

Legislative Fiscal Bureau

Robert Wm. Lang, Director



State of Wisconsin

One East Main, Suite 301 • Madison, WI 53703
Email: Fiscal.Bureau@legis.wisconsin.gov
Telephone: (608) 266-3847 • Fax: (608) 267-6873

January 23, 2015

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:

Annually, this office prepares general fund revenue and expenditure projections for the Legislature prior to commencement of legislative deliberations on the state's budget.

In the odd-numbered years, our report includes estimated revenues and expenditures for the current fiscal year and tax collection projections for each year of the next biennium. This report presents the conclusions of our analysis.

Comparison with the Administration's November 20, 2014, Report

On November 20, 2014, the Departments of Administration and Revenue submitted a report to the Governor and Legislature that identified general fund revenue and expenditure projections for the 2014-15 fiscal year and the 2015-17 biennium. That report, required by statute, identifies the magnitude of state agency biennial budget requests and presents a projection of general fund tax collections.

Our analysis indicates that for the three-year period, aggregate general fund tax collections vary by only \$3.3 million from the November 20 report. However, our annual projections compared to the administration's estimates are \$173.5 million lower in 2014-15, \$110.9 million higher in 2015-16, and \$65.9 million higher in 2016-17.

Based upon the November report, the administration's general fund condition statement for 2014-15 reflects a gross ending balance (June 30, 2015) of -\$132.1 million.

Our analysis indicates a gross balance of -\$283.4 million for 2014-15. This is \$151.3 million below that of the administration's report. The 2014-15 general fund condition statement is shown in Table 1.

TABLE 1**Estimated 2014-15 General Fund Condition Statement**

	<u>2014-15</u>
Revenues	
Opening Balance, July 1	\$516,891,000
Taxes	14,469,800,000
Departmental Revenues	
Tribal Gaming	0
Other	<u>504,934,500</u>
Total Available	\$15,491,625,500
Appropriations	
Gross Appropriations	\$15,883,157,300
Transfers to Transportation Fund	169,587,100
Compensation Reserves	133,056,500
Biennial Appropriation Adjustment	-4,395,000
Sum Sufficient Reestimates	-82,011,800
Less Lapses	<u>-324,403,800</u>
Net Appropriations	\$15,774,990,300
Balance	-\$283,364,800

The factors that cause the \$151.3 million variance are as follows. First, based on economic forecasts and tax collections to date, the estimated tax collections of this memorandum are \$173.5 million below the projections of the November 20 report. Second, departmental revenues (non-tax amounts deposited into the general fund) are projected to be \$2.7 million less than the estimate of the administration. Third, it is estimated that net appropriations will be \$24.9 million below the amount reflected in the administration's report. The primary reason for this difference is a reduction of \$18.4 million in debt service payments.

It should be noted that in both the November 20 report and this analysis no amounts are shown for tribal gaming revenues for the 2014-15 fiscal year. In 2013-14, no tribal gaming revenues were deposited into the general fund. This was primarily due to the Potawatomi Tribe withholding its 2013-14 payment. It is unknown, at this time, if the Tribe will make a payment in 2014-15 and, if so, at what amount.

Revenue Shortfall Provisions

As shown in Table 1, the 2014-15 fiscal year is projected to end with a balance of -\$283.4 million. Section 16.50(7) of the statutes establishes a process if there is a revenue shortfall. Under this provision, if at any time after enactment of the biennial budget the Secretary of the Department of Administration determines that previously authorized expenditures will exceed revenues in either year of the biennium by more than 0.5% of the estimated general fund

appropriations for that fiscal year, the Secretary is required to immediately notify the Governor, the presiding officer of each house of the Legislature, and the Joint Committee on Finance of the revenue shortfall. Following this notification, the Governor is required to submit to the Legislature a bill containing the Governor's recommendations for correcting the imbalance between projected revenues and authorized expenditures.

The projected general fund balance for 2014-15 is estimated to be -\$283.4 million. Consequently, authorized expenditures exceed revenues by more than 0.5%. As indicated, if the s. 16.50(7) process is to be implemented, the Secretary of the Department of Administration must first submit notification of the shortfall to the Governor and Legislature.

General Fund Tax Revenues

The following sections present information related to general fund tax revenues for 2014-15 and the 2015-17 biennium. The information provided includes a review of the U.S. economy in 2014, a summary of the national economic forecast for 2015 through 2017, and detailed general fund tax revenue estimates for the current fiscal year and the next biennium.

Review of the National Economy in 2014

In January, 2014, this office prepared updated revenue estimates for the 2013-15 biennium based on IHS Global Insight, Inc.'s January, 2014, forecast for the U.S. economy. That forecast called for real growth in gross domestic product (GDP) of 2.7% in 2014 and 3.2% in 2015. Global Insight incorporated the following assumptions into its forecast for 2014: (a) that the federal discretionary spending level agreed upon in the Bipartisan Budget Act would remain in place; (b) emergency unemployment benefits would not be extended; (c) the Federal Reserve would reduce the amount of long-term securities it purchased by \$10 billion per month following each meeting; and (d) Brent spot prices for crude oil would remain between \$99 and \$108 per barrel. Global Insight also noted that projecting growth in the first quarter of 2014 was complicated by the impacts of a number of significant changes to federal programs, such as the start-up of the federal exchanges under the Affordable Care Act and the expiration of emergency unemployment benefits. In addition, the build-up of excess business inventory during the third quarter of 2013 and the October federal government shutdown were expected to be a drag on real GDP growth in the fourth quarter of 2013.

Real GDP contracted in the first quarter of 2014 by 2.1%, the sharpest quarterly decline in growth since the 2008-2009 recession. However, Global Insight noted that the contraction in the first quarter was primarily a function of the inventory cycle and abnormal weather. Inventory accumulation during the second half of 2013, which was a drag on first quarter 2014 growth rather than on the fourth quarter of 2013 as previously forecasted, coupled with an unseasonably cold winter during the first quarter of 2014, were the primary causes of the first quarter contraction rather than underlying weakness in the economy. Growth rebounded sharply over the next two quarters, ending 2014 with real GDP growth of 2.4%, which was 0.3 percentage points lower than was forecast in January, 2014. The second and third quarters of 2014 showed strong growth of 4.6% and 5.0%, but growth slowed to 2.6% in the fourth quarter. Slower growth in the fourth quarter of 2014 was affected by a reduction in federal defense spending,

which subtracted an estimated 1.4 percentage points from the quarterly growth rate.

Private sector employment grew in 2014 at the fastest pace since the recession, as an average of nearly 207,000 jobs per month were added. Despite these payroll gains, the labor force participation rate continued to decline to 61.4%, which is more than three percentage points lower than the pre-recession rate of 64.6% in 2007. Consumer spending accelerated in 2014, with growth in personal consumption expenditures (PCE) of 3.9% in 2014. PCE growth was strongest for net purchases of used motor vehicles and motor vehicle leasing.

Federal fiscal policy and Fed monetary policy were consistent with Global Insight's assumptions in its January, 2014, forecast. Discretionary spending remained at the levels agreed upon in the Bipartisan Budget Act and the emergency unemployment insurance benefits were not extended. A number of temporary tax breaks that were scheduled to expire following calendar year 2013 were extended through 2014 under the Tax Increase Prevention Act of 2014, including the federal research and development credit, bonus depreciation, higher Section 179 expensing limits, the deduction for state and local sales taxes, and certain deductions related to education. The Federal Reserve's tapering of long-term securities purchases, which began following the Fed's meeting in December of 2013, was completed following its October, 2014, meeting. Prior to tapering, the Fed was purchasing long-term securities of \$85 billion per month to keep downward pressure on interest rates to support the economic recovery.

Oil prices were in line with Global Insight's January, 2014, forecast during the first three quarters, but declined significantly during the fourth quarter of 2014. Brent spot oil prices were expected to be between \$99/barrel and \$108/barrel at the end of 2014; however, the Brent spot price in the fourth quarter of 2014 averaged \$78/barrel and continued to decline, ending 2014 at \$56/barrel. As of mid-January, average U.S. gasoline prices had, in turn, declined by \$1.55/gallon from their June 30, 2014, peak and were \$1.17/gallon below prior-year levels. According to Global Insight, reduced oil prices have been caused by increased U.S. production, OPEC countries continuing to retain market share rather than cutting production, and weak non-U.S. economic growth, particularly in Europe and China, reducing demand for oil. Lower gasoline prices provide consumers increased disposable income that can be used for other discretionary spending.

National Economic Forecast

Global Insight's January, 2015, forecast calls for accelerated economic growth in 2015, followed by slower, but positive growth in 2016 and 2017. The main drivers of faster growth in the short term are expected to be continued lower gasoline prices, income gains, and positive consumer sentiment. Conversely, low energy prices are expected to reduce investment in industrial equipment and nonresidential structures, particularly in the mining and petroleum sectors.

Global Insight must make certain assumptions regarding fiscal policy, monetary policy, foreign economic growth, and changes in commodity prices when constructing its forecast for the national economy. The forecast assumes that Congress will increase the debt ceiling prior to the mid-March 2015 deadline, rather than default on federal obligations, and that the Federal

Reserve will begin increasing the federal funds rate in June of 2015. It is also assumed that real GDP among major trading partners of the United States and other important trading partners will grow at average annual rates of 2.0% and 4.3%, respectively, over the next decade. In addition, the trade-weighted value of the dollar is expected to appreciate 5.7% in 2015. Finally, it is assumed that oil prices will bottom out in the second quarter of 2015, and then rise throughout the remainder of the forecast period. After averaging \$100/barrel in 2014, the Brent spot price is expected to average \$64/barrel in 2015, \$75/barrel in 2016, and \$84/barrel in 2017. Over the longer term, prices are expected to continue rising to \$145/barrel by 2024.

Gross Domestic Product. It is estimated that real GDP grew by 2.4% in 2014. Global Insight expects accelerated GDP growth of 3.1% in 2015, primarily caused by lower energy prices, which stimulates growth by increasing the amount of disposable income that consumers can spend on discretionary purchases. Real GDP is expected to grow at a rate of 2.7% in 2016 and 2017. Growth in nominal (current-dollar) GDP is expected to track a similar course, accelerating from 4.0% in 2014 to 4.9% in 2015, followed by a slight slowdown to 4.6% in 2016 and 2017.

Consumer Prices. The consumer price index (CPI) increased by 1.6% in 2014. Global Insight expects the CPI to remain nearly flat in 2015 at 0.1% growth, before increasing at a 2.3% pace in 2016 and 2.4% in 2017. The anticipated decrease in consumer prices in 2015 primarily reflects the aforementioned decline in energy prices. After rising by 2.4% in 2014, food prices are expected to increase by between 1.5% and 2.0% through 2017. As in recent years, core inflation (which excludes food and energy) is expected to be approximately 2.0% per year.

Monetary Policy. The Federal Reserve began tightening monetary policy from its very accommodative position following the Federal Open Markets Committee (FOMC) meeting in December of 2013. Prior to that meeting, the Fed had been purchasing \$45 billion of long-term Treasuries and \$40 billion of mortgage-backed securities each month in a process known as quantitative easing. These purchases were intended to exert downward pressure on interest rates in support of the economic recovery. After its meeting in December of 2013, the Fed began reducing these purchases until they were terminated in late October of 2014.

In addition to quantitative easing, the Fed has maintained the federal funds rate at less than 0.25% since early 2009. At its meeting in December of 2014, the Fed indicated that it would be appropriate to maintain the 0% to 0.25% target for the federal funds rate for a considerable time following the termination of quantitative easing. Based on this guidance, Global Insight expects the first rate increase to occur in June of 2015. As the impact of oil price declines diminishes, Global Insight expects that additional gradual increases will occur throughout the remainder of the forecast period. The average federal funds rate is expected to increase from 0.09% in 2014 to 0.44% in 2015, 1.56% in 2016, and 3.33% in 2017.

Among other benchmark interest rates in 2014, the yield on 10-year U.S. Treasury notes averaged 2.54% and the rate for a 30-year conventional fixed-rate mortgage averaged 4.17%. Global Insight expects average annual yields on 10-year U.S. Treasury notes to increase over the forecast period to 2.68% in 2015, 3.59% in 2016, and 4.21% in 2017. The average annual interest rate on 30-year conventional fixed-rate mortgages is expected to follow a similar pattern, rising to 4.35% in 2015, 5.43% in 2016, and 6.10% in 2017.

Personal Consumption Expenditures. Nominal PCE rose by an estimated 3.9% in 2014. Sales of items generally subject to the state sales tax (most durable goods, clothing, restaurant meals and accommodations, and other taxable nondurable goods and services) grew by 3.4% in 2014, while sales of nontaxable items (food for home consumption, gasoline, certain medical equipment and products, and most services) grew 4.2%.

Global Insight expects that wage gains in 2015 and 2016 should outpace consumer price increases. In 2015, growth in nominal PCE is projected to remain at 3.9% before accelerating to 4.9% in 2016 and 2017. Purchases of items subject to the state sales tax are expected to grow at a faster rate in 2015, led by strong growth in sales of new and used light trucks and motor vehicle leasing services. Sales of taxable goods and services are anticipated to grow 4.5% in 2015, 4.3% in 2016, and 4.6% in 2017. Conversely, expenditures for goods and services that are generally not subject to sales tax are expected to grow at a slower rate in 2015, before growing at a faster pace in 2016 and 2017. The forecast for nontaxable items is significantly affected by the anticipated drop and rebound in oil prices, which affect personal consumption expenditures of gasoline and other energy products. Sales of nontaxable goods and services are expected to increase by 3.5% in 2015, 5.4% in 2016, and 5.2% in 2017.

Personal Income. Personal income grew by an estimated 3.9% in 2014. Global insight expects personal income growth to accelerate through the forecast period, with growth of 4.4% in 2015, 5.0% in 2016, and 5.5% in 2017. Growth in personal income will be driven primarily by higher private sector wages and personal interest income over the forecast period.

Employment. The average unemployment rate for 2014 was 6.2%, an improvement from a rate of 7.4% in 2013. The unemployment rate is expected to continue to decline through the forecast period, dropping to an average rate of 5.5% in 2015, 5.3% in 2016, and 5.2% in 2017. The labor force participation rate has fallen each year from 2006 through 2014, declining a total of 3.2 percentage points from 64.6% to 61.4%. This trend is expected to reverse over the forecast period, with the labor force participation rate increasing to 61.6% in 2015, 61.8% in 2016, and 62.0% in 2017.

Total nonfarm payrolls reached their first quarter 2008 pre-recession peak of 138.3 million during the second quarter of 2014. Global Insight expects total nonfarm payrolls to continue growing over the forecast period, increasing to average payrolls of 141.7 million in 2015, 144.2 million in 2016, and 146.0 million in 2017. Private sector payrolls, which reached their prerecession level in the first quarter of 2014, increased 2.5 million in 2014 and are expected to increase an additional 2.8 million in 2015, 2.4 million in 2016, and 1.6 million in 2017. Public sector payrolls grew by an estimated 37,000 in 2014, and are expected to continue growing by 59,000 in 2015, 87,000 in 2016, and 210,000 in 2017 due to increases in state and local employment. Federal employment is expected to decline slightly. Public sector payrolls are not expected to reach prerecession levels over the forecast period.

Housing. The housing market showed mixed growth in 2014. Average interest rates for conventional 30-year fixed-rate mortgages increased slightly from 4.0% to 4.2%. Sales of new and existing homes decreased by 2.7%, as sales of existing homes declined by 151,000 while sales of new homes increased by 3,000. Sales of new and existing homes are expected to grow

by 10.4% in 2015 and 7.4% in 2016, and then decline by 1.3% in 2017. Conversely, at 993,000, the number of housing starts grew by 6.9% in 2014, and is expected to continue strong growth of 169,000 additional starts in 2015, 186,000 in 2016, and 148,000 in 2017. It should be noted that sales of new and existing homes and the number of housing starts remain 36% and 52% below 2005 peak levels, respectively, and Global Insight believes that single-family home sales have reached a new normal level, given the recent rate of household formation.

Home prices continued to climb in 2014 by 6.3%, but at a slower pace than in 2013. Growth in home prices is expected to decelerate in the first two years of the forecast, increasing by 4.4% in 2015, 2.0% in 2016, and 3.6% in 2017. Unlike new and existing home sales and housing starts, overall home prices now exceed pre-recession levels.

Corporate Profits. In 2014, before-tax profits grew at a relatively fast pace of 9.1% over the prior year. Global Insight projects that before-tax profits will grow at a 5.5% rate in 2015, but then contract by 0.1% in 2016 and 5.8% in 2017. Economic profits, which are not affected by federal tax laws, grew by 0.7% in 2014 and are expected to show strong growth of 10.6% in 2015, slower growth of 1.8% in 2016, and contract by 3.9% in 2017. Both before-tax and economic profits are expected to grow in 2015, primarily from accelerated GDP growth, but are expected to decline in the future years due to anticipated higher business costs from rising oil prices, rising corporate interest payments, and rising wage growth in a tightening labor market. Before-tax profits are expected to contract faster than economic profits due to the scheduled expiration of a number of temporary federal business tax provisions.

Business Investment. Business investment in equipment showed growth of 7.2% in 2014, and is expected to show continued, strong growth of 7.8% in 2015, 7.6% in 2016, and 5.8% in 2017. Investment in nonresidential structures grew by 10.8% in 2014, but is expected to decelerate sharply to 0.3% growth in 2015 before rebounding to growth of 6.1% in 2016 and 11.9% in 2017. Global Insight notes that lower oil prices, uncertainty over single-family housing starts, weak foreign economic growth, and appreciation of the U.S. dollar are expected to drag on equipment spending over the first three quarters of 2015.

According to Global Insight, the reduction in growth of nonresidential structures is primarily caused by an anticipated decline in mining and petroleum investment, which grew by 10.2% in 2014 but is expected to contract by 14.3% in 2015 and 1.2% in 2016 before growing by 11.2% in 2017. The forecasted drop in investments for nonresidential structures is the flipside to lower energy prices. The steep decline in oil prices will likely make U.S. shale oil extraction less profitable. The mining and petroleum sector accounted for 30% of total nonresidential structure investment in 2014, and Global Insight notes that the expected decline in drilling activity in response to lower oil prices will be a drag on GDP growth of 0.35 percentage points during the first two quarters of 2015.

International Trade. Exports increased \$77 billion (3.4%) in 2014 compared to increased imports of \$89 billion (3.2%), which increased net imports by \$12 billion. Weak foreign growth (particularly in Europe and China), continued U.S. growth, and a stronger dollar are likely to cause international trade to be a drag on U.S. economic growth as imports strengthen over the medium-term of the forecast period. The recent decline in oil prices coupled with increased

domestic production in North Dakota and Texas, which have reduced crude oil imports to the slowest pace since February, 1993, are expected to cause a drop in 2015 net imports, with oil imports bottoming out in the second quarter of 2015. The dollar value of imports is expected to decline by 1.9% in 2015 (primarily caused by a 39.9% drop in the total value of petroleum imports) before increasing 6.7% in 2016 and 7.6% in 2017. The dollar value of exports is expected to continue growing over the forecast period, with growth of 3.0% in 2015, 5.2% in 2016, and 5.5% in 2017.

The projections outlined above, which reflect Global Insight's baseline forecast, are summarized in Table 2.

TABLE 2

Summary of National Economic Indicators
IHS Global Insight, Inc., Baseline Forecast, January, 2015
(\$ in Billions)

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Nominal Gross Domestic Product	\$17,441.3	\$18,301.4	\$19,149.2	\$20,037.1
Percent Change	4.0%	4.9%	4.6%	4.6%
Real Gross Domestic Product	\$16,089.0	\$16,587.5	\$17,031.2	\$17,486.1
Percent Change	2.4%	3.1%	2.7%	2.7%
Consumer Prices (Percent Change)	1.6%	0.1%	2.3%	2.4%
Personal Income	\$14,715.3	\$15,355.6	\$16,125.5	\$17,015.8
Percent Change	3.9%	4.4%	5.0%	5.5%
Personal Consumption Expenditures	\$11,928.4	\$12,394.4	\$13,006.4	\$13,646.4
Percent Change	3.9%	3.9%	4.9%	4.9%
Economic Profits	\$2,121.2	\$2,345.9	\$2,389.3	\$2,296.3
Percent Change	0.7%	10.6%	1.8%	-3.9%
Unemployment Rate	6.2%	5.5%	5.3%	5.2%
Total Nonfarm Payrolls (millions)	138.88	141.71	144.20	145.96
Percent Change	1.8%	2.0%	1.8%	1.2%
Light Vehicle Sales (millions)	16.41	16.89	17.24	17.49
Percent Change	5.7%	2.9%	2.1%	1.4%
Sales of New and Existing Homes (millions)	5.356	5.911	6.348	6.265
Percent Change	-2.7%	10.4%	7.4%	-1.3%
Housing Starts (millions)	0.994	1.163	1.349	1.497
Percent Change	6.9%	17.0%	16.0%	11.0%

Global Insight's forecast also includes an optimistic scenario and a pessimistic scenario. The January, 2015, forecast assigns a 15% probability to the former. Under the optimistic

scenario, oil prices are lower than the baseline forecast, and U.S. drilling activity remains higher than anticipated as producers assume the current price per barrel of oil is temporary. Reduced oil prices encourage additional consumer spending on other items. Expanded monetary policy successfully stimulates growth in the Eurozone and emerging markets implement structural reforms to increase labor productivity, which results in an appreciation of foreign currencies relative to the dollar. Under this scenario, higher exports lead to significant domestic wage and payroll gains. Real GDP growth increases under the optimistic scenario to 4.0% in 2015, 3.9% in 2016, and 3.4% in 2017.

Under the pessimistic scenario (also assigned a 15% probability), household formation declines as compared to the baseline, partly because of poor wage growth, which depresses housing starts. Declining stock prices lower consumer confidence, causing consumption to fall compared to the baseline forecast. Slower foreign growth in the pessimistic scenario further weakens businesses, which slows payroll growth, and the Federal Reserve elects to maintain a near-zero level for the federal funds rate until 2017. Real GDP growth is reduced under the pessimistic scenario to 1.9% in 2015, 0.8% in 2016, and 1.8% in 2017.

General Fund Taxes

Table 3 shows general fund tax revenue estimates for 2014-15 and each year of the 2015-17 biennium. Over the three-year period, these estimates are \$3.3 million higher than the projections released by the Department of Revenue (DOR) last November. By year, the new estimate for 2014-15 is \$173.5 million lower than DOR's estimate, while the new estimates for 2015-16 and 2016-17 are higher than DOR's figures by \$110.9 million and \$65.9 million, respectively.

TABLE 3

Projected General Fund Tax Collections (Millions)

	<u>2013-15 Biennium</u>		<u>2015-17 Biennium</u>	
	<u>2013-14</u> <u>Actual</u>	<u>2014-15</u> <u>Estimated</u>	<u>2015-16</u> <u>Estimated</u>	<u>2016-17</u> <u>Estimated</u>
Individual Income	\$7,061.4	\$7,350.0	\$7,845.0	\$8,255.0
Sales and Use	4,628.3	4,880.0	5,030.0	5,190.0
Corporate Income & Franchise	967.2	935.0	970.0	960.0
Public Utility	361.0	377.9	366.8	373.4
Excise				
Cigarettes	573.0	556.5	551.0	545.5
Tobacco Products	67.7	69.3	71.4	73.6
Liquor and Wine	49.0	47.6	48.6	49.6
Beer	9.0	8.8	8.6	8.4
Insurance Company	165.8	176.0	181.0	187.0
Miscellaneous Taxes	<u>65.8</u>	<u>68.7</u>	<u>73.9</u>	<u>76.3</u>
Total	\$13,948.1	\$14,469.8	\$15,146.3	\$15,718.8
Change from Prior Year		521.7	676.5	572.5
Percent Change		3.7%	4.7%	3.8%

In 2014-15, the total variance of \$173.5 million is due primarily to the individual income tax and the corporate income and franchise tax. The new projection of individual income tax collections in that year is lower than DOR's estimate by \$149.8 million and the new estimate for the corporate tax is \$73.3 million lower. These figures reflect more recent collections data. Smaller differences are estimated for the other tax sources and in each of the two years of the next biennium.

With the exception of Section 179 expensing, which is discussed below, all of the estimates reflect year-to-date collections data, the most recent national economic forecast, and all federal and state tax law changes enacted to-date.

Section 179 of the Internal Revenue Code allows taxpayers to claim an immediate deduction for the cost of acquiring certain types of business property, instead of depreciating such property over its useful life. There is a limit on the annual amount that may be deducted (deduction limit), which is decreased on a dollar-for-dollar basis if the taxpayer's total annual investment in eligible property exceeds a specified threshold (investment limit). Beginning in 2003, the permanent deduction limit was scheduled to be \$25,000 and the investment limit was scheduled to be \$200,000. However, Congress enacted a number of temporary increases to these limits in an effort to stimulate business investment. Although these increases have been enacted with sunset dates, subsequent federal legislation has continued or increased the higher limits each year since 2003. Most recently, the deduction limit of \$500,000 and the investment limit of \$2 million were extended to tax year 2014 under the federal Tax Increase Prevention Act of 2014, which was passed in late December. These limits were first enacted in 2010 and have been extended twice since then. Beginning in 2014, state law automatically conforms to the federal Section 179 provisions. The revised individual and corporate income tax estimates shown in Table 3 reflect the higher deduction and investment limits in 2014, and assume that they will be continued indefinitely. This assumption reflects the expectation that Congress will continue to extend these provisions as it has done since 2003.

Individual Income Tax. Individual income tax revenues are estimated to total \$7,350.0 million in 2014-15, which represents a 4.1% increase relative to income tax collections in 2013-14 of \$7,061.4 million. Individual income tax revenues are estimated at \$7,845.0 million in 2015-16 and \$8,255.0 million in 2016-17. These amounts represent increases of 6.7% in the first year and 5.2% in the second year.

The January, 2015, Global Insight forecast projects national personal income growth of 3.9% in 2014, 4.4% in 2015, 5.0% in 2016, and 5.5% in 2017. However, personal income includes both taxable components, such as wage and salary disbursements, and nontaxable components, such as employer contributions for employee fringe benefits and government transfer payments to individuals. The taxable components of personal income are estimated to increase by 3.9% in 2014, 4.6% in 2015, 5.3% in 2016, and 5.7% in 2017. Personal income, as measured by the U.S. Bureau of Economic Analysis, does not include income from capital gains realizations, which are subject to state and federal taxation.

Year-to-date income tax receipts through December are 6.4% below 2013-14 collections. However, this growth rate is significantly affected by changes to the withholding tables that were

implemented last April. Over the remainder of 2014-15, it is anticipated that collections will increase by 15.1% due to several factors. First, refunds for tax year 2014 will be significantly reduced and final payments will be increased because of the decreased amount of withholding taxes paid since last April. Also, beginning in April, 2015, growth in withholding collections should improve significantly because the current-year receipts will no longer be compared to collections that were based on the previous, higher withholding tables. In addition, it is believed that federal tax increases enacted late in 2012 induced taxpayers to realize additional investment income in that year, which otherwise would have been realized in 2013. This is believed to have artificially suppressed collections last Spring, which should lead to a "bounce-back" this year. These positive impacts will be partially offset by the effects of state tax reductions, primarily the decrease in the bottom marginal tax rate enacted in 2013 Act 145 and the continued phase-in of the manufacturing and agriculture credit. As noted, for the entire year, income tax collections in 2014-15 are expected to be 4.1% higher than in 2013-14.

An above-average growth rate of 6.7% is estimated for 2015-16, primarily because a large one-time revenue loss associated with the withholding table changes will no longer occur. In 2016-17, the increase in individual income tax collections is estimated to more closely approximate the increase in personal income, as a more normal pattern of growth in tax collections returns.

General Sales and Use Tax. State sales and use tax revenues totaled \$4,628.3 million in 2013-14, and are estimated at \$4,880.0 million for 2014-15. The estimate represents an increase of 5.4% over the prior year. Sales tax revenues in the next biennium are estimated at \$5,030.0 million in 2015-16 and \$5,190.0 million in 2016-17, reflecting growth of 3.1% and 3.2%, respectively.

Sales tax collections through December, 2014, are 4.7% higher than the same period in 2013 and are projected to accelerate to 6.0% for the remainder of the 2014-15 fiscal year.

Corporate Income/Franchise Tax. Corporate income/franchise taxes are estimated to decrease from \$967.2 million in 2013-14 to \$935.0 million in 2014-15. Corporate income/franchise tax revenues are forecast to increase to \$970.0 million in 2015-16 and decrease to \$960.0 million in 2016-17. This represents a decrease in revenues of 3.3% in 2014-15, followed by a 3.7% increase in 2015-16 and a decrease of 1.0% in 2016-17.

The estimate for 2014-15 is based, in part, on year-to-date corporate income/franchise collections. Through December, 2014, collections were 8.5% lower when compared to the same period in 2013-14. A number of tax law changes, including the phase-in of the manufacturing and agriculture tax credit, the expansion of the historic rehabilitation tax credit, and the automatic adoption of federal law changes to Section 179 expensing provisions, will reduce corporate income/franchise tax collections in 2014-15.

Projected corporate income/franchise tax revenues for 2015-16 and 2016-17 reflect the forecast for economic profits through the remainder of the forecast period. The forecast incorporates state tax law changes that are anticipated to have an impact on future state tax revenues, such as the continued increase in the manufacturing and agriculture tax credit and the

expiration of a number of business tax credits pursuant to 2013 Wisconsin Act 20. As previously noted, it is assumed that Congress will continue to extend the current Section 179 provisions through the forecast period, which would automatically be adopted under state law and cause further reductions in state corporate income/franchise tax revenues over the 2015-17 biennium.

Public Utility Taxes. Public utility taxes are estimated at \$377.9 million in 2014-15, \$366.8 million in 2015-16, and \$373.4 million in 2016-17. These estimates represent year-to-year changes of 4.7% in 2014-15, -2.9% in 2015-16, and 1.8% in 2016-17. The gross revenues tax group comprises about 70% of estimated collections over the three-year period, and private light, heat, and power companies are the largest taxpayer group among gross revenues taxpayers. As such, they exert considerable influence on total utility collections, and private light, heat, and power company tax collections are estimated to increase 4.3% in 2014-15, decrease 1.4% in 2015-16, and increase 3.4% in 2016-17. This pattern is influenced by cold weather and increased natural gas prices in the first quarter of 2014, more normal winter weather and lower natural gas prices in subsequent periods, and declining or low growth in commercial and industrial electricity sales due to a sluggish recovery from the economic downturn. Companies subject to a state ad valorem tax comprise the other group of taxpayers with public utility tax liabilities. Collections from these taxpayers are estimated to increase 6.0% in 2014-15, but then decrease by 6.7% in 2015-16 and 1.8% in 2016-17. The decreases result from falling ad valorem tax rates and the loss of tax base due to depreciation and obsolescence.

Excise Tax Revenues. General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), tobacco products, and beer. In 2013-14, excise tax collections totaled \$698.7 million. Of this amount, \$573.0 million (approximately 82%) was from the excise tax on cigarettes. Excise tax revenues are estimated at \$682.2 million in 2014-15, which represents reduced revenue of 2.4%. The estimated reduction in excise tax revenues in 2014-15 is primarily from weak growth through December, 2014, in year-to-date cigarette tax collections, which are currently 3.1% lower than collections over the same period in 2013. Excise tax revenues over the next biennium are estimated at \$679.6 million in 2015-16 and \$677.1 million in 2016-17, which reflects reduced revenue of 0.4% in 2015-16 and 2016-17.

Insurance Premiums Taxes. Insurance premiums taxes are projected to increase from \$165.8 million in 2013-14 to \$176.0 million in 2014-15, \$181.0 million in 2015-16, and \$187.0 million in 2016-17. The 2014-15 estimate is based, in part, on year-to-date insurance premiums tax collection growth of 7.6%, whereas the estimates for 2015-16 and 2016-17 reflect historic growth trends and industry forecasts of premiums growth for most lines of insurance. The estimates reflect annual growth in insurance premiums tax revenues of 6.2% in 2014-15, 2.8% in 2015-16, and 3.3% in 2016-17.

Miscellaneous Taxes. Miscellaneous taxes include the real estate transfer fee, municipal and circuit court-related fees, and a small amount from the occupational tax on coal. Miscellaneous tax revenues were \$65.8 million in 2013-14, of which 78% was generated through the real estate transfer fee. Based on the economic forecast for the housing sector, as well as collections through December, 2014, miscellaneous taxes are projected to increase to \$68.7 million in 2014-15, which represents a 4.5% increase from 2013-14 collections. Miscellaneous taxes are estimated to increase to \$73.9 million in 2015-16 and \$76.3 million in 2016-17,

primarily due to an anticipated continuation of the housing recovery.

This office will continue to monitor state revenues and expenditures and new economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,

A handwritten signature in black ink that reads "Bob". The letters are cursive and stylized, with the "B" being particularly large and the "o" and "b" following in a fluid, connected script.

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature