corporation receives income that is excluded from taxable business income, it must exclude this income from its apportionment factor. This proposal is projected to increase General Fund revenues by $216 million in the budget window.
- **Low Income Housing Tax Credits**—One-time additional $500 million in state Low Income Housing Tax Credits for 2024-25. This proposal has no revenue impact in the

budget window, but is projected to decrease General Fund revenues by $400 million in the multiyear.