Estimating Capital Gains Tax Collections

Forecasting revenue collections in FY 2014 and later years is complicated by the potential acceleration of capital gains realizations from future fiscal years into FY 2013. This topic has been discussed at the Finance Advisory Committee (FAC) meetings over the last year. On January 1, 2013, Bush-era tax cuts were scheduled to expire and a new 3.8% surtax on investment income was scheduled to go into effect as part of financing for federal health care legislation. In order to avoid higher federal tax rates from these and other policies, collectively referred to as the "fiscal cliff," investors were incentivized to accelerate realizations of capital gains into FY 2013.

At the October FAC meeting, JLBC Staff estimated the state would receive individual income tax collections related to capital gains equal to $255 million in FY 2014. That estimate has now been revised to $284 million. This report provides detail on how the updated estimate was made.

As part of our analysis, JLBC Staff reviewed estimates of other states. At least two of the three other estimates reviewed assume a higher portion of FY 2013 capital gains collections are one-time.

Table 1

Preliminary Individual Income Tax Forecast (December 2013) 1/

($ in millions)

Non-Capital Gains 2/	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**
Growth		5.7%	6.0%	6.0%	6.0%
Share		92.0%	92.0%	92.0%	92.0%
Amount	$ 3,088	$ 3,265	$ 3,461	$ 3,668	$ 3,889
Capital Gains	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**
Growth 3/		-8.3%	10.0%	5.2%	9.1%
Share		8.0%	8.0%	8.0%	8.0%
Amount 3/	$ 310	$ 284	$ 313	$ 329	$ 359
Overall Growth Rate		**4.5%**	**6.3%**	**5.9%**	**6.3%**
Total	**$ 3,398**	**$ 3,549**	**$ 3,773**	**$ 3,997**	**$ 4,247**

1/ Represents December 2013 update to the October 2013 Finance Advisory Committee forecast.

2/ Includes tax collections on such items as wages and salaries, small business profit, taxable benefit payments, dividends, interest, and rent.

3/ FY 2014 amount reflects 20% base growth, adjusted downward for $(26) million in capital gains that were accelerated from FY 2014 to FY 2013, due to the fiscal cliff. FY 2015 and FY 2016 amounts each reflect 5% base growth, adjusted downward for $(13) million in capital gains that were accelerated to FY 2013.

Table 2

Preliminary Capital Gains Revenue Forecast (December 2013)
($ in millions)

	Base Forecast		Adjusted Forecast		Difference
Fiscal Year	$	%	$	%	$
2012	207		207		0
2013	258	25.0%	310	50.0%	52
2014	310	20.0%	284	-8.3%	-26
2015	326	5.0%	313	10.0%	-13
2016	342	5.0%	329	5.2%	-13
2017	359	5.0%	359	9.1%	0

Notes on Table 2

Base Forecast assumptions

- Forecasted Arizona Individual Income Tax collections on capital gains income, had there been no incentives to accelerate gains into TY 2012 (FY 2013). A number of federal tax policies took effect or were scheduled to take effect on January 1, 2013.
- FY 2013 base growth assumes $51 million (about half) of the $103 million FY 2013 increase is not related to the fiscal cliff and is therefore, ongoing base revenue.
- FY 2014 base growth rate is consistent with 20.5% annual growth from FY 2010 - FY 2012 and our 25% growth estimated in FY 2013.
- FY 2015 - FY 2017 reflects growth that is close to the long-run historical average.

Historical annual growth in Arizona capital gains realizations (IRS Data):

Last 2 years (FY 2010 - FY 2012)	20.5%
Last 5 years (FY 2007 - FY 2012)	(20.9)%
Last 10 years (FY 2002 - FY 2012)	0.6%
Last 25 years (FY 1987 - FY 2012)	3.3%

Adjusted Forecast assumptions

- Base forecast adjusted for impacts related to the fiscal cliff.
- FY 2013 growth rate of 50% was used to approximate the Congressional Budget Office's national forecast for capital gain realizations (58% in FY 2013, *The Budget and Economic Outlook Fiscal Years 2013 to 2023*). FY 2013 is an estimate as IRS data has not yet been made available.
- The FY 2013 amount assumes about 50% of the $103 million ($52 million) increase that year is related to the fiscal cliff and therefore, not ongoing. This is arrived at by assuming that about 50% of the $103 million ($51 million) is ongoing and based on strong stock market performance.
- Assumes that $52 million in collections was accelerated from FY 2014 - FY 2016.
- FY 2014 amount of $284 million reflects 20% base growth, adjusted downward for $(26) million in capital gains that were accelerated from FY 2014 to FY 2013. It was assumed that about half of the $52 million increase in FY 2013 related to the fiscal cliff was accelerated from FY 2014.
- FY 2015 and FY 2016 amounts each reflect 5% base growth, adjusted downward for $(13) million in capital gains that were accelerated to FY 2013. It was assumed that a quarter of the $52 million increase in FY 2013 related to the fiscal cliff was accelerated from FY 2015 and from FY 2016.

Capital gains tax forecasts in other states

- *California*: JLBC's growth rates in FY 2014 and FY 2015 are more moderate than those of California's Legislative Analyst's Office. This occurs because JLBC assumes a larger portion of increased collections in FY 2013 are ongoing and unrelated to the fiscal cliff. Additionally, JLBC assumes revenues were accelerated from FY 2014 - FY 2016 while LAO assumes the entire accelerated amount was from FY 2014.

	LAO - California		JLBC - Arizona	
	$ (billions)	%	$ (millions)	%
FY 2013	$ 10.0		$ 310	
FY 2014	$ 7.7	-23%	$ 284	-8.3%
FY 2015	$ 11.5	49%	$ 313	10.0%

- *Utah*: The state's Office of the Legislative Fiscal Analyst assumes 20% of the FY 2013 increase in capital gains tax revenue is ongoing and 80% is an acceleration due to the fiscal cliff. Similar to JLBC, they assume collections were accelerated into FY 2013 from FY 2014, FY 2015, and FY 2016.
- *Colorado*: The state's Office of Strategic Planning and Budgeting estimates that the entire amounts that were accelerated into FY 2013 due to the fiscal cliff would have otherwise occurred in FY 2014. The accelerated amount was assumed to equal 25% of projected FY 2014 base revenues.
- In the fall of 2013, the National Association of State Budget Officers updated their *Fiscal Survey of States*. The report found that while states' personal income tax collections collectively increased by 9.6% in FY 2013, collections are projected to decrease by (0.3)% in FY 2014. The primary reason for the projected decline in FY 2014 was thought to be the loss of one-time tax collections realized in FY 2013 in the lead up to the federal fiscal cliff.