
Finance Advisory Committee

Revenue and Budget Update

January 18, 2018

JLBC

A Summary of State General Fund Conditions

- The '19 JLBC Baseline

- The Baseline compares revenues with funding formula requirements to provide a guideline of available resources
- Both the current budget and '19 Baseline have projected shortfalls:
 - '18 = \$(20) M and '19 = \$(108) M

The Caveats

- ❑ The shortfall is likely greater since the Baseline eliminates \$89 M in “1-time” ’18 spending that appears ongoing in nature
- ❑ Federal tax conformity not scored in Baseline or Executive. Projections are highly speculative.
 - DOR ‘19 estimate: \$50 M to \$250 M (\$236 M detail)
 - JLBC ‘19 estimate: \$133 M

Arizona Ranks 14th in Economic Momentum

- Same Rank as a Year Ago

	<u>AZ Rate</u>	<u>AZ Rank</u>
<input type="checkbox"/> Change in Personal Income (Sept)	2.4%	20
<input type="checkbox"/> Change in Population (July)	1.6%	6
<input type="checkbox"/> Change in Employment (Nov)	1.5%	18
<input type="checkbox"/> Unemployment Rate (Nov)	4.3%	29

Momentum calculations via State Policy Reports – Joint NGA/NCSL Project

'18 YTD Growth Higher than '17

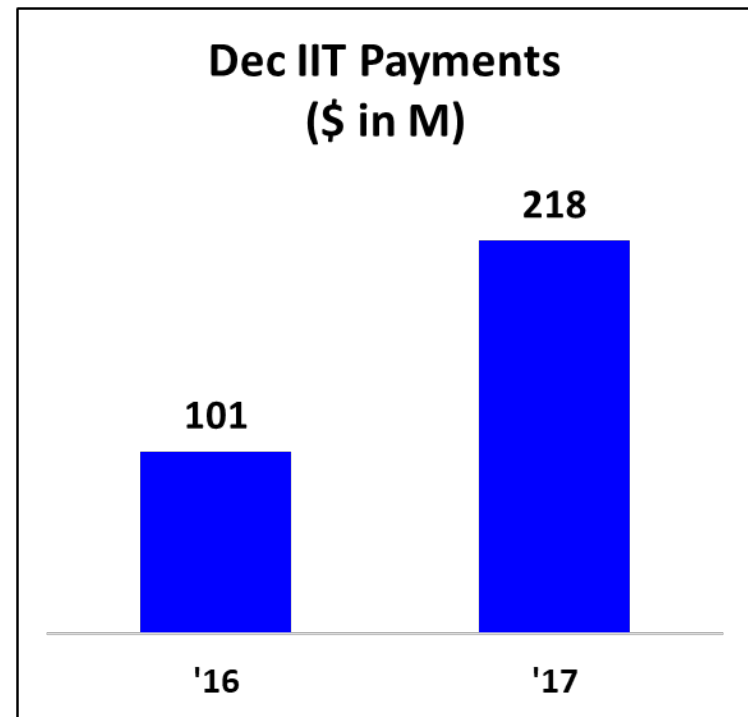
	<u>'17 Actual</u>	<u>'18 YTD</u>
Sales	4.5%	6.0%
Individual Income	4.1%	10.3%
Corporate Income	(35.5)%	(25.0)%
Insurance Premium	2.8%	3.1%
Other	<u>(2.9)%</u>	<u>(9.3)%</u>
Overall	1.5%	6.1%

- ❑ Includes preliminary December estimates
- ❑ Revenues exclude fund transfers and urban revenue sharing
- ❑ Through December, year-to-date revenues \$143 M above forecast

December Income Tax Payments Doubled

- Blip or Trend? Need to Monitor

- Why? We don't know
- Payments due Jan. 15 – a processing issue?
- Avoid '18 Fed SALT cap?
- Capital gains from 25% '17 stock market gain?
- Pass-through profitability?



Beyond Conformity, How Could Federal Tax Bill Affect AZ Revenue?

- ❑ Wide difference of opinion on the long run impact on the economy
- ❑ More general consensus that lower tax burden will generate growth in the next 2 years
 - 90% of 62 economists in Wall Street Journal survey concur
 - But no consensus on magnitude of growth
 - JLBC revenue forecast does not reflect legislation
- ❑ 47% of WSJ respondents thought that stimulus would last more than 2 years
 - Disagreement about long run impact on the federal deficit and the corresponding impact on interest rates
- ❑ Historical Context: by end of '19, we will have tied record for post WW2 expansion

How Does JLBC Forecast Revenues?

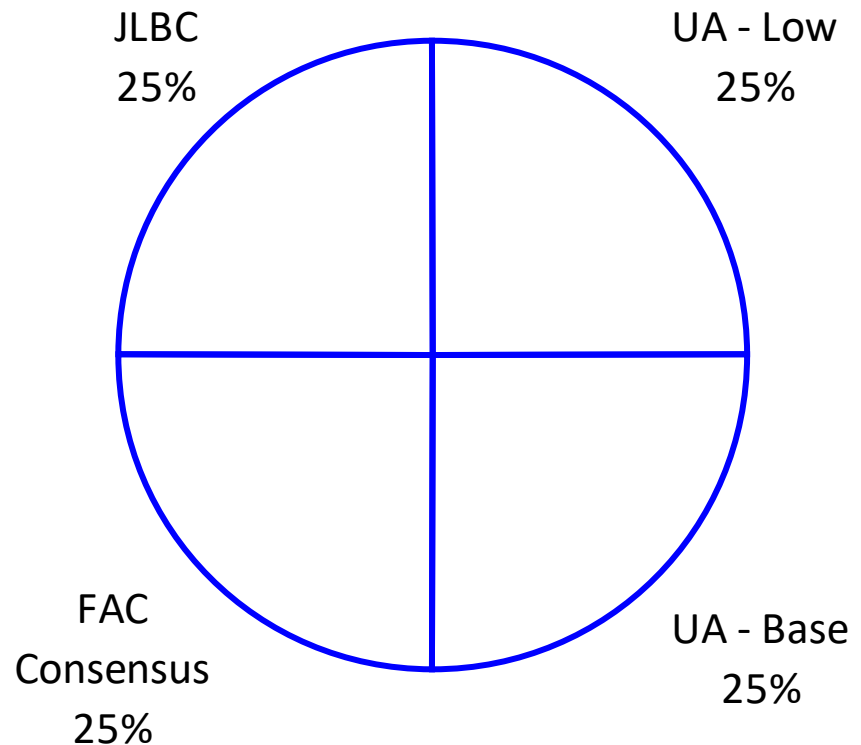
- Four-Sector Consensus Forecast

4-sector forecast equally weights:

- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast

Model Includes:

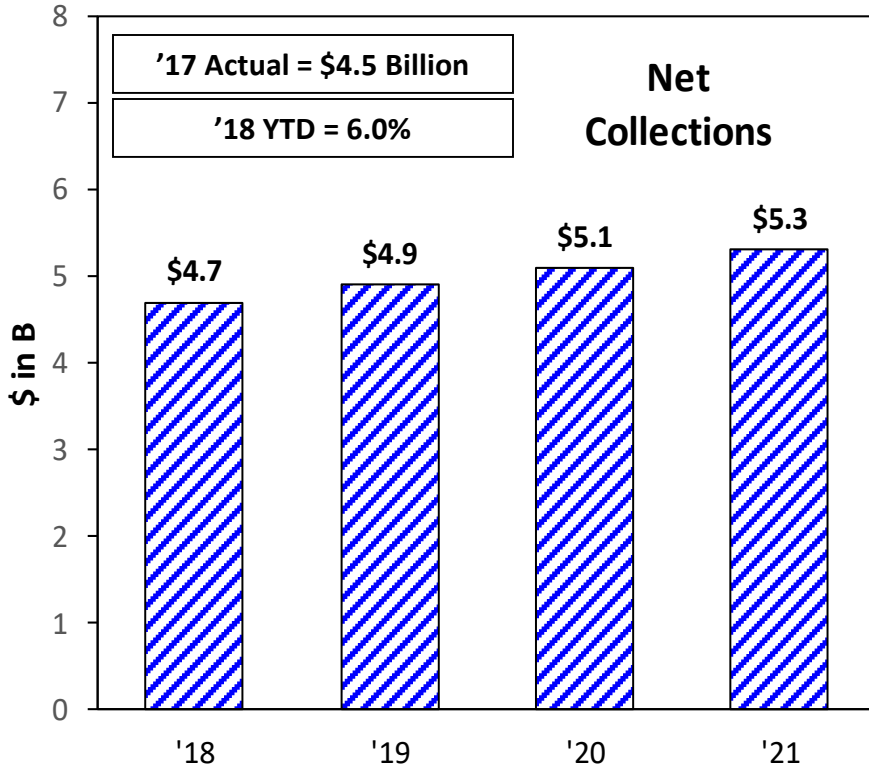
- Sales Tax
- Individual Income Tax
- Corporate Income Tax
- Insurance Premium Tax
- Remaining revenues (5% of total) are staff forecast



* The Finance Advisory Committee is a 14-member panel of public and private sector economists that publicly meets 3 times a year to advise the Legislature on the state of the Arizona economy.

Sales Tax and Corporate Income Tax

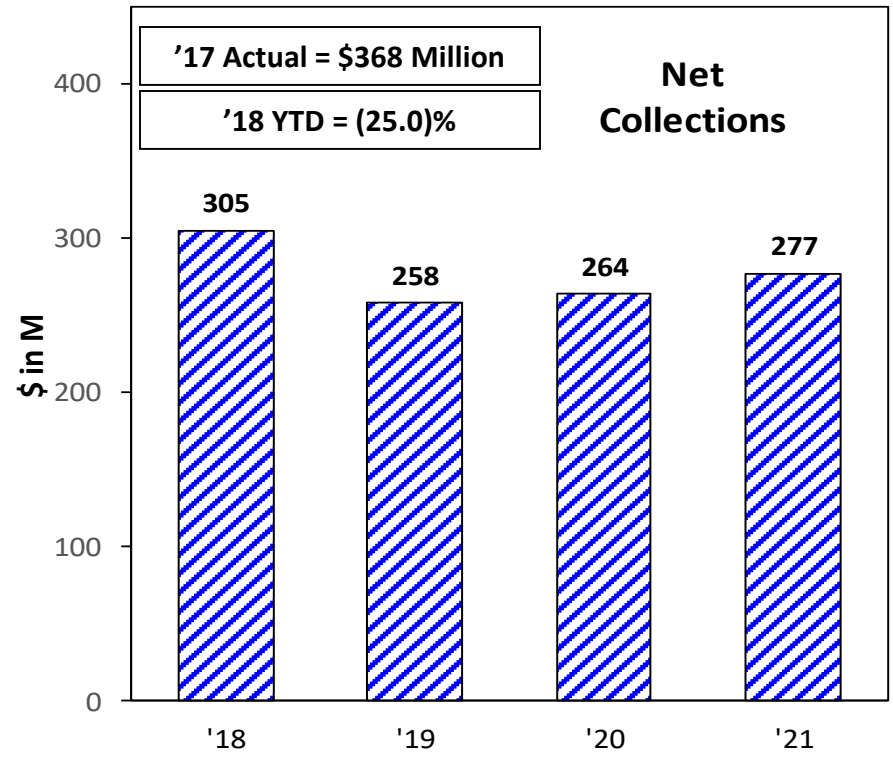
Sales Tax



Base %	4.4%	3.7%	4.3%	4.4%
Net %	4.1%	3.7%	4.3%	4.4%

- YTD Retail 4.6%
- YTD Contracting 13.4%

Corporate Income Tax

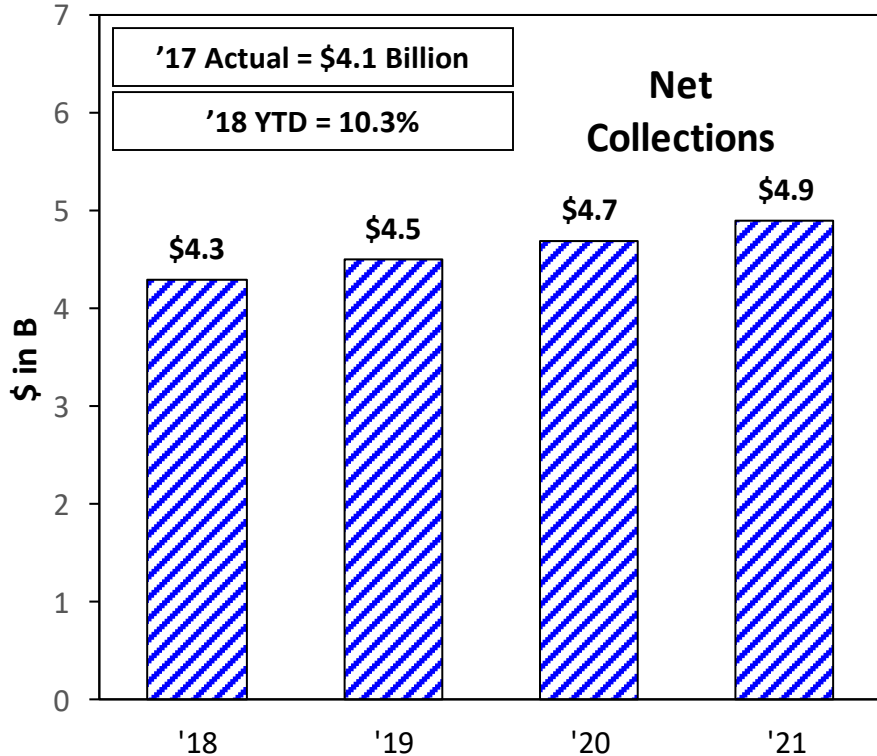


Base %	2.9%	3.4%	2.4%	5.5%
Net %	(17.0)%	(15.4)%	2.0%	5.2%

- '19 Completes Tax Cut Phase-in
- Speculative, could take longer
- STO Credit Slowing

Individual Income Tax and Insurance Premium Tax

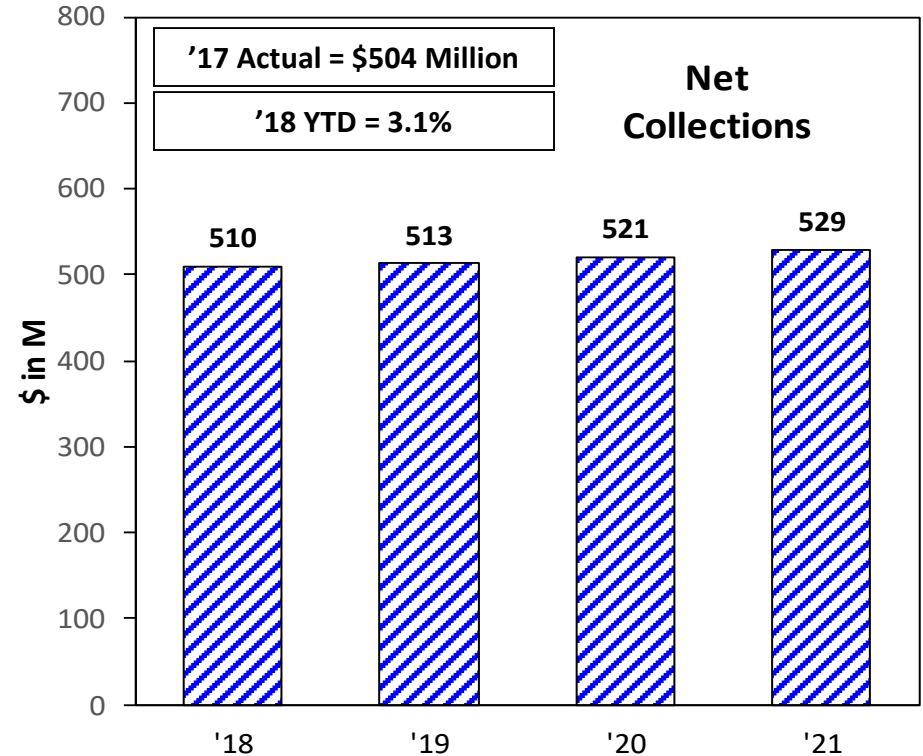
Individual Income Tax



Base %	5.1%	3.5%	4.7%	4.9%
Net %	4.7%	3.3%	4.7%	4.9%

- YTD Withholding 5.4%
- Pass-through income: \$500 M?

Insurance Premium Tax



Base %	3.0%	2.6%	2.5%	2.6%
Net %	1.2%	0.5%	1.5%	1.6%

- Individual Mandate Repeal Impact?

Consensus: Modest Growth Through '21

January Consensus Forecast

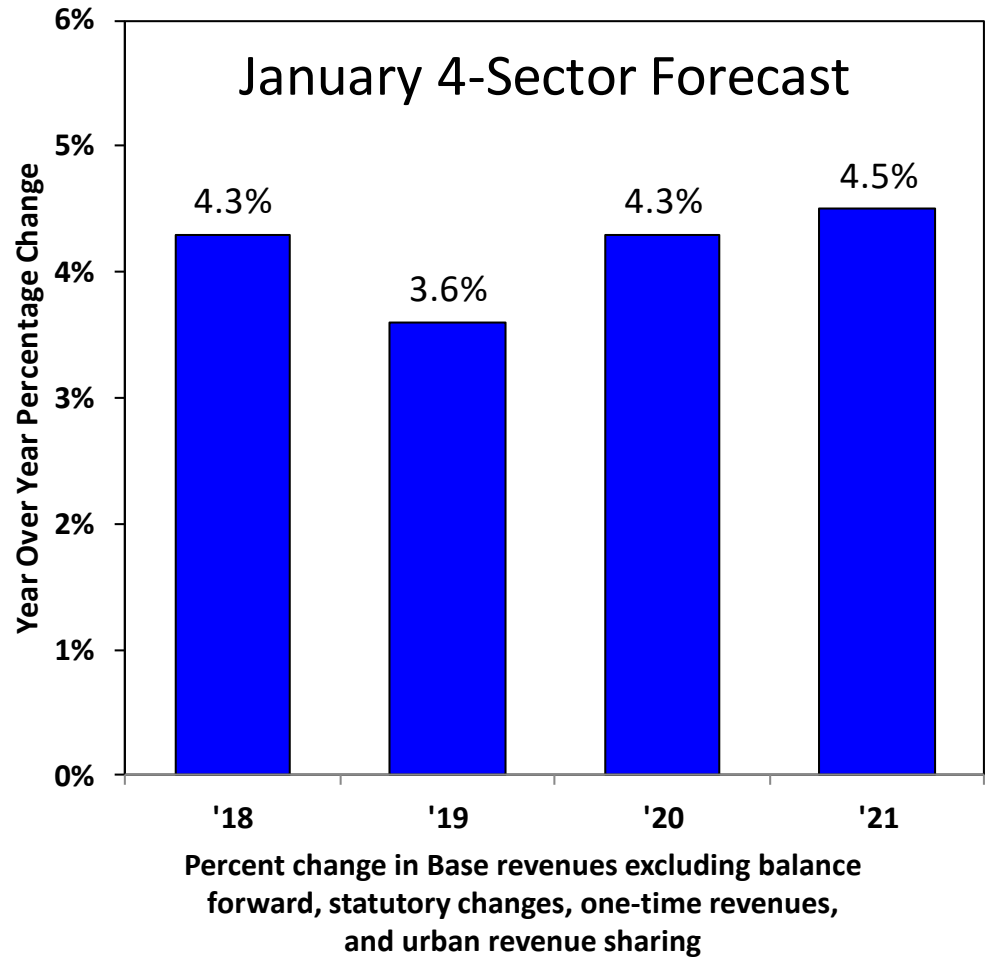
- Finance Advisory Committee
- UA model – base
- UA model – low
- JLBC Staff

Chance of Exceeding Forecast

- 60%

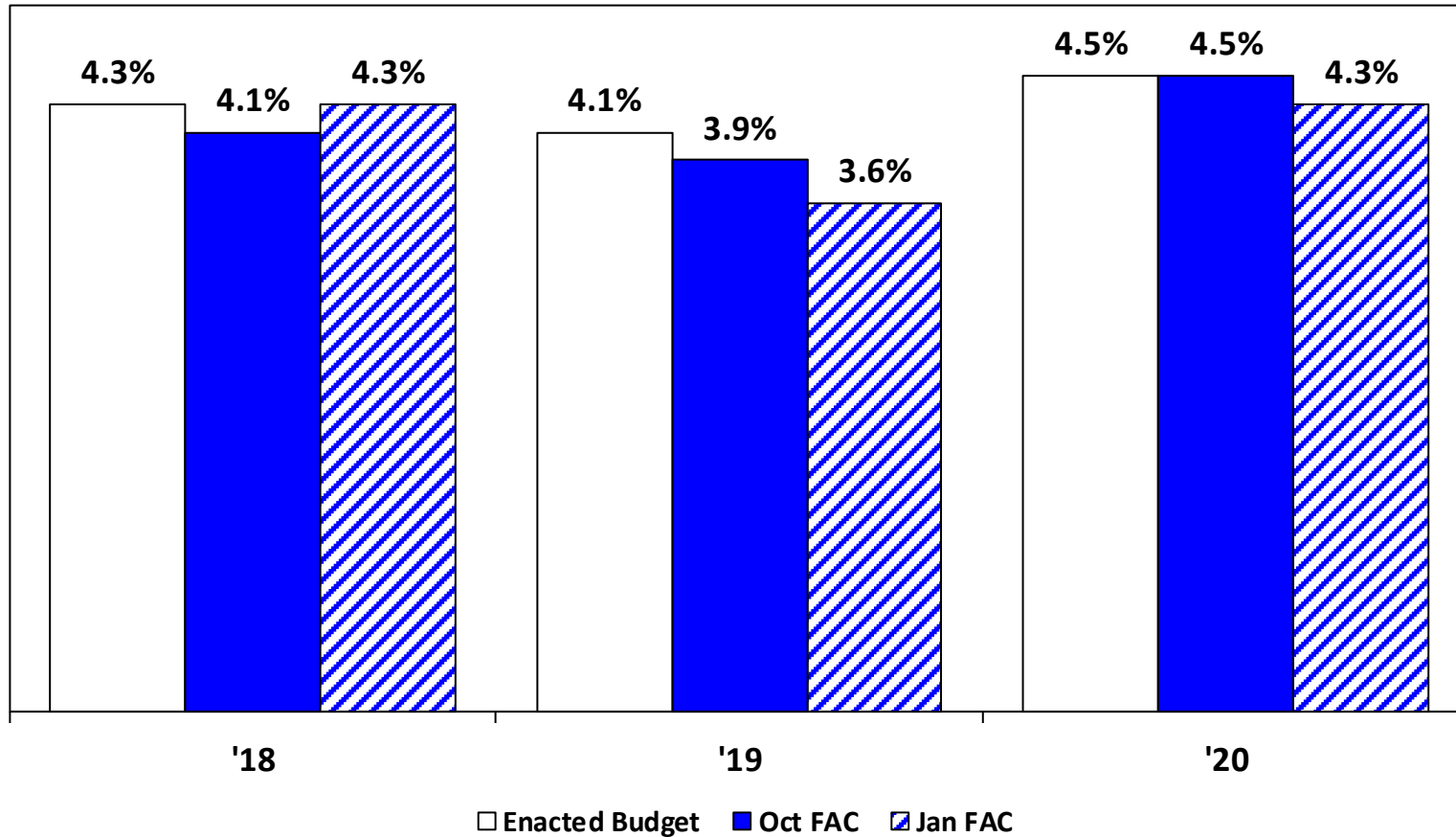
Long Run Average Growth

- 4.25%



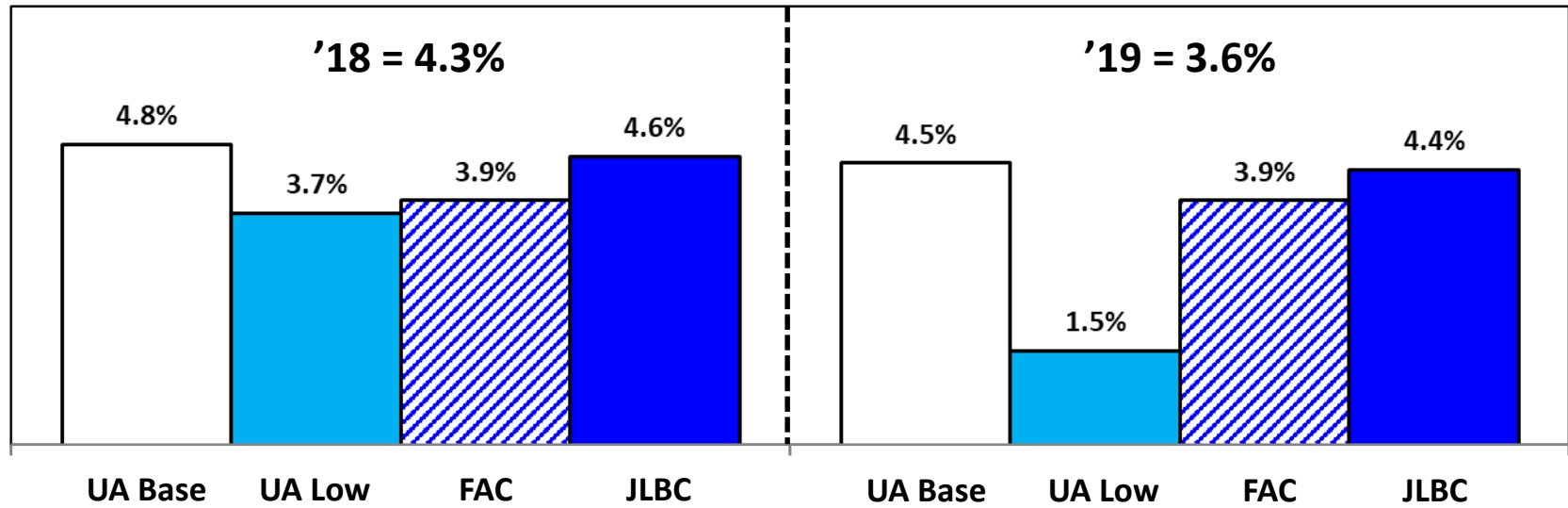
'19 & '20 Forecast Below Enacted Budget

Base Revenue Growth Rate *



*Excludes one-time revenues, tax law changes, and urban revenue sharing

“UA Low” Adds More Caution to Forecast



- ❑ “UA Low” is a slower growth scenario; not a recession
- ❑ ... but we are approaching historical length of expansion

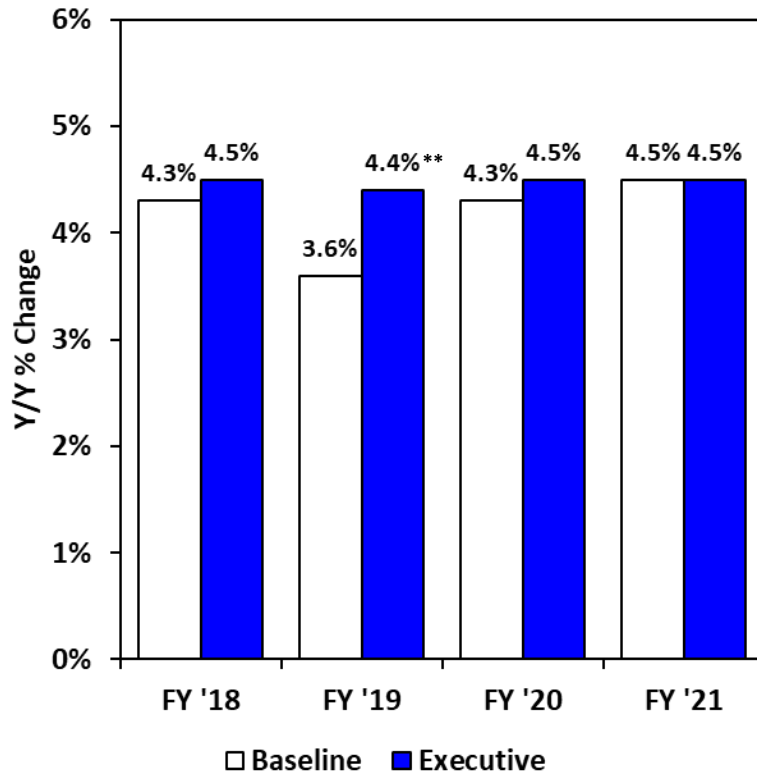
Details in Appendix A

Base Revenue growth adjusted for small categories

'19 Executive Base Revenue \$90 M Higher

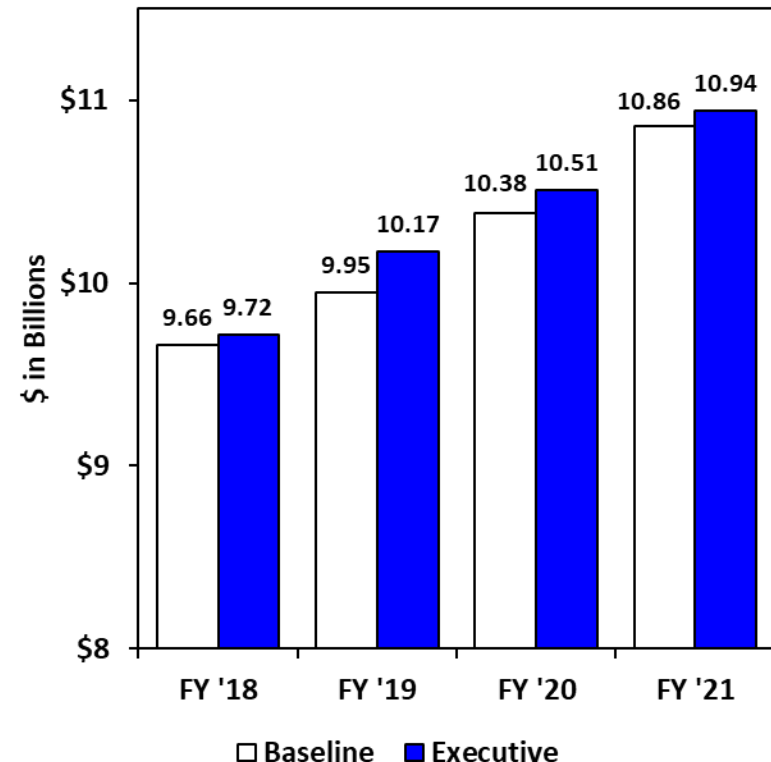
- Plus \$55 M in Executive Enforcement Revenue
- Plus \$53 M ('18) + \$76 M ('19) in New Fund Transfers

Base Growth Rate*



*Excludes tax law changes and one-time revenue
 **4.5% when compared to JLBC '18 base

Total Revenue***



*** Excludes Balance Forward

Forecasted Net '19 Revenue Growth is 3.0%

- Net Growth Adjusts Base for Transfers & Tax Cuts

	'18	'19	'20	'21
Base Revenue Growth (4.3%/3.6%/4.3%/4.5%)	426	368	457	504
Loss of 1-Time Fund Transfers	(137)	(8)	0	0
Previously Enacted Tax Legislation	(118)	(75)	(6)	(6)
Urban Revenue Sharing	(17)	6	(20)	(14)
Total	154	291	431	484
% Change	1.6%	3.0%	4.3%	4.7%

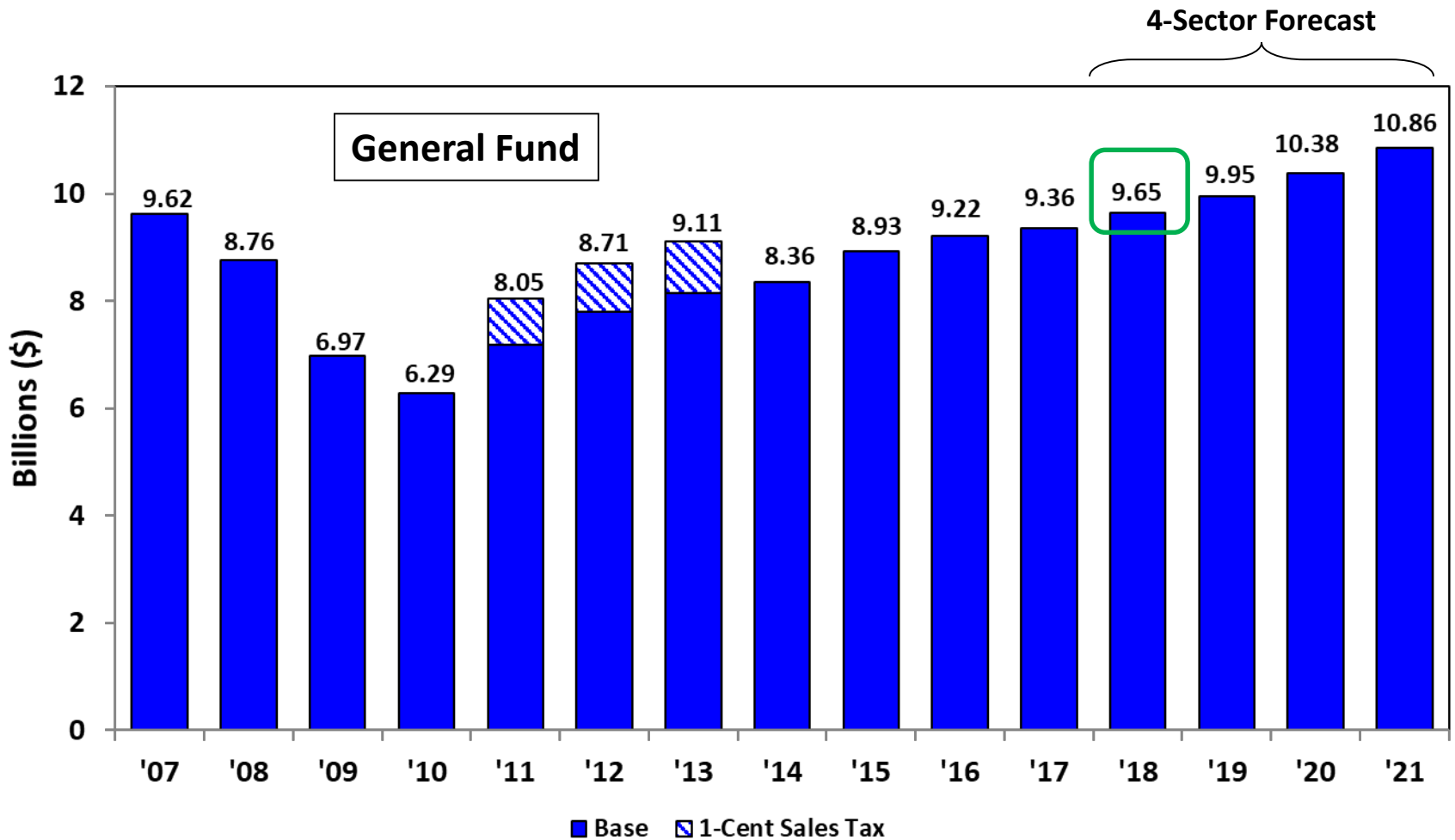
Excludes Change in Beginning Balance

Phase-In of \$87 M of Enacted Tax Reductions

	\$ in M*		
	<u>'19</u>	<u>'20</u>	<u>'21</u>
Corporate Rate Reduction/Sales Factor	(44)	(0)	(0)
Corporate/IPT School Tuition Indexing	(15)	(0)	(0)
IPT Rate Reduction	(4)	(5)	(5)
Other	(12)	(1)	(1)
Total	<u>(75)</u>	<u>(6)</u>	<u>(6)</u>

*By '21, revenue base is \$(87) M lower than in '18

Forecast Reaches Pre-Recession Level in '18

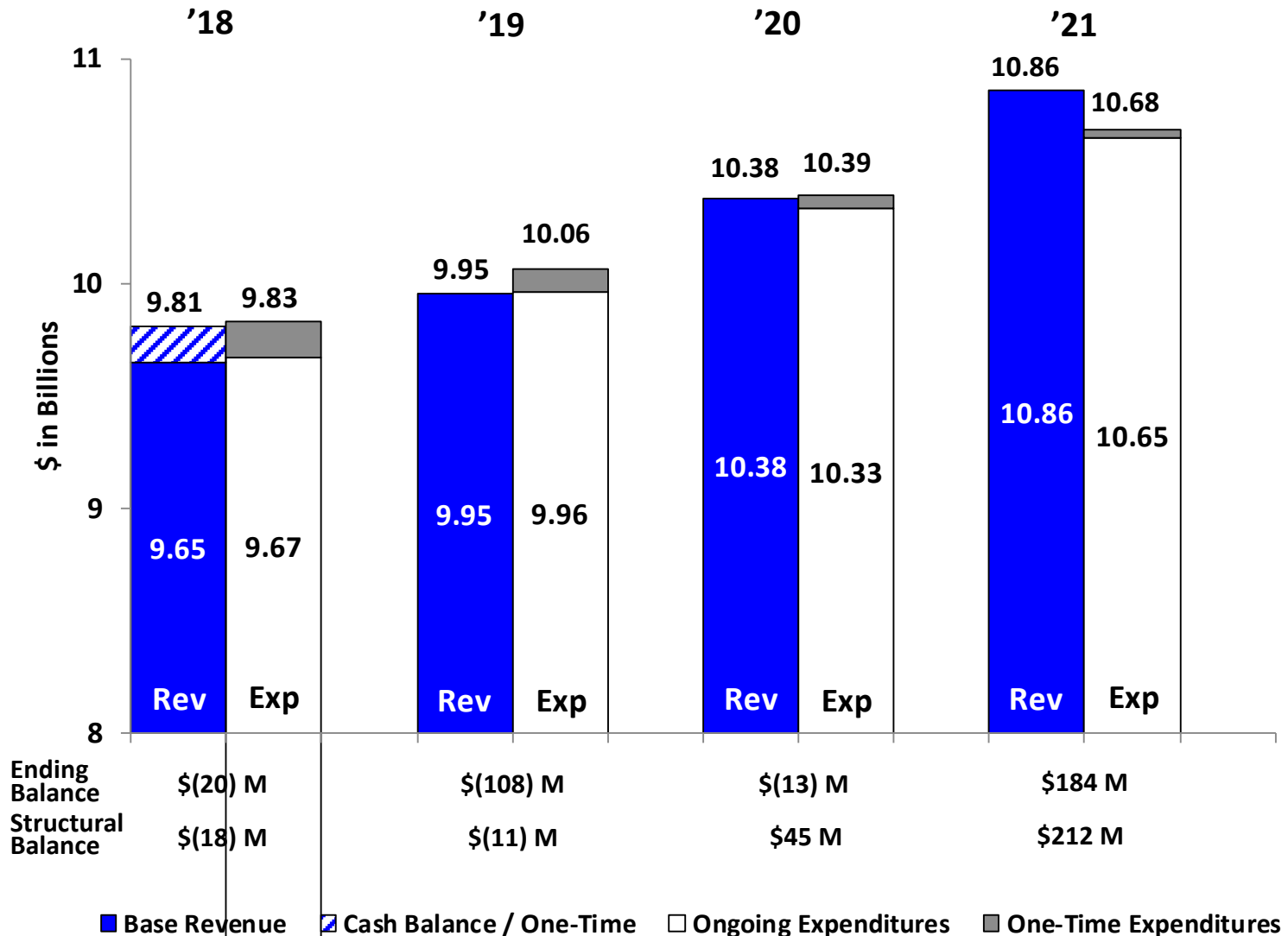


Excludes balance forward and other one-time revenues. Includes tax law changes and urban revenue sharing.

Cash and Structural Balance Shortfall

\$ (108) M '19 Shortfall Grows to a \$184 M '21 Balance

- But Excludes Any Discretionary Changes in Next 3 Years



Ending Balance
Structural Balance

Projected cash shortfalls assumed to be solved
as part of the budget process



Tax Conformity Issues

How Will Federal Tax Law Changes Affect AZ?

- AZ uses income on the federal form as the starting point for our own individual and corporate income tax
- When feds change their income definition, AZ has to decide whether to conform in statute
- Conformity is not automatic – state needs to enact legislation

When Are AZ and Federal Taxes Linked?

Linked

No

Tax Rates

- Feds lowered both individual and corporate rates, but no AZ impact

Deductions

Yes/No

- We do not conform to feds' standard & medical deductions
- AZ currently conforms to most others
- Feds have now reduced deductions, which would generate more state revenue

Conformity Is Very Difficult to Estimate

- ❑ Federal legislation includes over 100 provisions, is very complex and is the largest revision in the tax code in 30 years
- ❑ Some provisions can be estimated using AZ-specific data
- ❑ Most provisions, however, require prorating national data
 - Some national estimates are highly speculative
 - AZ's percent share of national estimates further adds to the speculation
- ❑ JLBC Staff's conformity projection is a \$133 M net gain in '19

Main Conformity Provisions

- Assumes Current Delinking Continues

	<u>\$ in M</u>
<input type="checkbox"/> Conform Itemized Deductions	138
• Eliminate 2% Business/Employee Expenses	
• Cap State & Local Taxes at \$10 K	
<input type="checkbox"/> Limit Pass-Through Losses to \$250k/\$500k	32
<input type="checkbox"/> Higher Bonus Depreciation/Business Expensing	(47)
<input type="checkbox"/> Expand Simplified Cash Accounting	(24)
<input type="checkbox"/> Limit Interest Expense Deduction to 30% of Earnings	17
<input type="checkbox"/> Net of All Other	17
Total	<u>133</u>

Key Conformity Assumptions

- ❑ Continue any current “delinking”
 - Medical expenses
 - Limit bonus depreciation to individual filers. Expanding to corporate filers costs \$68 M
 - No taxation of foreign profits

- ❑ Discount estimates for safety factor
 - 25% on any prorated federal estimates
 - 10% on DOR model runs (itemized deduction calculations)

Appendix A: January 2018 4-Sector Forecast

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Sales Tax				
JLBC Forecast	4.5%	4.2%	4.1%	4.0%
UA – Low	3.9%	1.7%	4.0%	4.8%
UA – Base	4.7%	4.8%	5.2%	4.5%
FAC	4.5%	3.9%	4.0%	4.3%
Average:	4.4%	3.7%	4.3%	4.4%
Individual Income Tax				
JLBC Forecast	5.6%	4.6%	5.3%	5.2%
UA – Low	4.2%	0.9%	4.4%	5.6%
UA – Base	6.1%	4.4%	5.4%	5.0%
FAC	4.5%	3.9%	3.7%	4.0%
Average:	5.1%	3.5%	4.7%	4.9%
Corporate Income Tax				
JLBC Forecast	4.3%	5.7%	4.2%	3.0%
UA – Low	3.9%	0.5%	2.7%	9.4%
UA – Base	4.5%	4.6%	3.6%	4.6%
FAC	-1.1%	2.5%	-1.4%	5.3%
Average:	2.9%	3.4%	2.4%	5.5%
Insurance Premium Tax				
JLBC Forecast	3.4%	4.1%	3.8%	3.8%
UA – Low	2.7%	1.3%	1.4%	1.3%
UA – Base	2.7%	1.5%	1.5%	1.8%
FAC	3.4%	3.4%	3.1%	3.3%
Average:	3.0%	2.6%	2.5%	2.6%

JLBC Weighted Average	4.9%	4.4%	4.6%	4.5%
UA Low Weighted Average	4.0%	1.3%	4.0%	5.1%
UA Base Weighted Average	5.2%	4.4%	5.1%	4.6%
FAC Consensus Weighted Average	4.2%	3.9%	3.7%	4.2%
“Big-4” Weighted Average	4.6%	3.4%	4.2%	4.5%
Consensus Weighted Average*	4.3%	3.6%	4.3%	4.5%
Adjusted Consensus Weighted Average**	3.1%	2.8%	4.2%	4.5%

* Represents ongoing revenue adjusted for small revenue categories.

** Represents ongoing revenue adjusted for tax law changes; excludes urban revenue sharing.