Preliminary April Revenue Update

JLBC Staff typically reports at the end of each month to the Legislature on the status of General Fund revenue collections. However, given the significance of tax filing season on overall collections, this preliminary report provides an initial look at April collections.

Preliminary April General Fund revenue collections are $804 million. Excluding the 1-cent sales tax, these collections were 18.5% above April 2010. Year to date, FY 2011 General Fund revenues are $6.63 billion, or 9.4% above FY 2010 without the 1-cent sales tax.

April General Fund revenues were $94 million above the January Baseline forecast, which leaves year-to-date revenues at $202 million above the January forecast. The recently enacted budget incorporated $40 million of that higher revenue level, leaving year-to-date collections at $162 million above the enacted budget.

Growth In Individual Income Tax Collections

Through March, General Fund revenues were $108 million above the January forecast. Of this amount, $72 million was the result of higher than expected individual income tax (IIT) collections. At that time, the year-to-date IIT gains were thought to be temporary due to the change in withholding rates in the summer of 2010. Since the 6% year-to-date withholding growth was much higher than job and wage growth, there appeared to be the possibility that these gains would be given back in the form of higher refunds in April. As a result, the revenue levels in the March revised FY 2011 budget only accounted for the non-IIT gains.

The April revenue results accelerated the role of IIT collections in the state's overall revenue gain and yielded some new information about the status of tax collections. At the end of April, $191 million of the $202 million forecast overage is due to IIT. The April data also revealed that refunds have not grown as quickly as expected. April 2011 refunds are less than 1% higher than the April 2010 level. The timing of the Department of Revenue's income tax refund payments appears on a similar pace to last year, which eliminates changes in processing time as a reason for the small change in refunds.

Along with not giving back any of the year-to-date gains, the April data also suggest that taxpayer liability grew much more quickly than forecasted. Overwithholding may still have occurred, but overall liability growth appears to have far outpaced that factor.

Based on preliminary data, $89 million, or 95%, of April's net forecast overage of $94 million was attributable to payments submitted with individual income tax returns. Compared to last year, payments grew by 25%, the largest April increase since 2005.

While the detailed data will not be available for some time, this year's increase appears to be related to lower itemized deductions and significantly higher capital gains.

Based on DOR data, itemized deductions are down by (26)% compared to the same period (January through April) last year. This may be due to a decline in the use of the mortgage

interest deduction (which historically comprises 40% to 45% of total deductions). The state's high foreclosure rate may be reducing home ownership and eliminating the mortgage interest deduction for some taxpayers.

Capital gains appear to be another factor behind April's surge in tax payments. The improved performance of the stock market during calendar 2010 may have generated substantial capital gains, which in turn raised the level of April tax payments. The Investment Company Institute, a national association of investment companies serving over 90 million shareholders, reports an almost 3-fold increase in mutual fund capital gains distributions in 2010 compared to the prior year.

In terms of the other major revenue categories, sales tax collections (excluding the temporary 1-cent) were flat in April compared to a year ago. Sales tax revenues had grown 7% in the last 3 months, but the April results are difficult to interpret due to a number of one-time adjustments in the April 2010 collections. April corporate income tax revenues grew by 35% over the historic lows in FY 2010, but that growth rate was actually smaller than the first 9 months of the year.

Budget Impacts

The FY 2011 enacted budget revisions presumed a year-end shortfall of $(332) million. The budget then resolved this shortfall during FY 2012. If the year-to-date "above forecast" revenue gain of $162 million is sustained through the end of June, the FY 2011 shortfall would decline to $(170) million.

Several factors will influence the sustainability of the current year-to-date gain through June. Income tax refunds will continue to be processed in May and quarterly individual and corporate income tax payments are due in June. Quarterly payment months represent opportunities for both upside and downside surprises. Given current data patterns, however, it seems likely that the $162 million forecast gain will be maintained through June.

A lower FY 2011 shortfall and a higher revenue base will also lead to a potential budget surplus at the end of FY 2012. A number of other factors, however, could influence the overall status of the FY 2012 budget, including: 1) the outcome of the state's Medicaid waiver request, 2) the accuracy of the entitlement spending projections and 3) national economic issues, such as the recent increase in gasoline prices. In addition, the state will also need to address the expiration of the 1-cent sales tax at the end of FY 2013. The status of the FY 2012 through FY 2014 budgets will be re-assessed once final FY 2011 data is available.