Legislative Fiscal Bureau

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State of Wisconsin

May 15, 2019

Representative John Nygren, Assembly Chair
Senator Alberta Darling, Senate Chair
Joint Committee on Finance
State Capitol
Madison, WI 53702

Dear Representative Nygren and Senator Darling:

Last January, this office prepared estimates of general fund tax collections for 2018-19 and the two years of the 2019-21 biennium. These projections were incorporated into the Governor's 2019-21 biennial budget bill.

Recently, tax collections data for April became available and IHS Markit released its May, 2019, forecast of the national economy. The collections data show significant strength in individual income tax and corporate income/franchise tax collections, compared to the January estimates, as well as strength in insurance premiums tax collections. However, weaker than estimated collections data for sales and use taxes, public utility taxes, and cigarette taxes partly offset this growth.

IHS Markit's May economic forecast is similar to the January forecast, which was used in preparing the earlier tax revenue estimates. Growth in home sales, personal consumption expenditures (PCE), personal income, and nominal gross domestic product (GDP) is expected to be somewhat lower in 2019 compared to the January forecast. However, the May forecast expects this slower growth to be offset by improved growth for personal income, PCE, real GDP, and employment in 2020 and 2021. The forecast for growth in corporate and economic profits has been revised slightly higher in 2019, but slightly lower in 2020 and 2021 compared to the January forecast.

Based on our review of collections data and the economic forecast, we now believe that general fund taxes will be higher than the previous estimates by $592 million in 2018-19, $68 million in 2019-20, and $93 million in 2020-21. The three-year increase is $753 million, or 1.5%.

Over the three-year forecast period, the individual income tax estimates have been increased by \$460 million, the corporate income/franchise tax estimates have been increased by \$610 million, and taxes on insurance companies have been increased by \$25 million. The sales and use tax estimates have been reduced by \$280 million, the cigarette tax estimates have been reduced by \$37 million, and public utility taxes have been reduced by \$25 million over the three-year forecast period. The estimates for other general fund taxes have not been revised because collections are consistent with the January figures.

As noted, the primary factor in the increased estimates is unexpected strength in individual income tax collections and corporate income/franchise tax collections. At the time the January estimates were prepared, growth in income tax collections through December, 2018, equaled 5.6%. However, December collections decreased 19.8%, compared to December, 2017, due to lower estimated payments and pass-through withholding. Preliminary data from the Department of Revenue (DOR) indicated that this decrease would likely also occur in January 2019. In January, the decrease in estimated payments and pass-through withholding was attributed to the following four factors: (a) taxpayers accelerating payments in December, 2017, and January, 2018, in response to the federal Tax Cuts and Jobs Act of 2017 (TCJA); (b) pass-through entities whose owners were previously subject to the individual income tax changing their filing status in 2018 to C corporations to take advantage of certain federal tax treatments enacted under the TCJA; (c) pass-through entities previously subject to the state individual income tax electing to be taxed under the entity-level tax created under 2017 Wisconsin Act 368; and (d) diminished capital gains following the stock market "correction" in the last quarter of tax year 2018. These factors were expected to add volatility to final payments and refunds during the 2018 tax filing season.

The expected decrease in collections did occur in January, as overall individual income tax collections declined by 13.2% compared to the prior January. However, this collection pattern reversed itself beginning in February. Individual income tax collections grew by 22.2% from February through April compared to the three-month period in the prior year, primarily based on stronger than expected collections for estimated and final payments. Individual income tax collections are now anticipated to grow by 5.5% over the remainder of 2018-19, as compared to the prior year.

In anticipation that Congress would enact legislation to allow states to collect sales tax from out-of-state retailers, 2013 Wisconsin Act 20 established a procedure to proportionally reduce individual income tax rates in the taxable year following the 12-month period after a change in federal law to allow Wisconsin to collect sales tax from remote sellers. Following the 2018 U.S. Supreme Court decision under *South Dakota v. Wayfair, Inc.*, Act 368 modified the Act 20 provision to: (a) accelerate the individual rate reductions to take effect in tax year 2019; and (b) specify that the U.S. Supreme Court decision, rather than an act of Congress, triggered the income tax rate reduction.

At the time Act 368 was enacted, the rate reduction was expected to reduce tax rates on an ongoing basis. However, after reviewing the language of Act 368, it was determined that the rate reductions would be applicable only to tax year 2019, and then revert to the pre-Act 368 levels. As a result, individual income tax revenues have been reestimated higher in 2020-21 by \$60 million to reflect the one-time nature of the Act 368 rate reductions, compared to the January estimate. If the Act 368 provision is modified to maintain the lower rates on an ongoing basis, as assumed in 2013 Act 20, the tax estimate for 2020-21 will need to be reduced by approximately $60 million.

At the time of the January estimates, corporate income/franchise tax collections had grown by 23.1% through December, compared to collections through the same period in the prior year. This higher year-to-date growth was attributed to corporate taxpayers shifting taxable income from tax year 2017 to tax year 2018 by accelerating deductible expenses in response to the TCJA (the federal tax rate for C corporations was reduced from 35% to 21% beginning in tax year 2018). Corporate collections were expected to moderate over the remainder of 2018-19 as the income shifting effects of the TCJA grew more distant and the revenue reductions associated with certain tax law changes, such as the expansion of Section 179 expensing provisions, were expected to reduce corporate collections. Over the 2019-21 biennium, the January forecast anticipated continued growth in corporate tax collections attributable, in part, to pass-through entities. First, some pass-through entities were expected to change their filing status to C corporations in response to the TCJA. Second, other pass-through entities were expected to pay state taxes at the entity level under Act 368. DOR indicated it would report entity-level tax paid by S corporations and partnerships under the corporate income/franchise tax, rather than the individual income tax. Although S corporations could elect to pay the entity level tax retroactively for tax year 2018, Act 368 was not expected to significantly shift the composition of corporate and individual income taxes in 2018-19.

Following the January estimates, corporate tax collections did not moderate as expected from January through April. Instead, collections grew by $330 million compared to the same four-month period in 2017-18. Excluding pass-through withholding (which is reconciled by DOR at the end of each fiscal year), year-to-date collections for 2018-19 are now more than 70% above the comparable period in the prior year. The higher collections are partly attributed to the continued one-time effects of corporations shifting deductible expenses and taxable income between tax years 2017 and 2018 in response to the TCJA. In addition, preliminary data from DOR suggest that S corporations remitted over $115 million to-date, significantly higher than previously estimated, attributable to those entities electing to be taxed at the entity level under Act 368 for tax year 2018 (partnerships were not eligible to elect entity-level taxation in 2018). The higher amount of tax being remitted under the entity-level tax is expected to shift additional revenue that previously would have been reported under the individual income tax to the corporate income/franchise tax and is expected to add volatility in estimated payments, refunds, and final payments under the two taxes over the next few years.

Table 1 outlines the May, 2019, economic forecast by IHS Markit. Table 2 shows the revised general fund tax collection estimates for 2018-19 and the two years of the next biennium. It should be noted that the revenue estimates reflect current state and federal law and do not incorporate any of the tax law changes proposed by the Governor in his 2019-21 budget recommendations.

TABLE 1

Summary of National Economic Indicators
IHS Markit Baseline Forecast May, 2019
($ in Billions)

	2018	2019	2020	2021
Nominal Gross Domestic Product	$20,494.1	$21,404.8	$22,374.3	$23,337.5
Percent Change	5.2%	4.4%	4.5%	4.3%
Real Gross Domestic Product	$18,566.4	$19,061.3	$19,467.6	$19,813.0
Percent Change	2.9%	2.7%	2.1%	1.8%
Consumer Prices (Percent Change)	2.4%	2.2%	2.2%	2.3%
Personal Income	$17,582.4	$18,290.7	$19,183.6	$20,088.3
Percent Change	4.5%	4.0%	4.9%	4.7%
Nominal Personal Consumption Expenditures	$13,948.5	$14,536.4	$15,250.6	$16,015.5
Percent Change	4.7%	4.2%	4.9%	5.0%
Economic Profits	$2,262.8	$2,406.2	$2,455.1	$2,485.4
Percent Change	7.8%	6.3%	2.0%	1.2%
Unemployment Rate	3.9%	3.6%	3.5%	3.6%
Total Nonfarm Payrolls (Millions)	149.1	151.4	153.2	154.3
Percent Change	1.7%	1.6%	1.2%	0.7%
Light Vehicle Sales (Millions of Units)	17.19	16.80	16.63	16.48
Percent Change	0.3%	-2.3%	-1.0%	-0.9%
Sales of New and Existing Homes (Millions of Units)	5.958	5.959	6.176	6.316
Percent Change	-3.1%	0.0%	3.6%	2.3%
Housing Starts (Millions of Units)	1.249	1.199	1.274	1.324
Percent Change	3.4%	-4.0%	6.2%	4.0%

TABLE 2

Projected General Fund Tax Collections
Under Current Law
($ in Millions)

	2017-19 Biennium		2019-21 Biennium	
	2017-18 Actual	2018-19 Estimated	2019-20 Estimated	2020-21 Estimated
Individual Income	$8,479.2	$8,950.0	$9,090.0	$9,410.0
General Sales and Use	5,448.1	5,650.0	5,845.0	5,895.0
Corporate Income/Franchise	893.9	1,355.0	1,165.0	1,205.0
Public Utility	365.3	353.0	366.0	364.0
Excise				
Cigarette	538.9	523.0	515.0	507.0
Tobacco Products	80.2	86.0	90.0	94.0
Liquor and Wine	52.0	54.0	55.0	56.0
Beer	8.9	8.9	8.9	8.9
Insurance Company	186.3	195.0	203.0	211.0
Miscellaneous Taxes	91.4	91.0	97.0	102.0
Total	$16,144.2	$17,265.9	$17,434.9	$17,852.9
Change from Prior Year		$1,121.7	$169.0	$418.0
Percent Change		6.9%	1.0%	2.4%

The following sections present information on the individual taxes that are modified under this analysis.

Individual Income Tax. Individual income tax receipts are estimated at $8,950.0 million in 2018-19, $9,090.0 million in 2019-20, and $9,410.0 million in 2020-21. These revised amounts represent increases relative to the previous estimates of $310.0 million in 2018-19, $70.0 million in 2019-20, and $80.0 million in 2020-21. These increases total $460.0 million.

The reestimate for 2018-19 is influenced by one-time effects. At the end of 2017 (2017-18), there was a surge in estimated payments and pass-through withholding payments that was likely related to the TCJA and the federal limitation on state and local tax deductions beginning in tax year 2018. While a correction was expected in December, 2018, estimated payments and pass-through withholding payments decreased by a greater margin than anticipated. Because these payments reflect taxpayers' actual tax liabilities, the payments were expected to increase in 2019-20, when the collection pattern would normalize. However, this normalization appears to have occurred in March and April of this year. This collection pattern has been experienced by a number of other states.

In addition to realizing the additional estimated payments and pass-through withholding payments, the 2018-19 reestimate incorporates a somewhat higher rate of increase in withholding payments and growth in final payments. These factors result in a 2018-19 growth rate in individual income tax collections of 5.6%, compared to a 1.9% rate of growth assumed in January. This increase is followed by a smaller estimated increase of 1.6% in 2019-20, which is influenced by the implementation of the entity-level tax authorized under 2017 Act 368, resulting in some payments that had been previously recorded under the individual income tax to be reflected under the corporate income/franchise tax instead. For 2020-21, the payments under the individual income tax are estimated to increase by 3.5%.

General Sales and Use Tax. State sales and use tax revenues are estimated at $5,650.0 million in 2018-19, which represents growth of 3.7% over the prior year. Sales tax revenues are estimated at $5,845.0 million in 2019-20 and $5,895.0 million in 2020-21, reflecting growth of 3.5% and 0.9%, respectively. The estimates have been reduced by $65.0 million in 2018-19, $110.0 million in 2019-20, and $105.0 million in 2020-21, relative to the January estimates.

In January, this office estimated year-over-year growth in sales tax revenues of 4.9% in 2018-19 based, in part, on year-to-date growth of 5.0% through December. Through April, year-to-date collections growth is 3.9%. Collections in January and February were considerably weaker than anticipated compared to the same months in the prior year, with year-over-year growth in that period of only 0.1%. January has historically experienced some of the highest sales tax revenues of the year, and the unexpectedly low growth in that month has contributed to the reduced estimate for 2018-19. Moreover, the May forecast for taxable PCE over calendar year 2019 is 1.2 percentage points lower than in the January forecast, which has contributed to the reduction in estimated sales tax revenues for fiscal years 2018-19 and 2019-20, relative to January. While the projected growth in taxable PCE in the May forecast for 2020-21 exhibits a similar trend to the January forecast, estimated revenues in that year have been reduced based on the lower estimated amounts in the preceding year.

Corporate Income/Franchise Tax. Corporate income/franchise tax revenues are now projected to be $1,355.0 million in 2018-19, $1,165.0 million in 2019-20, and $1,205.0 million in 2020-21, which reflects annual growth in collections of 51.6% in 2018-19, reduced annual collections of 14.0% in 2019-20, and growth of 3.4% in 2020-21. Compared to the previous estimates, the reestimates represent increased revenues of $365.0 million in 2018-19, $115.0 million in 2019-20, and $130.0 million in 2020-21. The new estimates reflect year-to-date corporate tax collections, which, as noted above, have grown by over 70% compared to the same period through April of last year.

As noted, higher than expected entity-level tax payments and shifting of income from tax year 2017 to tax year 2018 in response to the TCJA contributed to higher than expected year-to-date collections. In addition, compared to the January forecast, IHS Markit's May forecast of 2019 growth in economic profits increased by 1.6 percentage points to 6.3%. For tax year 2019, S corporations and partnerships choosing to pay at the entity level are required to make quarterly payments, resulting in a one-time higher fiscal effect from S corporations remitting two estimated payments for tax year

2019 and full-year tax payments for tax year 2018. Previously, for tax purposes, such entities would have passed through their income to their owners, most of whom would have filed under the individual income tax. As a result, collections data suggest that a sizable amount of payments will now be made under the corporate income/franchise tax on a continuing basis. Due to the factors described above, this forecast anticipates growth in corporate tax collections of 51.6% in 2018-19. For context, the highest annual growth rate in corporate tax collections over the last 40 years occurred following the 2008-09 recession, with growth of 32.6% in 2009-10 compared to 2008-09.

Collections in 2019-20 and 2020-21 are estimated to be lower than in 2018-19 for three reasons. First, as discussed above, the effect of tax planning for the TCJA is expected to be a one-time shift that would not have a similar effect on revenues in the 2019-21 biennium. Second, entity-level tax collections are expected to be lower over the next two fiscal years after accounting for the one-time increase in collections described above. In addition, it is anticipated that collections under the entity-level tax may stabilize at a lower annual amount going forward if refunds are owed once entity-level tax forms are released by DOR and S corporations can accurately calculate their final payments for tax year 2018 later this year. Finally, IHS Markit forecasts that the growth in economic profits in 2021 (1.2%) will be 1.1 percentage points lower than previously forecast in January.

Public Utility Taxes. Relative to the January estimates, public utility tax collections are estimated to be lower by $15.0 million in 2018-19, $3.0 million in 2019-20, and $7.0 million in 2020-21. Through May 10, 2019, collections are lower than anticipated from both the gross revenue tax group and the ad valorem tax group. On a year-to-year basis, the reestimates assume a reduction of 3.4% in 2018-19, an increase of 3.7% in 2019-20, and a decrease of 0.5% in 2020-21.

Cigarette Tax. Cigarette tax revenues are estimated at $523.0 million in 2018-19, $515.0 million in 2019-20, and $507.0 million in 2020-21, and are lower than the previous estimates by $9.0 million in 2018-19, $12.0 million in 2019-20, and $16.0 million in 2020-21. When cigarette tax revenues were estimated in January, it was assumed that the decline in cigarette tax collections of 4.5% in 2017-18 compared to the prior year might be overstating ongoing declines in cigarette consumption compared to the average decline of 0.8% in the preceding five years. At that time, collections to-date were 1.8% lower than the comparable period in the previous year. Over the last four months, cigarette revenues are 5.6% lower than comparable collections in the prior year. The reestimates reflect the more recent trend of declining cigarette consumption.

Taxes on Insurance Companies. Insurance premiums taxes are now projected to be $195.0 million in 2018-19, $203.0 million in 2019-20, and $211.0 million in 2020-21. Compared to the previous estimates, the revised estimates represent increased insurance premiums tax revenues of $6.0 million in 2018-19, $8.0 million in 2019-20, and $11.0 million in 2020-21. The new estimates reflect year-to-date collections, which are higher than previously forecast and have grown by 5.0% compared to the same period through April of last year.

2018-19 Deposit to Budget Stabilization Fund

Pursuant to s. 16.518 of the statutes, whenever actual general fund tax collections in any year exceed the estimated amount of collections as shown in the biennial budget act, one-half of the excess is deposited into the budget stabilization fund. 2017 Act 368 directed that the amount of sales and use taxes collected in 2018-19 under the *Wayfair* decision be excluded from the calculation.

Under these provisions, it is estimated that for 2018-19, $291.1 million would be transferred to the budget stabilization fund. That calculation is shown below.

TABLE 3

2018-19 Deposit to the Budget Stabilization Fund (in Millions)

Current Tax Collections Estimate	$17,265.9
Estimated Collections under *Wayfair*	-45.0
Subtotal	$17,220.9
2017 Act 59 Tax Estimate	-16,638.8
Difference	$582.1
Difference ÷ 2 for Deposit to the Budget Stabilization Fund	$291.1

The budget stabilization fund currently has a balance of $325.4 million. With the transfer shown here, that balance would increase to $616.5 million, plus whatever interest accrues to the fund.

Impact on the 2018-19 General Fund Balance

In our January estimate, it was projected that the gross general fund balance for 2018-19 would be $691.5 million. That balance is now projected to increase by $312.2 million to $1,003.7 million. The $312.2 million is the net result of increased taxes of $592 million, increased departmental revenues of $10.1 million, reduced expenditures of $2.7 million, an increased transfer of $1.5 million to the transportation fund, and the $291.1 million transfer to the budget stabilization fund ($592 + $10.1 + $2.7 - $1.5 - $291.1 = $312.2)

The 2018-19 general fund condition statement is shown in Table 4.

TABLE 4

Estimated 2018-19 General Fund Condition Statement

	2018-19
Revenues	
Opening Balance, July 1	$588,472,000
Taxes	17,265,900,000
Departmental Revenues	
Tribal Gaming	26,139,600
Other	483,783,500
Total Available	$18,364,295,100
Appropriations, Transfers, and Revenues	
Gross Appropriations	$17,829,835,700
Sum Sufficient Reestimates	-162,687,400
Biennial Appropriation Adjustment	-1,100,000
Transfers to:	
Transportation Fund	43,164,800
Budget Stabilization Fund	291,100,000
Compensation Reserves	52,081,600
Less Lapses	-691,750,500
Net Appropriations	$17,360,644,200
Balances	
Gross Balance	$1,003,650,900
Less Required Statutory Balance	-75,000,000
Net Balance, June 30	$928,650,900

This office will continue to review revenue and expenditure estimates as well as tax collection data and economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,

Bob Lang

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature