A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

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CA Controller Reports State Revenues Fell Short of February Projections

California revenues of $6.52 billion for February fell short of projections in the governor's proposed 2017-18 budget by $772.7 million, or 10.6 percent, State Controller Betty T. Yee reported.

Recent month-to-month fluctuations have not developed a clear pattern. January revenues beat projections by 6.2 percent. The variance can often be as simple as one large payment due on the first of the month being recorded on the last day of the prior month.

Personal income taxes (PIT), corporation taxes, and retail sales and use taxes all fell short of January's revised budget estimates for February, and only corporation taxes—the smallest of the three—topped fiscal year-to-date projections in the governor's proposed 2017-2018 budget.

For the 2016-17 fiscal year that began in July, total revenues of $73.28 billion are $663.9 million below last summer's budget estimates, and $888.1 million short of January's revised fiscal year-to-date predictions.

February PIT of $3.12 billion was shy of projections in the governor's proposed budget by $5.3 million, or 0.2 percent. In the current fiscal year, California has collected total PIT receipts of $50.97 billion, or 0.9 percent less than January's revised estimate.

Corporation tax receipts of $168.2 million for February were 35.0 percent short of assumptions in the proposed 2017-18 budget. Fiscal year-to-date corporation tax receipts of $3.82 billion are 3.3 percent above projections in the proposed budget.

February sales tax receipts of $3.06 billion missed expectations in the governor's proposed 2017-18 budget by $710.2 million, or 18.8 percent. For the fiscal year to date, sales tax receipts of $16.29 billion are $613.5 million below the revised estimates released in January, or 3.6 percent.

The state ended February with unused borrowable resources of $27.44 billion, which was $3.27 billion more than predicted in the governor's proposed budget. Outstanding loans of $13.53 billion were $628.3 million higher than projected in early January.

For more details, read the cash report.

Inside this issue

Outdated Tax Structure Leaves "Modern" Roads Crumbling

In both human terms and in dollars, the cost of failing to invest in and maintain California's aging infrastructure raced to the forefront in February with the failure of the main and emergency spillways at the Oroville Dam in northern California.

A much less dramatic though deeper and more expensive failure is one we all grapple with: the day-by-day, year-by-year decline of California's roads and freeways.

> **California motorists and the state's economy are losing more than $50 billion a year [in related costs].**

A 2016 report by TRIP, a national transportation research group, explained the impact in a way any car owner can feel in the pocketbook: the state's poor road conditions are costing each driver in major metropolitan areas more than $1,800 a year.

California motorists and the state's economy are losing more than $50 billion a year in higher vehicle operating costs, lost productivity, reduced fuel efficiency, and car repairs.

While many funding streams are used to build and maintain the state's transportation network, the primary source has been the gasoline excise tax, now 27 cents per gallon. For decades, this was like a "user-fee" tax—the theory being that the wear and tear on roads comes from vehicles driving on them.

The approach worked well for the state when the miles per gallon (MPG) did not vary significantly between vehicles and overall fuel economy was relatively low. (According to the U.S. Energy Information Administration, the average for light-duty cars did not exceed 20 MPG until 1990.)

Slowly, technology and environmental policy surpassed tax and infrastructure investment policies. Today, the average light-duty vehicle gets 23.2 MPG, with others averaging 30, 40, 50, or 60-plus—a far cry from the 16 MPG average of 1980 or the 14.5 MPG average of 1956 when the state's modern highway system was born.

Now there are substantially more cars on the road using substantially less gas than their cousins from prior decades. That is overwhelmingly positive for the future health of our economy and our environment, but these improvements have unmasked the reality that California's method for

financing road repairs and improvements relies on poor fuel economy.

Combined with the fact the gas tax is not indexed to inflation—meaning a 1994 dollar is now worth 55 cents—it is easy to understand why California roads are in the condition they are today.

The failure of our transportation infrastructure stems from a lack political will to raise the money needed to maintain a system once the envy of the nation. The FY 2016-17 state budget includes a transportation funding package. Legislative leaders have put forth a number of valuable ideas as well. The common thread? Money. Fixing this problem will not be quick, and it will not be cheap.

However, addressing this transportation infrastructure deficit is critical to maintaining California's economic health and demands attention now.

Understanding the New Employment Credit

To promote net new job hires in California, the state's New Employment Credit (NEC) is available for taxable years beginning January 1, 2014, and before January 1, 2021.

Prior to 2014, California law provided tax incentives for those conducting business in designated enterprise zones (EZs), including the EZ Hiring Credit. When research showed the EZ Hiring Credit added to program costs without creating a net increase in jobs, the EZ Hiring Credit was repealed and replaced with the NEC. Unfortunately, the NEC is being underutilized.

When the NEC was enacted, FTB estimated that $22 million in credits would be claimed for the 2014 tax year and $69 million for 2015 tax year. Based on the year-to-date return data available to FTB, taxpayers claimed $3.9 million in credits on 2014 tax returns and $1.7 million on 2015 tax returns.

To obtain a NEC, a qualified taxpayer must hire a qualified full-time employee on or after January 1, 2014. That employer must also pay qualified wages for work performed by the employee in a designated geographic area (DGA), receive a tentative credit reservation from the California Franchise Tax Board (FTB), and certify each qualified employee annually.

The NEC is based on 35 percent of qualified wages, or wages between 150 percent and 350 percent of minimum wage. To generate an allowable credit, the qualified taxpayer must have a net increase in the total number of full-time employees in California.

A qualified taxpayer is an employer engaged in a trade or business within a DGA who hires a qualified employee to work an average of at least 35 hours per week, among other requirements.

The employer cannot be engaged in any excluded business (temporary help services or retail trades, and those primarily in food services, alcoholic beverage places, theater companies and dinner theater, or casinos and casino hotels—unless considered a small business) or be engaged in a sexually-oriented business.

To be considered a qualified employee, one must be: unemployed for the six months immediately preceding employment, or a veteran who has not been employed since separation from service, or a recipient of the federal earned income tax credit for the previous taxable year, or an ex-offender immediately preceding employment.

FTB staff have identified potential changes in the program that could increase NEC utilization. One proposal is to expand the DGAs to census tracts beyond the highest unemployment and poverty areas in California. Other ideas for boosting participation include removing some of the restrictions of a qualified employee, changing the range of qualifying wages, removing the reservation requirement, removing some businesses from the exclusion list, and increasing the credit percentage.

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www.sco.ca.gov

EOinquiry@sco.ca.gov

P.O. Box 942850
Sacramento, California 94250-5872
(916) 445-2636

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