Revenue Forecasting Challenges in California

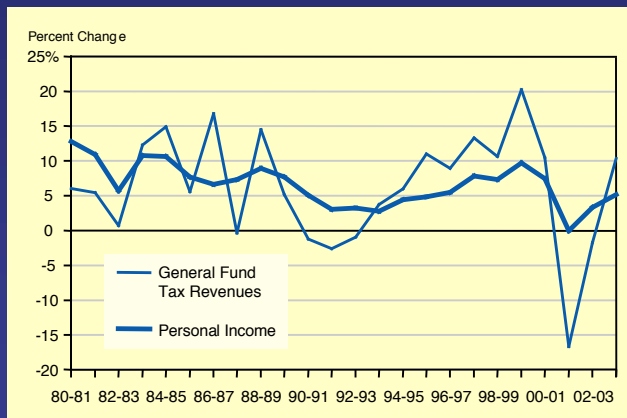## Legislative Analyst's Office

LAO

LAO's Basic Approach to Forecasting

> **Top Down Approach—Relying Mainly on Regression-Based Models**
> - National and State Economic Variables
> - Tax Liabilities
> - Cash Receipts

> **Main Focus of Revenue Forecast—Personal Income Tax**
> - Use a micro simulation model which ages a base-year distribution of taxpayers and applies CA's progressive tax rate structure

> **Supplement With Cash Trend Analysis**

LAO

California's Key Challenge: Extremely Volatile Revenue System

Percent Change chart showing General Fund Tax Revenues and Personal Income from 80-81 through 02-03.
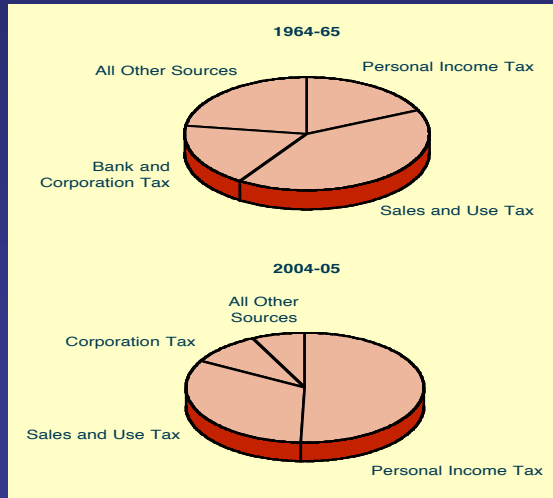
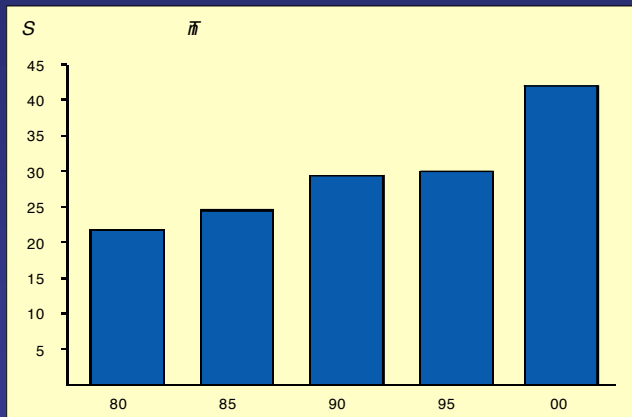---

Measures of California Revenue Volatility

> **1979-80 Through 1990-91**
  - **Average percent change—7.1 percent**
  - **Standard deviation—6.4 percent**
> **1990s Through 2003-04**
 - **Average percent change—5.2 percent**
  - **Standard deviation—9.4 percent**

Key Reason for Increased Volatility: Growing Importance of the Personal Income Tax…

1964-65

All Other Sources

Personal Income Tax

Bank and Corporation Tax

Sales and Use Tax

2004-05

All Other Sources

Corporation Tax

Sales and Use Tax

Personal Income Tax

LAO

…and the Increased Concentration of Income at the "High End"

S	m̄

45
40
35
30
25
20
15
10
5

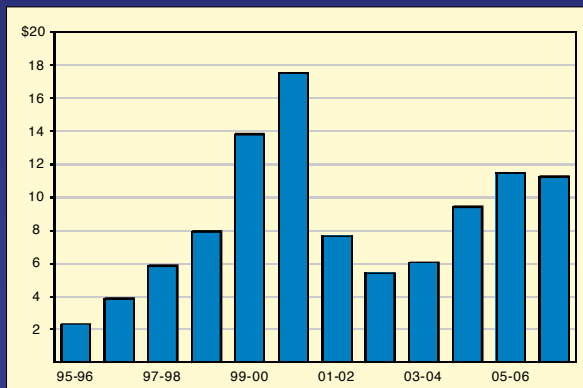80   85   90   95   00

LAO

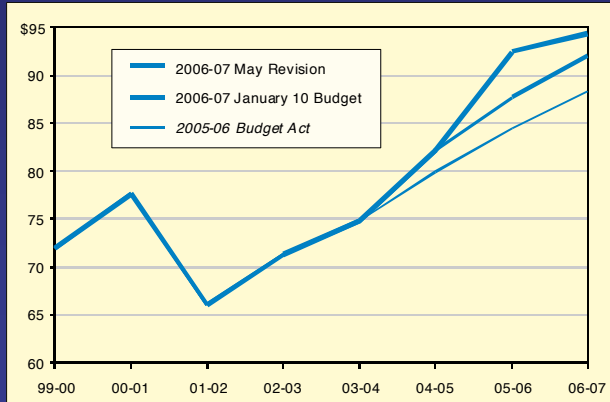## High Income Taxpayers Have Volatile Income Sources
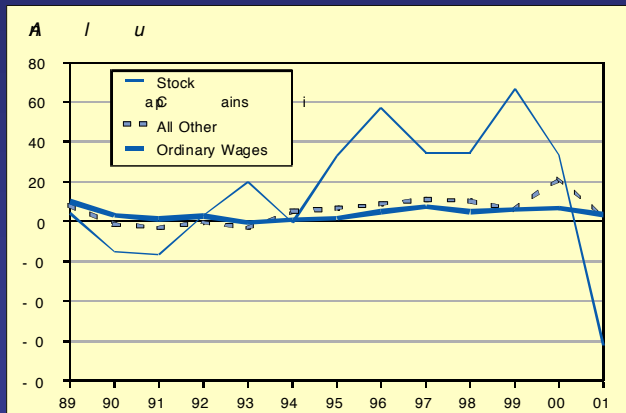
Stock Options and Capital Gains Have Been Major Factors

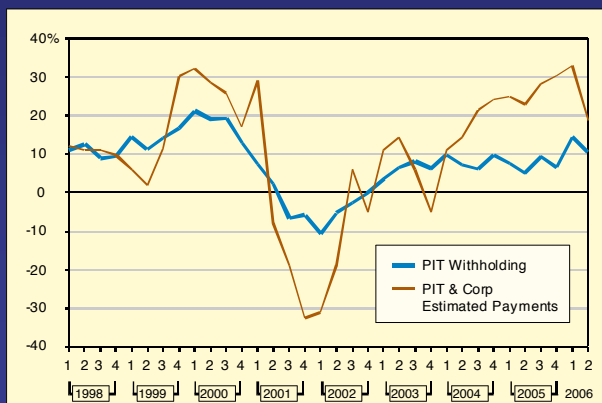Personal Income Taxes From Options and Gains
(In Billions)

CA Has Recently Benefited From Booming Revenue Growth
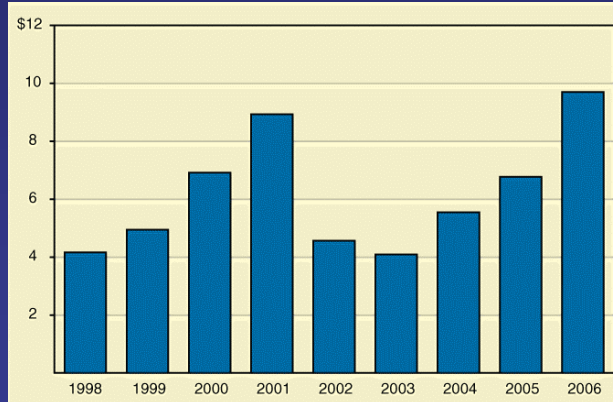
Total General Fund Revenues (In Billions)

…Quarterly Estimated Payments Have Been Strong

Year-to-Year Percent Change, by Quarter

April Final Payments Have Been Even Stronger

(Billions of Dollars)

LAO

Will Growth Continue?

> **Key General Economic Factors**
>> + **Effects of soaring energy costs on households and businesses**
>> + **Extent of state's housing decline**
>> + **Wage and profit trends**

> **Revenue-Specific Factors**
>> • **Sources of recent strength in payments (in particular, the "April surprise")**
>>> + **Extent to which these sources are one-time versus ongoing in nature**

LAO

Limitations and Challenges

> **Underlying Tax Liability Data Not Available On Timely Basis**
>
> • **For example, most large payments received in April were filed with extension requests**
>
> **Even if Underlying Sources Are Known, Outlook Is Still Highly Uncertain**
>
> • **Especially true of large nonrecurring stock sales**

LAO

Avenues of Exploration

> **Supplement Government Data With Industry Data**
>
> • **Filings with SEC**
> • **Company reports**
> • **Surveys such as "Silicon Valley 150"**
>
> **Prepayments Toward Next Year's Taxes**
>
> • **So far, payments holding up**
>
> **Franchise Tax Board Efforts**

LAO

Where the Large April 2006 Payments Came From

(Dollars in Millions)

ᵃPayments of over $100,000.