Revenue Forecasting Challenges in California

Legislative Analyst’s Office

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
California’s Key Challenge: Extremely Volatile Revenue System

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...

...and the Increased Concentration of Income at the “High End”
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)

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
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

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
Where the Large April 2006 Payments Came From

(Dollars in Millions)

*Payments of over $100,000.