

## REVENUE ESTIMATES

After a record economic expansion, the U.S. economy abruptly entered into a recession in March of this year. This change in the economic landscape has had an immediate negative impact on revenues, with all three major revenue sources showing significant declines relative to the Governor's Budget forecast. From 2018-19 through 2020-21, the May Revision baseline revenue estimate (absent policy changes) has decreased by over \$41 billion, and over \$43 billion before accounting for transfers. The changes in the three largest tax sources are:

- Personal income tax revenues are revised downward by almost \$33 billion due to a decline in all income sources, but particularly wages, proprietorship income, and capital gains.
- Sales tax receipts are down by almost \$10 billion due mainly to lower consumption and investment by businesses.
- Corporation tax revenues are down over \$5 billion based on a significant drop in corporate profits.

After accounting for transfers, which includes loan repayments as well as automatic and discretionary transfers to the Rainy Day Fund, baseline General Fund revenues at the May Revision forecast are down relative to the Governor's Budget by \$41.2 billion over the budget window; higher than the Governor's Budget by \$665 million in 2018-19; lower than the Governor's Budget by \$9.7 billion in 2019-20; and lower than the Governor's Budget by over \$32 billion in 2020-21.

## REVENUE ESTIMATES

The baseline General Fund Revenue Forecast table compares the revenue forecasts by source in the Governor's Budget to the baseline May Revision forecast.

**2020-21 May Revision  
General Fund Revenue Forecast  
Baseline**  
(Dollars in Millions)

Source	2020-21 Governor's Budget	May Revision	Change From Governor's Budget Forecast	
<b>Fiscal 2018-19: Preliminary</b>				
Personal Income Tax	\$98,599	\$99,189	\$590	0.6%
Sales & Use Tax	26,128	26,150	22	0.1%
Corporation Tax	14,063	14,075	13	0.1%
Insurance Tax	2,723	2,727	4	0.2%
Alcoholic Beverage	378	378	0	0.0%
Cigarette	62	62	0	0.0%
Pooled Money Interest	648	648	0	0.0%
Other Revenues	1,223	1,242	19	1.6%
<b>Subtotal</b>	<b>\$143,823</b>	<b>\$144,471</b>	<b>\$648</b>	<b>0.5%</b>
Transfers <sup>1/</sup>	-4,444	-4,427	17	-0.4%
<b>Total</b>	<b>\$139,379</b>	<b>\$140,044</b>	<b>\$665</b>	<b>0.5%</b>
<b>Fiscal 2019-20</b>				
Personal Income Tax	\$101,682	\$94,773	-\$6,909	-6.8%
Sales & Use Tax	\$27,185	\$24,941	-2,244	-8.3%
Corporation Tax	\$15,305	\$13,870	-1,435	-9.4%
Insurance Tax	\$3,023	\$3,052	29	1.0%
Alcoholic Beverage	\$383	\$385	2	0.6%
Cigarette	\$60	\$58	-2	-3.8%
Pooled Money Interest	\$574	\$547	-27	-4.6%
Other Revenues	\$2,187	\$3,208	1,020	46.7%
<b>Subtotal</b>	<b>\$150,399</b>	<b>\$140,833</b>	<b>-\$9,565</b>	<b>-6.4%</b>
Transfers <sup>1/</sup>	-3,913	-4,001	-88	2.2%
<b>Total</b>	<b>\$146,486</b>	<b>\$136,833</b>	<b>-\$9,653</b>	<b>-6.6%</b>
<b>Fiscal 2020-21</b>				
Personal Income Tax	\$102,877.72	\$76,619.63	-\$26,258	-25.5%
Sales & Use Tax	\$28,242.79	\$20,570.80	-7,672	-27.2%
Corporation Tax	\$16,006.93	\$12,367.49	-3,639	-22.7%
Insurance Tax	\$3,116.77	\$2,985.80	-131	-4.2%
Alcoholic Beverage	\$388.51	\$388.98	0	0.1%
Cigarette	\$58.03	\$55.80	-2	-3.8%
Pooled Money Interest	\$514.18	\$183.53	-331	-64.3%
Other Revenues	\$2,197.73	\$6,071.57	3,874	176.3%
<b>Subtotal</b>	<b>\$153,403</b>	<b>\$119,244</b>	<b>-\$34,159</b>	<b>-22.3%</b>
Transfers <sup>1/</sup>	-1,768	187	1,955	-110.6%
<b>Total</b>	<b>\$151,635</b>	<b>\$119,431</b>	<b>-\$32,204</b>	<b>-21.2%</b>
<b>Three-Year Total</b>			<b>-\$41,192</b>	
Totals may not add because of rounding.				
<sup>1/</sup> Includes transfers to Budget Stabilization Account for each year.				

## REVENUE SOLUTIONS

As part of the balanced approach to managing the budget deficit, the May Revision includes two significant temporary changes to tax law, two measures to reduce the sales tax gap, and maintains three tax measures included in the Governor's Budget.

These tax measures as a whole are intended to raise revenue, stimulate economic growth, and help those in need. These revenue measures net \$4.4 billion in 2020-21, \$3.3 billion in 2021-22 and \$1.4 billion in 2022-23.

- The May Revision maintains three General Fund tax proposals in the Governor's Budget:
  - Extending the sales tax exemption for diapers and menstrual products through the end of 2022-23.
  - Extending the carryover period for film credits awarded under Program 2.0 from 6 years to 9 years.
  - Extending the current exemption from the minimum tax for first year corporations to first year LLCs, partnerships, and LLPs.
- The May Revision also maintains a new tax on e-cigarettes based on nicotine content and will be deposited in a new special fund.
- The Administration is committed to streamlining and increasing compliance of the state's cannabis tax collection, but is delaying changes proposed in the Governor's Budget.
- Suspend Net Operating Losses for 2020, 2021, and 2022 for medium and large businesses.
- Limit business incentive tax credits from offsetting more than \$5 million of tax liability for 2020, 2021, and 2022.
- Require used car dealers to remit sales tax to the Department of Motor Vehicles with the registration fees.
- Require the use of market value for determining price for private auto sales.

**Changes in Revenues**

(Benefit to General Fund, Dollars in Millions)

	2020-21	2021-22	2022-23
Suspend Net Operating Losses for 2020, 2021, and 2022	\$1,820	\$1,300	\$380
Limit Business Incentive Tax Credits to Offset no more than \$5 million of Tax Liability Per Year for 2020, 2021, and 2022	2,000	1,540	910
Interaction Between NOL Suspension and Credit Limitation	611	454	206
Require Used Car Dealers to Remit Sales Tax to DMV with Registration Fees	12	24	24
Require the use of Market Value for Determining Price for Private Auto Sales	30	61	61
<b>New May Revision General Fund Revenue Solutions</b>	<b>\$4,473</b>	<b>\$3,379</b>	<b>\$1,581</b>
Provisions included in Governor's Budget			
Extension of Sales Tax Exemption for Diapers and Menstrual Products through 2022-23	0	-23	-46
Extend the First Year Exemption from Minimum Tax to LLCs, Partnerships, and LLPs	-50	-100	-100
Extend Carryover Period for Program 2.0 Film Credits from 6 years to 9 years	0	0	-1
<b>General Fund Revenue Solutions</b>	<b>\$4,423</b>	<b>\$3,256</b>	<b>\$1,434</b>

**MAY REVISION REVENUE FORECAST**

The May Revision General Fund Revenue Forecast table shows total General Fund revenue and changes relative to the Governor's Budget forecast, after inclusion of the revenue solutions. The total revenue for 2020-21 is forecast to be \$124.9 billion. After inclusion of transfers, which includes a \$7.8 billion withdrawal from the Rainy Day Fund, total revenue for 2020-21 is \$137.4 billion, and overall revenues are \$23.2 billion lower than the Governor's Budget forecast.

**2020-21 May Revision  
General Fund Revenue Forecast**  
(Dollars in Millions)

Source	2020-21 Governor's Budget	May Revision	Change From Governor's Budget Forecast	
<b>Fiscal 2018-19: Preliminary</b>				
Personal Income Tax	\$98,599	\$99,189	\$590	0.6%
Sales & Use Tax	26,128	26,150	22	0.1%
Corporation Tax	14,063	14,075	13	0.1%
Insurance Tax	2,723	2,727	4	0.2%
Alcoholic Beverage	378	378	0	0.0%
Cigarette	62	62	0	0.0%
Pooled Money Interest	648	648	0	0.0%
Other Revenues	1,223	1,257	34	2.8%
<b>Subtotal</b>	<b>\$143,823</b>	<b>\$144,485</b>	<b>\$663</b>	<b>0.5%</b>
Transfers <sup>1/</sup>	-4,444	-4,426	18	-0.4%
<b>Total</b>	<b>\$139,379</b>	<b>\$140,060</b>	<b>\$681</b>	<b>0.5%</b>
<b>Fiscal 2019-20</b>				
Personal Income Tax	\$101,682	\$94,773	-\$6,909	-6.8%
Sales & Use Tax	\$27,185	\$24,941	-2,244	-8.3%
Corporation Tax	\$15,305	\$13,870	-1,435	-9.4%
Insurance Tax	\$3,023	\$3,052	29	1.0%
Alcoholic Beverage	\$383	\$385	2	0.6%
Cigarette	\$60	\$58	-2	-3.8%
Pooled Money Interest	\$574	\$547	-27	-4.6%
Other Revenues	\$2,187	\$3,209	1,022	46.7%
<b>Subtotal</b>	<b>\$150,399</b>	<b>\$140,835</b>	<b>-\$9,564</b>	<b>-6.4%</b>
Transfers <sup>1/</sup>	-3,913	-3,998	-85	2.2%
<b>Total</b>	<b>\$146,486</b>	<b>\$136,837</b>	<b>-\$9,649</b>	<b>-6.6%</b>
<b>Fiscal 2020-21</b>				
Personal Income Tax	\$102,878	\$76,841	-\$26,037	-25.3%
Sales & Use Tax	\$28,243	\$20,613	-7,630	-27.0%
Corporation Tax	\$16,007	\$16,577	570	3.6%
Insurance Tax	\$3,117	\$2,986	-131	-4.2%
Alcoholic Beverage	\$389	\$389	0	0.1%
Cigarette	\$58	\$56	-2	-3.8%
Pooled Money Interest	\$514	\$184	-331	-64.3%
Other Revenues	\$2,198	\$7,222	5,025	228.6%
<b>Subtotal</b>	<b>\$153,403</b>	<b>\$124,867</b>	<b>-\$28,535</b>	<b>-18.6%</b>
Transfers <sup>1/</sup>	-1,768	12,550	14,318	-809.9%
<b>Total</b>	<b>\$151,635</b>	<b>\$137,417</b>	<b>-\$14,218</b>	<b>-9.4%</b>
<b>Three-Year Total</b>			<b>-\$23,186</b>	
Totals may not add because of rounding.				
<sup>1/</sup> Includes transfers to Budget Stabilization Account for each year.				

## THE IMPACT OF TAX PAYMENT DEFERRALS ON REVENUE

On March 21, 2020, the federal government delayed the Internal Revenue Service tax filing deadline from April 15 to July 15. The state conformed to the federal deadline. It is anticipated that a large amount of income and corporate tax payments that would typically be received in April, May and June will be deferred until the 2020-21 fiscal year. The delay in receiving payments is not expected to affect revenue as the

deferred payments that are received in July or later will be accrued back to the 2019-20 fiscal year.

The quarterly sales tax filing deadline for all tax payers with sales tax payments less than \$1 million was delayed until July 31, 2020. The California Department of Tax and Fee Administration (CDTFA) will also grant a one-year payment plan for certain tax payers, providing additional relief for small businesses impacted by the COVID-19 Recession. Similar deferrals have been granted for other fees and taxes administered by CDTFA.

## LONG-TERM FORECAST

The Long-Term Revenue Forecast table below shows the forecast for the largest three sources of General Fund revenues from 2018-19 through 2023-24. Total General Fund revenues from these sources are expected to drop from \$139.4 billion in 2018-19 to a low point of \$114 billion in 2020-21. By 2023-24, it will only have grown to \$128 billion.

### Long-Term Revenue Forecast — Three Largest Sources

(General Fund Revenue — Dollars in Billions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Average Year-Over-Year Growth
Personal Income Tax	\$99.2	\$94.8	\$76.8	\$76.8	\$81.4	\$87.7	-1.9%
Sales and Use Tax	\$26.1	\$24.9	\$20.6	\$23.7	\$24.6	\$25.4	0.0%
Corporation Tax	\$14.1	\$13.9	\$16.6	\$15.9	\$16.0	\$14.9	1.6%
<b>Total</b>	<b>\$139.4</b>	<b>\$133.6</b>	<b>\$114.0</b>	<b>\$116.4</b>	<b>\$122.0</b>	<b>\$128.0</b>	-1.4%
Growth	6.4%	-4.2%	-14.6%	2.1%	4.8%	4.9%	

Note: Numbers may not add due to rounding.

## PERSONAL INCOME TAX

Compared to the Governor's Budget forecast, the baseline personal income tax forecast is higher by \$590 million in 2018-19, and lower by \$6.9 billion in 2019-20 and \$26.3 billion in 2020-21. Over the three-year period, the personal income tax forecast reflects a total decrease of \$32.6 billion.

Due to higher unemployment, taxable wages have been revised substantially lower, which negatively impacts personal income tax wage withholding receipts. Typically, wages comprise around 55 percent to 60 percent of all personal income tax receipts.

Taxable wages were revised from 5.9 percent growth to a decline of 12.6 percent in 2020, and from 4.2 percent growth to 3.3 percent in 2021.

The S&P 500 is forecast to drop from its current level to bottom at 2,032 in the 4<sup>th</sup> quarter of 2020—a 40-percent decline from its peak levels—and increase by 5.5 percent per year from those levels. This is a significant downgrade from the Governor's Budget, which assumed that the S&P 500 would be at 3,129 at the end of 2020. This forecast reflects the expected ongoing disruption to economic activity from the COVID-19 pandemic in the second half of 2020 and into 2021, which does not yet appear to be fully reflected in stock market prices at the end of April. This downgraded market forecast leads to a significant decrease in the forecast for capital gains realizations from \$151 billion to \$119 billion in 2020 (see figure with Capital Gains Realizations), \$147 billion to \$70 billion in 2021, and \$144 billion to \$84 billion in 2022. Capital gains realizations are forecast to return to a normal level of 4.5 percent of personal income by 2025 at \$132 billion, still well below the Governor's Budget forecast of \$152 billion due to the lower personal income forecast.

Forecasting revenues associated with capital gains is subject to significant uncertainty because realizations are heavily dependent upon stock market performance and when taxpayers choose to buy or sell stock. The S&P 500 is assumed to drop 40 percent from its peak level in February 2020 of 3,386 to 2,032 in the fourth quarter of 2020. In the last recession, the S&P 500 dropped by over 50 percent; in the technology-driven recession of 2001, it dropped by about 47 percent.

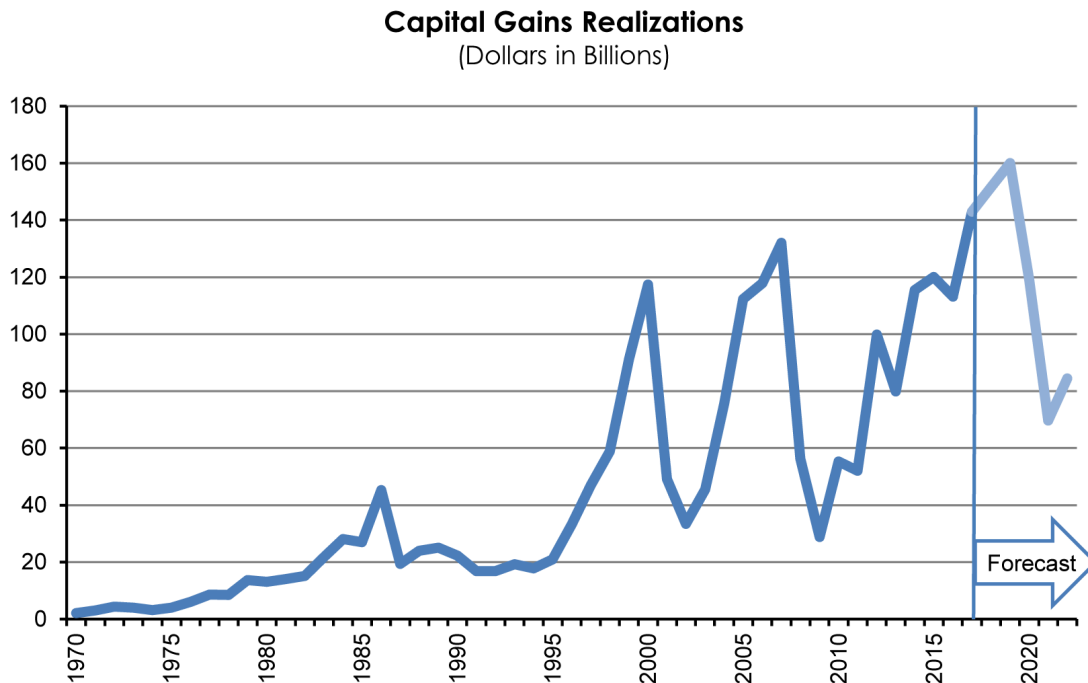
The personal income tax forecast includes Propositions 30 and 55 revenues, which are estimated at \$7.6 billion in 2019-20 and \$5.9 billion in 2020-21. These estimates are lower than the Governor's Budget by \$878 million and \$2.5 billion, respectively, due primarily to lower wages and capital gains realizations.

The highest-income Californians continue to pay a very large share of the state's personal income tax. For the 2018 tax year, the top one percent of income earners paid over 46 percent of personal income taxes. This percentage has been greater than 40 percent for 14 of the last 15 years.

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## **SALES AND USE TAX**

The baseline sales tax forecast is lower by \$2.2 billion in 2019-20 and \$7.7 billion in 2020-21. Due to the COVID-19 Recession, taxable sales are expected to decline by



4.6 percent in 2019-20 and a further 17.3 percent in 2020-21. At Governor's Budget, taxable sales were expected to grow 4.4 percent in 2019-20 and 3.3 percent in 2020-21.

Taxable consumer spending is expected to be lower than Governor's Budget by 11 percent in 2019-20 and by 28 percent in 2020-21. While consumer spending declined only 8.9 percent during the Great Recession from 2007-08 to 2008-09, it is expected to decline by 15.6 percent from 2019-20 to 2020-21. Of the industries that generate significant taxable consumer sales, restaurants, automobile dealerships, and retail clothing stores are expected to decline more significantly.

By contrast, taxable capital investment is expected to be lower than Governor's Budget by 7.7 percent in 2019-20 and 34 percent in 2020-21. Investment is expected to decline 25 percent from 2019-20 to 2020-21 compared with 17.6 percent during the Great Recession from 2007-08 to 2008-09.

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## CORPORATION TAX

The baseline corporation tax forecast is higher by \$13 million in 2018-19, lower by \$1.4 billion in 2019-20, and lower by \$3.6 billion in 2020-21. Corporate profits are expected to grow 4.4 percent in 2019-20 and then decline 18 percent in 2020-21 due to the COVID-19 Recession. At the Governor's Budget, corporate profits were forecast to grow by 3.6 percent in 2019-20 and 4.1 percent in 2020-21. Corporate profits are



expected to fare better during the recession than profits from smaller firms, such as those that report their business income on personal income tax returns.

Businesses incur net operating losses (NOLs) for tax purposes when allowable deductions and losses exceed taxable income. Federal law allows businesses with NOLs to carry forward these losses indefinitely and deduct them against 80 percent of income earned in future years. Federal tax law after changes adopted in 2017 did not allow NOLs to be carried back to offset income in prior years. The federal Coronavirus Aid, Relief, and Economic Security (CARES) Act provided a 5-year carryback for NOLs incurred in 2018, 2019, and 2020 and suspended the 80-percent limitation for NOLs carried forward for 2018, 2019, and 2020. California law, which prior to the adoption of the 2017 federal tax changes was in conformity with federal NOL rules, conformed to the carryback prohibition, but not to the 80-percent taxable income limitation. Further, California has not conformed to the CARES Act re-allowance of NOL carrybacks. In 2018, over \$27 billion in NOL deductions were used, which could have reduced corporate tax revenues by over \$2 billion.

Business incentive tax credits directly reduce corporate tax liability and are generally intended to encourage a certain type of behavior, such as research and development, which may occur to a lesser extent in the absence of the credit. In 2018, businesses reduced their corporate tax liability by over \$2.9 billion through the use of credits, with \$2.4 billion from the research and development tax credit.

The May Revision revenue solutions recognize the disproportionate tax relief that has been provided to larger corporations, compared to small businesses, which has resulted in relatively lower tax payments. Accordingly, the May Revision suspends NOLs for three years for medium and large businesses and limits credit utilization to no more than \$5 million in recognition of the COVID-19 Recession and its impacts on small businesses.

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## **INSURANCE TAX**

The insurance tax forecast is higher by \$29 million in 2019-20 and lower by \$131 million in 2020-21. The forecast includes the Insurance Commissioner's order for insurance companies in certain lines of insurance to refund premiums for March and April to reflect re-classifications of risk due to the COVID-19 pandemic. Despite the pandemic, the impact to insurance tax revenues is expected to be relatively modest and is expected to follow the pattern of prior recessions. Insurance tax premiums are expected to decline 2 percent in 2020 versus growth of 3 percent assumed in the

Governor's Budget, and are expected to grow 3 percent in 2021, which is unchanged from the Governor's Budget.

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### **ELECTRONIC CIGARETTE TAX**

In order to address the rapidly increasing youth use of potent nicotine-based vaping products, the May Revision maintains the new vaping tax based on nicotine content proposed in the Governor's Budget. The new tax will begin on January 1, 2021, and will be \$2 for each 40 milligrams of nicotine in the product, equivalent to the tax on a pack of cigarettes. The new tax will be in addition to all existing taxes on e-cigarettes, which are presently taxed as tobacco products under state law.

Revenues from the new tax are expected to be \$33 million in 2020-21, will be deposited into a new special fund, and will be used to increase enforcement and to offset Medi-Cal costs. The Budget includes \$13.9 million and 10.5 positions for the Department of Tax and Fee Administration to administer the proposed tax and \$7 million for the California Highway Patrol to establish a task force in collaboration with the Department of Justice dedicated to combatting the underground market for vaping products. In addition to the tax, the Administration will support a statewide ban on all flavored nicotine products as of January 1, 2021.

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### **CANNABIS EXCISE TAX**

Proposition 64, commonly referred to as the Adult Use of Marijuana Act, levies excise taxes on the cultivation and retail sale of both recreational and medical cannabis. The cultivation tax is paid on all recreational and medicinal cultivation of cannabis, and was increased, to adjust for inflation, to \$9.65 per ounce of flower, \$2.89 per ounce of trim, and \$1.35 per ounce of fresh cannabis plant on January 1, 2020. In addition, there is a 15-percent tax on the retail price of cannabis. Both cannabis excise taxes together generated \$299 million in 2018-19. The revenue from excise taxes was revised down from \$479 million to \$443 million in 2019-20 and \$590 million to \$435 million in 2020-21. While similar products like alcohol and tobacco tend to be recession-resistant, the forecast assumes that cannabis businesses will be more negatively impacted by the COVID-19 pandemic. Cannabis businesses have less access to banking services that could provide liquidity, have a younger consumer base likely to be disproportionately affected by the COVID-19 Recession, and still must contend with competition from the black market (See the Statewide Issues and Various Departments chapter for additional discussion).

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## PROPERTY TAX

The property tax is a local revenue source; however, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools generally offset General Fund expenditures.

Preliminary data show statewide property tax revenues increased 5.8 percent in 2019-20, which is 0.6 percentage point lower than the 6.4-percent growth rate anticipated at the Governor's Budget. California counties committed to cancel penalties and charges related to late payments that may arise due to hardships arising from COVID-19, which is reflected in the 2019-20 preliminary data. Property tax revenues are expected to grow 3.5 percent in 2020-21, which is 2.2 percentage points lower than the 5.7-percent growth expected at the Governor's Budget due to increased delinquencies, which typically rise in a recession. Approximately 42 percent (\$32 billion) of 2020-21 property tax revenues will go to K-14 schools. While this amount includes \$2.3 billion that schools are expected to receive in 2020-21 due to the dissolution of redevelopment agencies, it excludes the \$9.4 billion shifted from schools to cities and counties to replace Vehicle License Fee (VLF) revenue losses stemming from the reduced VLF rate of 0.65 percent.

On May 6, an executive order was issued waiving penalties for property taxes paid after April 10 for residential property and small business taxpayers who demonstrate they have experienced financial hardship through May 6, 2021. The executive order also extended the deadline for certain businesses to file Business Personal Property Statements through May 31, 2020, to avoid penalties.