



North Carolina General Fund

Revenue Consensus Forecast—May Revision

FORECAST HIGHLIGHTS

Over-collections for FY 2018-19 will be higher than expected

The February forecast expected collections to be 0.6% above the budgeted amount. The revised consensus forecast expects collections to be 2.7% over budget.

The 2019 biennium revenue forecast has been increased

The forecast increased revenue during the biennium by a total of \$285.6 million (\$106.3 in FY 2019-20 and \$179.3 in FY 2020-21).

Surge in April collections represents mostly one-time revenue

The significant increases in Personal Income Tax Final Payments and in Corporate Income collections are both considered mostly one-time in nature.

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The Fiscal Research Division and the Office of State Budget and Management have reached consensus on revising the revenue forecast for the 2019 biennium. This report summarizes the revised forecast.

FORECAST SUMMARY

The forecast expects FY 2018-19 collections to be above the original budgeted amount by \$643.3 million (2.7%). The increase in the forecast for this fiscal year's collections is the result of significant growth in year-over-year final tax payments in April. Most of the increased collections were considered a one-time, non-recurring increase. The underlying economic conditions have not changed since February's forecast with stable, modest growth expected to continue during the upcoming biennium.

Table 1. General Fund Revised Consensus Forecast Summary (\$ in Millions)

Fiscal Year	February Forecast	Revised Forecast	Change
2017-18	\$23,565.9	n/a	n/a
2018-19 (est.)	\$24,080.8	\$24,573.4	\$492.6
2019-20 (est.)	\$24,814.0	\$24,920.3	\$106.3
2020-21 (est.)	\$25,801.5	\$25,980.8	\$179.3

CURRENT FISCAL YEAR REVENUE

The revised consensus forecast reflects a continuation of steady economic growth. The forecast projects that total baseline revenue for the fiscal year (i.e., total collections adjusted for tax rate and base changes) will grow at over 8% as the result of increased Final Payments for the 2018 tax year.

By June 30th, net General Fund revenue is forecast to increase by 4.3% over the amount collected in FY 2017-18. Sales Tax collections are expected to finish very close to the original revenue target. Similarly, personal income withholding on wages and salaries is close to the original forecast projection. Thus, the revenue surplus is primarily the result of a increase in Final Payments on Personal Income, as well as better-than-expected Corporate Income Tax payments. The February consensus forecast estimated a \$150.8 million (0.6%) revenue surplus for the current fiscal year. With this revision the surplus has ballooned to \$643.3 million (2.7%). The revenue surplus compares the revised projected revenue to the original May 2018 (session-adjusted) revenue forecast.

April always has the potential to be an unpredictable collections month in which income from non-withholding sources such as dividends, capital gains, and business income can vary considerably from year to year. This variation can lead to sizable swings in income tax collections.

Other revenue sources remain constant

Except for the surge in April Personal Income and business tax payments, other revenue sources are forecast to finish the fiscal year in line with February's projections.

North Carolina's experience is not unique

Many other states are reporting similar results for their April collections.

Personal Income Taxes

Tax withholding on wages and salaries have been tracking close to expectations and with little change in economic conditions the revised forecast is very similar to the February forecast.

Sales Taxes

Sales Tax collections are up slightly, primarily due to the Wayfair decision which expanded the State's authority to require retailers to collect and remit Sales Taxes.

Revenue for the rest of FY 2018-19 may have more volatility than usual

These year-end revenue estimates are subject to a little more volatility than usual given the April results.

This April, collections did generate a true "surprise." While the choice to provide conservative estimates is prudent from a budgeting perspective, the cautious forecast left more room for a positive "April surprise." Additional caution was warranted this February with much lower than expected Estimated Payments on Personal Income for the last quarter of the 2018 tax year. This downshift in payments was the result of taxpayer behavior in response to federal tax changes rather than a drop in non-withholding income.

Therefore, the surge in April collections was primarily caused by higher-than-expected Final Payments on the Personal Income Tax. Final Payments came in at \$395 million above expectations and 46% over what the State collected in April, 2018. This is the largest year-over-year increase in payments since 2005, when payments increased by 52% from the previous year.

Given that wage and salary income withholding have been tracking very close to forecast, the surge in Final Payments is almost entirely the result of increased non-withholding income. Additionally, Corporate Income Tax payments in April were up 42% over last year and exceeded April's projection by \$75 million. Finally, Franchise Tax payments, based largely on corporations' net worth, are expected to add to the revenue surplus, exceeding the original budget forecast by \$56.8 million.

It should be noted that the surge in April income tax payments is not unique to North Carolina, as many of our contacts in other states are reporting similar results.

FORECAST REVISIONS FOR THE 2019 BIENNIUM

The two largest revenue sources, Personal Income withholding and the Sales Tax, are tracking close to the original forecast with both sources running slightly ahead of the monthly targets. Additionally, the economic forecast has not changed since the February biennium forecast. Therefore, the revised revenue forecast had only slight adjustments to these key sources.

The forecast assumes that the surge in April income collections was primarily one-time in nature. During most of 2018, equity markets continued to make solid gains, but in the last quarter of 2018, equity markets had grown more turbulent. Additionally, there were increased concerns that the economy may be rapidly weakening. These two conditions led more North Carolinians to adjust their investments, which increased capital gains in 2018. The increased realization of capital gains significantly expanded taxable income. Since then, however, equity markets have stabilized and the economy remains on solid footing, although it is still expected to weaken. This means the forecast does not expect these historically-high capital gain realizations to continue during the biennium.

The result of this forecast scenario of one-time income tax payments for the 2018 tax year plus modest withholding and Sales Tax growth is that the February forecast was increased by \$106.3 million for the first year of the biennium and by \$179.3 million for the second fiscal year.

As a final note, end-of-year revenue estimates produced after April collections usually fall within a range of plus or minus \$20 to \$30 million of the projection. A little more volatility is in play this year given the April results.

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