

Commonwealth of Pennsylvania



MID-YEAR Revenue Update

January 29, 2018

IF^O Independent Fiscal Office

Welcome to the IFO Mid-Year Update

▶ **Three parts.**

- Economic forecast: upward revisions due to recent data and tax reform.
- Federal tax cut: economic and General Fund impact.
- Revenues: FY 17-18 update; preliminary look at FY 18-19.

▶ **Public presentation later today.**

- Rachel Carson Building at 2:30.
- Presentation to be posted to IFO website.

PA Economic Forecast Revisions

		Annual Growth Rates or Change			
		2016	2017	2018	2019
Real GDP	Jun 2017	1.1%	1.8%	1.9%	
	Jan 2018	0.6%	2.0%	2.3%	2.3%
Wages-Salaries	Jun 2017	2.8%	3.7%	3.8%	
	Jan 2018	1.3%	3.9%	4.3%	4.2%
Philadelphia CPI-U	Jun 2017	0.6%	2.0%	2.0%	
	Jan 2018	0.6%	1.3%	2.3%	2.2%
Employment (000s)	Jun 2017	52.2	54.4	52.5	
	Jan 2018	52.2	60.4	61.8	60.1

Note: Real GDP and Wage data revised for 2016. Wage growth for 2017 based on withholding trends through December.
 Source: Historical data from U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecasts by IFO.

Final
 Preliminary
 Projection

Recent Economic Trends

United States	2017.1	2017.2	2017.3	2017.4
Real GDP	1.2%	3.1%	3.2%	2.6%
Personal Consumption	1.9%	3.3%	2.2%	3.8%
Domestic Investment	-1.2%	3.9%	7.3%	3.6%
Government Expenditures	-0.6%	-0.2%	0.7%	2.9%
Corporate Domestic Profits	0.5%	6.2%	3.1%	n.a.
Pennsylvania				
Real GDP	0.3%	2.5%	3.2%	n.a.
Home Price Index	4.3%	4.6%	4.3%	n.a.
Philadelphia CPI-U	2.1%	1.0%	1.4%	0.8%
Net Job Gains (000s)	68.9	57.2	69.8	70.2
<p>Note: Real GDP and components are quarterly annualized rates. All others are year-over-year. Job gains represent annual rate of net job creation. All data except CPI-U are preliminary and subject to revision. Sources: U.S. Bureaus of Labor Statistics and Economic Analysis.</p>				

PA Employment Growth (000s)

	2014	2015	2016	2017
Mining-Logging	1.7	-3.8	-9.0	-1.2
Construction	4.8	6.5	3.7	7.0
Manufacturing	3.0	0.0	-9.3	-5.8
Wholesale-Retail	2.8	1.0	-2.7	-4.1
Transportation	7.4	11.2	9.0	6.5
Professional Services	13.3	18.0	14.4	17.8
Healthcare-Social	14.3	11.2	23.7	24.6
Leisure-Hospitality	5.1	7.5	13.1	17.9
State-Federal Govt	-2.0	0.3	0.9	-2.0
Local Government	-7.3	-6.8	-0.9	-1.8
All Other Sectors	<u>4.3</u>	<u>1.5</u>	<u>9.3</u>	<u>7.7</u>
Total Job Gains	47.4	46.7	52.2	66.5

Note: Figures represent change in average level for calendar year. Figure listed on PA Economic Forecast slide assumes that 2017 value will be revised down. Source: U.S. Bureau of Labor Statistics. Data for 2017 are preliminary and will be revised.

Federal Tax Changes

Federal Changes Impact PA General Fund

▶ **Changes to U.S. corporate net income tax.**

- Lower rate and repatriations: higher PA cap gains, dividends, wages.
- 100% bonus depreciation (and corporate tax bulletin 2017-02).
- Eliminate/limit deductions: broadens PA tax base.

▶ **Changes to U.S. personal income tax.**

- More disposable income: higher PA consumer spending (sales tax).
- Boost to PA capital gains and dividends forecast (income tax).
- Indirect effect: more consumer spending increases income.

Impact of Tax Change for Singles

Status	Wage Income	Number Children	Itemized Deductions		Change in Tax Paid	
			SALT	Other	Dollar	Percent
Single	\$40,000	0	n.a.	n.a.	-\$756	-19.3%
Single	80,000	0	n.a.	n.a.	-2,091	-16.1%
Single	80,000	0	\$8,500	\$11,500	-476	-5.0%
Single	120,000	0	11,250	12,750	-926	-5.0%
Single	180,000	0	14,000	14,000	-2,511	-7.3%
Single	300,000	0	23,000	19,000	149	0.2%

Notes: Itemized deductions based on IRS tabulations for PA for tax year 2015. SALT is the state and local tax deduction for income (or sales) and property taxes. For PA, roughly 14% of taxpayers with AGI of \$40,000 claimed an itemized SALT deduction. For AGI of \$300,000, roughly 93% claimed the deduction. Simulation includes impact of EITC.
 Source: Tax Policy Center at <http://tpc-tax-calculator.urban.org/>.

Impact of Tax Change for Married

Status	Wage Income	Number Children	Itemized Deductions		Change in Tax Paid	
			SALT	Other	Dollar	Percent
Married	\$40,000	2	n.a.	n.a.	-\$1,417	refund
Married	80,000	2	n.a.	n.a.	-2,269	-49.2%
Married	80,000	2	\$8,500	\$11,500	-1,219	-34.3%
Married	150,000	2	12,500	13,000	-2,683	-14.7%
Married	300,000	2	23,000	19,000	-9,278	-15.8%
Married	600,000	2	44,500	25,500	-8,397	-5.3%

Notes: Itemized deductions based on IRS tabulations for PA for tax year 2015. SALT is the state and local tax deduction for income (or sales) and property taxes. For PA, roughly 14% of taxpayers with AGI of \$40,000 claimed an itemized SALT deduction. For AGI of \$300,000, roughly 93% claimed the deduction. Simulation includes impact of EITC and assumes children under age 17.
Source: Tax Policy Center at <http://tpc-tax-calculator.urban.org/>.

Two Estimates of Federal Tax Cut

	FFY 2018-19 (\$ billions)	
	Joint Committee	U Penn Wharton
Individuals and Pass Throughs	-\$188.8	-\$168.5
Corporate - lower rate, broaden base	-133.8	-129.2
Corporate - tax on foreign profits	<u>42.6</u>	<u>40.5</u>
Total Tax Cut	-280.0	-257.2
All Individual and Pass Throughs	-188.8	-168.5
One-Third Net Corporate	<u>-30.4</u>	<u>-29.5</u>
Tax Cut Realized	-219.2	-198.1
Estimated PA Share	3.5%	3.5%
Increase PA Disposable Income	7.7	6.9

Note: Corporations use revenues from the tax cut to (1) pay dividends, (2) repurchase shares, (3) purchase equipment/structures, (4) pay workers, (5) pay down debt, (6) reduce prices or (7) simply retain the funds. The computation assumes that one-third of the tax cut in the first full fiscal year will flow through to individuals as higher dividends, capital gains or wages. Excludes indirect (dynamic) effects of tax cuts, which would manifest in later years.

Economic Impact of Federal Tax Cut

- ▶ **Most estimates assume \$1.8 trillion tax cut over 10 years.**
 - This is a "static" estimate that does not include dynamic effects.
 - The dynamic effect is the offsetting revenue from a larger economy.

	Total Tax Cut FFY 2018-27 (\$ billions)	Dynamic Offset FFY 2018-27	Extra Real GDP Growth	
			Only CY 2018	Cumulative to CY 2027
Joint Committee	-\$1,770	26.4%	0.9%	0.7%
Tax Policy Center	-\$1,770	12.8%	0.8%	0.0%
U Penn Wharton	-\$2,296	13.4%	0.8%	0.8%
IHS Markit	-\$1,770	n.a.	0.1%	0.6%
Tax Foundation	-\$1,783	69.5%	0.5%	3.4%

Note: Figures exclude the budget impact from eliminating the ACA individual mandate. JCT estimates that provision reduces outlays by \$297 billion and reduces debt by \$314 billion over ten years. Sources: Supporting documentation may be found at entity websites.

Corporate Net Income Tax Detail

- ▶ **Reduce federal tax rate from 35% to 21% (2018 and later).**
 - Shift income out, accelerate deductions into 2017. Pay down debt.
 - FY 17-18: -\$100 million | FY 18-19: +\$20 million.
- ▶ **Federal 100% bonus depreciation (full expensing).**
 - Conformity: ~-\$500 to -\$600 million combined FY 17-18 + FY 18-19.
 - Corp Revenue Bulletin 2017-02: decouples and denies deductions.
 - FY 17-18: +\$50 million | FY 18-19: +\$160 million.
- ▶ **Eliminate/limit certain deductions (broaden tax base).**
 - Eliminate Section 199 deduction. Limit interest deduction.
 - FY 17-18: +\$40 million | FY 18-19: +\$160 million.

Personal Income and Sales Tax Detail

- ▶ **Pennsylvania does not use federal tax base.**
 - Main impact: consumers have more disposable income.
 - Options: spend, save or pay down debt.
 - Occurs with delay. IHS Markit assumes 6 months.
- ▶ **Sales tax: gain from higher disposable income and spending.**
 - FY 17-18: +\$10-\$20 million | FY 18-19: +\$60-\$80 million.
- ▶ **Income tax: direct and indirect effects.**
 - Direct: higher dividends and capitals gains.
 - Indirect: new spending becomes taxable income for others.
 - Some shifting of business profits out of 2017 to 2018.

Other Aspects of Federal Tax Change

- ▶ **Taxation of deferred foreign income (aka repatriation).**
 - JCT estimate assumes ~ \$1.1 trillion in deferred income 2018 + 2019.
 - Income was already invested, most likely in U.S. debt.
 - Can now flow out as dividends, buybacks, wages and investment.
- ▶ **Some gains from migration to corporate business form.**
 - Significant corporate tax rate reduction.
 - Large PA rate differential: 9.99 vs. 3.07.
- ▶ **Modest negative impact on housing market.**

Revenue Update

Recent Tax Revenue Trends

	FY 16-17			FY 17-18	
	2016.4	2017.1	2017.2	2017.3	2017.4
General Fund Tax	2.3%	1.2%	4.1%	4.8%	5.3%
Corporate Net Income	-1.2%	-12.3%	3.9%	10.9%	-3.3%
Sales - Non-Motor	0.3%	1.1%	1.8%	3.0%	4.3%
Sales - Motor Vehicle	-0.6%	9.7%	0.8%	-0.9%	4.8%
Income - Withholding	2.7%	4.0%	3.7%	4.4%	4.3%
Income - Non-Withheld	-7.9%	1.9%	-0.9%	0.9%	35.1%
Cigarette	51.6%	45.3%	39.4%	10.6%	-11.1%
All Other Tax	-7.1%	-4.0%	6.1%	5.1%	14.1%

Note: PIT withheld adjusted for extra deposit days. Non-motor sales tax adjusted for tax law changes and miscellaneous transfers. Also uses one month lag.

IFO Official FY 2017-18 Estimate

	June 2017 Estimate		Revenue Package	Revised Official	
	Amount	Growth		Total	Growth
General Fund	\$32,491	2.6%	\$2,255	\$34,745	9.7%
Corporate Net Income	2,855	3.8%	218	3,072	11.7%
Sales - Non-Motor	8,833	2.3%	5	8,837	2.3%
Sales - Motor	1,404	2.7%	0	1,404	2.7%
PIT - Withholding	9,975	3.8%	10	9,985	3.9%
PIT - Other	3,347	9.7%	-51	3,296	8.1%
Cigarette	1,241	-1.7%	0	1,241	-1.7%
Gaming Expansion	0	N/A	103	103	N/A
Loan-Lease-Transfers	4	N/A	2,000	2,004	N/A
All Other	4,833	1.7%	-30	4,803	1.1%

Note: dollar amounts in millions. June 2017 base growth rates were 4.7 percent, 3.2 percent and 10.7 percent for corporate net income, sales - non-motor and PIT - other, respectively. Revenue package includes a reduction of \$33 million to insurance premiums tax for the anticipated increased usage of PHLIGA credits. PIT is personal income tax.

Updated Estimate FY 2017-18

	Revenues Through January				Mid-Year Update	
	Actual	Growth	Estimate	\$ Diff	Total	\$ Change
General Fund	\$17,355	7.8%	\$16,906	\$450	\$34,780	\$35
Corporate Net Income	1,320	6.1%	1,332	-11	2,991	-81
Sales - Non-Motor	5,321	4.3%	5,306	15	8,852	14
Sales - Motor	806	1.8%	815	-9	1,387	-16
PIT - Withholding	5,836	6.2%	5,824	12	10,016	31
PIT - Other	1,457	18.7%	1,335	122	3,284	-12
Cigarette	705	-3.1%	723	-18	1,231	-10
Gaming Expansion	96	N/A	27	70	188	85
Loan-Lease-Transfers	216	N/A	2	214	1,937	-67
All Other	1,598	8.8%	1,542	55	4,894	91

Note: dollar amounts in millions. PIT is personal income tax. All Other YTD gain from gross receipts (\$11 million), insurance premiums (\$10 million) and inheritance (\$27 million) tax gains.

Revisions to Official Estimate

	\$ Change from Official	Notes on Revisions
General Fund	\$35	
Corporate Net Income	-81	December weakness, income shifting
Sales - Non-Motor	14	Solid, but January was flat
Sales - Motor	-16	General weakness
PIT - Withholding	31	Steady gains
PIT - Other	-12	Monies shifted from finals to quarterlies
Cigarette	-10	Unusual recent weakness
Gaming Expansion	85	Pick up from first two auctions; five assumed
Loan-Lease-Transfers	-67	\$300 original lease-transfers, revised down to \$233
All Other	91	Inheritance +\$40, VW Settlement +\$40

Note: dollar amounts in millions. PIT is personal income tax.

Revenues Outstanding

	Official Estimate	Updated Estimate	Dollar Change	Revenue Outstanding
Baseline Revenues	\$32,442	\$32,459	\$17	\$14,904
NOL and Tax Changes	200	200	0	nearly all
Gaming Expansion	103	188	85	92
Tobacco Fund Securitization	1,500	1,500	0	1,500
Farm Show Lease	200	200	0	0
Special Funds and JUA	<u>300</u>	<u>233</u>	<u>-67</u>	200
Total Revenues	34,745	34,780	35	

Note: dollar amounts in millions. Revenue from the lease of the farm show complex is anticipated in January. JUA is the \$200 million transfer from the Joint Underwriters Association.

Personal Income Tax Trends

▶ **Withholding very close to forecast.**

- CY 2017 growth at 4.0%. Forecast was 3.7%.
- Latest quarterly data show YOY gains of +4.3%.

▶ **Estimated payments very weak until December.**

- Final Dec-Jan estimated payment up ~+\$196 million (+33%).
- Accelerate payments to deduct against federal income tax.
- Shift from finals, purposeful overpayments.

▶ **Moderate growth in April final payments.**

- Strong stock market gains (+17% annual growth) offsets some shifting.

Sales-Use Tax Trends

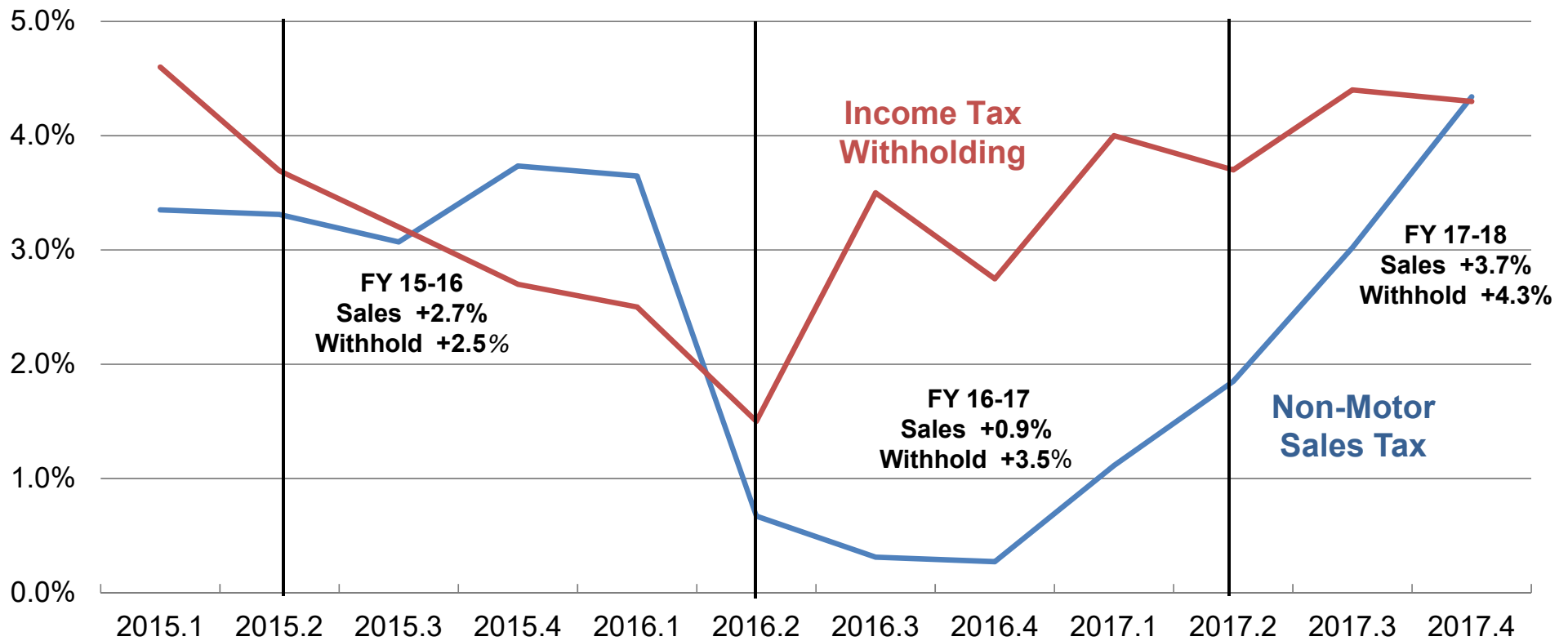
▶ **Solid growth in non-motor vehicle revenues.**

- Underlying base growth rate +4.3% for November to January.
- Strong holiday sales. But, January remittances are flat.
- Expect continued solid growth due to tax cut and wage gains.

▶ **Motor vehicle revenues slightly underperform.**

- Number of U.S. light vehicle sales down 1.8% in 2017.
- U.S. CPI-U for 2017: new vehicles -0.2%; used vehicles -3.6%.
- Forecast decline of 1.3% for 2018 sales (IHS Markit). Saturated market.

NMV Sales Tax Growth Gap Closes



Note: Sales tax series controls for expanded tax base and transfers to various accounts and funds. Series lagged one month to control for payment rules.

Corporate Net Income Tax Trends

- ▶ **Non-financial domestic profits growth thru 2017 Q3 is 1.5%.**
 - Mar-Jun-Sept estimated payments up +4.5%. December up +7.0%.
 - Anticipate relatively weak final payment due to shifting.
- ▶ **Corp. Bulletin 2017-02 decouples from federal bonus.**
 - Denies regular depreciation deductions until property is sold/disposed.
 - Hedge: IFO has not reflected revenue impact in projections.
- ▶ **Risk: assumed revenue impact from NOL court case.**
 - IFO assumes +\$215 million for FY 2017-18.
 - Nearly all shows up in April-May final payment.

Initial Outlook for FY 2018-19

	Preliminary Amount	Annual Increase	
		Dollar	Percent
General Fund	\$33,914	-\$866	-2.5%
Corporate Net Income	3,318	327	10.9%
Sales - Non-Motor	9,213	362	4.1%
Sales - Motor	1,416	29	2.1%
PIT - Withholding	10,454	438	4.4%
PIT - Other	3,449	165	5.0%
Cigarette	1,194	-37	-3.0%
Gaming Expansion	82	-107	N/A
Loan-Lease-Transfers	4	-1,933	N/A
All Other	4,784	-110	-2.2%

Note: dollar amounts in millions. Tax revenue growth rate is 3.9%.

Summary

▶ **Significant revenue uncertainty for rest of fiscal year.**

- NOL cap: \$215 million (unclear how much has been received).
- JUA transfer: \$200 million (included in estimate).
- Remaining gaming expansion monies: \$92 million.
- Shifting vs. real monies: impact on final payments.
- Bonus depreciation and corporate tax bulletin.

▶ **Modest short-term economic bump from tax cut.**

- Affects FY 2018-19. Little impact for FY 2017-18.
- Key: What will corporations do with tax cut?
- How quickly does it show up in the PA economy?