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1999 Annual FTA Revenue Estimation and Tax Research Conference *Summary of Proceedings*

To State Tax Administrators:

Summary

The 54th Annual FTA Revenue Estimating and Tax Research Conference was held September 26-29, 1999, in Nashville, Tennessee. Presiding over the conference was Richard Kaluzny of the New Jersey Department of the Treasury and Chair of the FTA Research Section. This bulletin summarizes the proceedings and lists the various papers available from FTA.

The 54th Annual FTA Revenue Estimating and Tax Research Conference was held September 26-29, 1999, in Nashville, Tennessee. Presiding over the conference was Richard Kaluzny of the New Jersey Department of the Treasury and Chair of the FTA Research Section. Welcoming the participants was the Conference Host, Ruth E. Johnson, Commissioner of the Tennessee Department of Revenue.

The program included presentations by the major forecasting firms and industry representatives on their economic forecasts for the next 18 months. Presentations were also made on deregulation of the electric utility industry, and the *Mobile Telecommunications Sourcing Act*. In addition, a presentation was given by Washington Department of Revenue, winner of the 1999 FTA Research Award. The entire day Tuesday was dedicated to various concurrent sessions covering issues of interest to state economists such as e-commerce and the impact on state revenues, new methods of capital gains forecasting, tax reform modeling, data base development, tax exemptions, and managing a research section.

On Wednesday morning, the participants heard several presentations on topics of broad interest to state economists. These presentations included an update on Federal legislative activity, the impact of e-commerce on government statistics, and state revenue trends.

Economic Forecasts

The conference began with several presentations by the major forecasting companies on the overall macro, regional, and international economic outlooks. Cynthia Latta, Standard and Poor's DRI, gave the overall macro economic forecast. She described the current economic conditions as the *best in a generation*. Core inflation, unemployment and interest rates are the lowest in 30 years. And, with real personal income growing in all groups, consumer confidence is at a record high. She noted that spending on computers is a key driving force behind the current high rate of growth, adding about one-half of a percentage point to the annual growth rate. But, the questions persist as to how long this trend can continue.

Ms Latta noted that the high level of consumer spending, driving most of this growth, is the result of wealth created by expansion in the stock market. This is reflected in the data for vehicle and housing sales, which have been reporting strong growth rates. Still, consumer spending could slow due to heavy debt load. A tight labor market could lead to higher wage inflation or productivity growth could slow from recent gains. However, DRI still forecasts a real GDP growth rate of 3.8 percent for 1999, falling to 2.7 percent in 2000.

Mark Zandi, Regional Financial Associates/Dismal Science, gave the regional economic outlook. Mr Zandi noted that the current economic expansion is hitting all areas of the country. Indeed, 80 percent of the Metropolitan Statistical Areas (MSAs) have an unemployment rate below 5 percent. Technological advances are the key driving force in the economy, with the amount of Information Technology (IT) industries becoming the key indicator of how well a region is doing. States in the northeast and California are benefiting from these IT industries. With the increased importance of IT industries, traditional measures—such as the level of employment—have become less important in understanding how well different regions are doing. In today's economy, income and wealth measures are better indicators for comparing regions.

While the economy is doing extremely well, Mr. Zandi does not expect it to continue indefinitely. He notes that the economy is currently expanding above its potential. The strong growth in IT industries is inflating stock prices, leading to large wealth effects driving current consumer spending. With the labor market being tight, wages are beginning to rise, and the federal reserve is raising interest rates. Also, the decrease in Y2K spending and the completion of the IT infrastructure will slow growth in future years. Zandi notes that the same regions currently benefiting from the growth in IT industries would be expected to experience the greatest slowdown.

The international finance crisis is over according to Kurt Karl, with the WEFA Group, who presented the international economic outlook. Asia and Japan are recovering from their financial crisis, with imports to the region beginning to grow. While Japan is only experiencing weak growth, the rest of Asia is exhibiting strong rates of growth. Meanwhile, Latin America is having mixed growth. While Mexico and Brazil are currently having slow growth, other countries have been hurt by low commodity prices.

While the U.S. has been profiting from the low commodity prices, these prices are beginning to rise. Still, Mr. Kurt expects the U.S. to experience robust growth, projecting a 3.8 percent real GDP growth rate in 1999 though he expects the growth rate to fall to 2.3 percent in 2000. International trade has contributed 0.2 to 0.3 percentage points to this growth rate. However, he listed several factors that could worsen the economic outlook. They include a collapse in the global equity market (U.S. stock market), prolonged financial crisis in Asia, worldwide Y2K problems, or protectionism halting trade growth.

Deborah Bierbaum, from AT&T, gave an update on the Mobile Telecommunications Uniform Sourcing Act. It was created by the Wireless Tax Group, a group of tax professionals representing facilities-based wireless carriers. The purpose is to provide a uniform method of "sourcing" mobile telecommunications services. Many states currently follow the logic set forth under *Goldberg v. Sweet* in their taxation of telecommunication services, which does not work well under the newer technology and newer services. The result has been a patchwork of rules different in each state.

The Uniform Sourcing Act would utilize the customer's place of primary use to source mobile telecommunications services. All wireless services, regardless of where the service occurs, would be treated as retail sales in the place of primary use. The state would be responsible for providing an electronic database for the appropriate taxing jurisdiction. If the state does not provide an electronic database, the service provider will utilize the 9-or-more-digit zip code.

Currently, the Act has been endorsed by the major tax and state government organizations, with the final bill being redrafted to meet technical protocols.

Lorrie Brown, Washington State Department of Revenue, discussed the methodology and results of a recent study estimating the cost to retailers of collecting and remitting sales taxes. This study, winner of the 1999 FTA Research Award, improved on earlier studies by taking a marginal cost approach—additional costs attributed to collecting sales taxes. Working with retailers' associations, the Department was able to identify the added costs associated with collecting the tax (i.e., extra personnel time, training, and additional/more sophisticated point-of-sale equipment). They sent questionnaires to 3,000 Washington retailers and 400 Oregon retailers (control group to better identify and estimate the marginal costs).

The final report details the costs of collecting and remitting sales taxes for small, medium and large businesses. According to Ms. Brown, total costs for small retailers amount to 6.47 percent of the total tax remitted. However, this can be partially offset by an estimated benefit (float and lower B&O tax rate) of 0.69 percent of the total tax. On the other hand, it costs large retailers a total of 0.97 percent of the tax, while the benefits totaled 0.63 percent.

The luncheon speaker was Bill Fox with the University of Tennessee. He noted that the state of Tennessee is in the midst of a major tax reform effort. The state relies primarily on the sales tax and a business franchise tax for most of its revenue. This leads to a major problem in that the sales tax is inelastic—revenue does not keep pace with economic growth. Meanwhile, the business tax excludes foreign-owned limited liability companies and partnerships. While recent legislation has closed the loophole in the business franchise tax, the overall tax structure is still inelastic. State policymakers are debating several options, including broadening the sales tax base, a statewide property tax, a gross receipts tax, or a state income tax.

Professor Fox pointed out that the key problem is image. The public is not convinced that there is a problem with state government finances. This is compounded by the tobacco settlement, which will be enough to finance any shortfall for several years. Thus, the various options will not be debated seriously until public perception has changed.

Wednesday Morning

On Wednesday morning, participants heard presentations of general interest to state tax analysts. Thomas Neubig, with Ernst and Young, began the day with a discussion of federal legislative activities. He noted that the strong economy and tight discretionary spending limits have resulted in a projected surplus of \$2.7 trillion. With the Republican Congress favoring tax cuts and the Clinton administration supporting Medicare and Social Security reforms, there is currently a lot of political maneuvering going on.

The Republican Congress approved a \$792 billion tax cut, using all of the on-budget surplus. The largest element of this tax bill was a decrease in the personal income tax rates and making adjustments for the marriage penalty. It was vetoed by the president. Several options now include negotiating a compromise bill (unlikely), a limited bill extending the expiring provisions, or no tax bill. Mr. Neubig concluded his remarks by listing many of the key issues for Congress which may also become campaign issues next year. The list includes e-commerce, tobacco litigation, Social Security/Medicare reform, and tax reductions. One significant issue not debated and unlikely to be a campaign issue, is fundamental tax reform.

Barbara Fraumeni, with the Bureau of Economic Analysis (BEA), discussed her agency's recent efforts to improve economic statistics provided by the government. With e-commerce and the information technology (IT) industries becoming an increasingly important segment of the economy, government statistical agencies have been working to improve how they measure this

segment. These efforts should help the agencies understand the size of the digital economy and its impact on the national accounts.

Several recent changes were made to the national accounts to take into account the unusual nature of the IT industry. BEA introduced a quality-adjusted price index for computers and chain-type quantity and price indexes to allow for falling computer prices. Census will be developing a specialized e-commerce survey and will be adding questions to its annual retail trade survey. The Bureau of Labor Statistics will be incorporating e-commerce into its CPI surveys and conducting additional research to improve this index.

Ms. Fraumeni concluded that the changing economy creates a challenge for government statistical agencies to more accurately reflect the nature of e-commerce. Their goal is to separate e-commerce from other activities to better understand the e-commerce phenomenon. Also, they need to identify and better quantify IT infrastructure.

Donald Boyd, from the Center for the Study of the States, gave a presentation discussing recent trends in state taxation. He noted that state policymakers have enacted tax decreases over the last six years. Yet, tax burdens, measured as a percentage of personal income, have risen. He attributes much of this to the delayed implementation of tax cuts. Also, recent economic growth can be attributed to shifts in the income distribution and capital gains. Mr. Boyd warns state revenue estimators that this trend may not continue, and the recent tax-cutting activities of states could lead to fiscal crisis in the future.

Phil Blatsos invited the participants to attend the 2000 FTA Revenue Estimating Conference in Waterville Valley, New Hampshire. The conference will be held September 24 - 27, 2000.

Breakout Sessions

On Tuesday, conference participants were offered several concurrent breakout sessions. The topics included e-commerce and the impact on state revenues, new methods of capital gains forecasting, tax reform modeling, data base development, tax exemptions, and managing a research section.

Below is a complete list of papers available from FTA. If a topic was discussed for which no paper is available, please contact us and we can put you in contact with the presenter.

Sincerely,

Harley T. Duncan
Executive Director

List of Papers

1999 FTA Revenue Estimation & Tax Research Conference Nashville, Tennessee

Monday Morning, General Session

The Ebullient U.S. Economy: Too Good to Last, Cynthia Latta, Standard and Poor's DRI (powerpoint presentation)

The WEFA Global Forecast: Improving Outlook, Kurt Karl, WEFA Group (powerpoint presentation)

Mobile Telecommunications Uniform Sourcing Act, Deborah Bierbaum, AT&T (powerpoint presentation)

Retailers' Cost of Collecting and Remitting Sales Tax, Lorrie Brown, Washington State Department of Revenue (Executive Summary of Report)

Monday Afternoon, Concurrent Sessions

Outlook for Selected Sectors

Retail Sales Keep the Economy Humming, Cynthia Latta, Standard and Poor's DRI, (powerpoint presentation)

The Housing Market Outlook, Mark Zandi, Regional Financial Associates (freelance presentation)

Housing is Key, Mark Zandi, Regional Financial Associates

Motor Vehicle Outlook, Mark Haas, Michigan Department of Treasury (powerpoint presentation)

Tax Implications of Deregulating Utilities

Electric Utility Deregulation and Tax Reform in Ohio, Mike Sobul, Ohio Department of Taxation

An Update on Public Utility Restructuring in Pennsylvania, Daniel Hassell, Pennsylvania Department of Revenue (powerpoint presentation)

Summary of The Electric Service Customer Choice and Rate Relief Law of 1997, James Monk, Illinois Energy Association

Tuesday Morning, Concurrent Sessions

E-Commerce and the Impact on State Revenues

Further Thoughts on State and Local Taxation of Telecommunications and Electronic Commerce, Robert Strauss, Carnegie Mellon University

The Internet and State Revenues, David Broomhall, Standard and Poor's DRI (table of results)

New Methods of Capital Gains Forecasting

Alternative Models for Estimating Capital Gains Realizations, Thomas Stinson, Minnesota Department of Finance (tables accompanying remarks)

Capital Gains Model Selection Using Consistently Good, Rolling Out of Sample Forecasts, Nicholas Bull, U.S. Department of Treasury (outline of remarks)

Forecasting Capital Gains, Larry Ozanne, U.S. Congressional Budget Office (tables and outline of remarks)

Tax Reform Modeling

Evaluating Comprehensive Tax Reform: Lessons from West Virginia, Mark Burton, Marshall University

Cooking with REMI: A Recipe for Analyzing Property Tax Changes in Arkansas, Gordon Rucker, Arkansas Bureau of Legislative Research (table of results)

Dynamic Analysis in State Government: Economic Effects from Tax Law Changes Using REMI, John Heleman, Texas State Comptroller (powerpoint presentation)

Data Base Development

Group Modeling in a Single Entity World: a Multi-Dimensional Approach to Corporate Tax Modeling, Yeang-Eng Braun, Wisconsin Department of Revenue

The Use of Nonlinear Programming to Reweight a Sample File: An Application to the New York State Personal Income Tax, Tanette McCarty, New York State Division of the Budget

Long Term Planning: Revenue Estimation in a Data Warehousing Environment, Kim Coleman, District of Columbia Office of Tax and Revenue (powerpoint presentation)

Erosion of the Tax Base Through Tax Exemptions

Arizona's Individual Income Tax Credits for Schools, Georganna Meyer (with Elaine Smith), Arizona Department of Revenue

Florida Sales Tax Holiday, Christian Weiss, Florida Department of Revenue (powerpoint presentation)

Managing a Research Section/Compliance Research

Washington Department of Revenue Geographic Information System--Summary of Project Costs, Mary Welsh, Washington Department of Revenue (one page fact sheet)

Cigarette Tax Stamping--Michigan's Experience, Mark Haas (with Jeffrey Guilfoyle), Michigan Department of Treasury (powerpoint presentations)

Technologically Related and Merging Communications Industries, Mary Ayala, Florida Department of Revenue (tables accompanying remarks)

Citizens Jury--A Tool of Tax Reform in Minnesota, Richard Gebhart, Minnesota Department of Revenue (outline of remarks)

Wednesday Morning, General Session

The Digital Economy and E-Commerce from a Measurement Perspective: Keeping Up With the Changes, Barbara Fraumeni (with Brent Moulton), Bureau of Economic Analysis

State Tax Trends, Donald Boyd, Center for the Study of the States (tables and outline of remarks)