Driven by another strong month of personal income tax proceeds, state revenues in October beat estimates by $191.9 million, or 3.1 percent, State Controller Betty T. Yee reported.

Personal income tax revenues of $5.1 billion for the month exceeded projections in the state budget signed in July by $234.5 million, or 4.8 percent. That was more than enough to offset lower-than-expected collections from the state’s two other largest revenue sources, the retail sales and use tax and the corporation tax. Sales tax revenue of $935.0 million fell short of projections by $2.0 million, or 0.2 percent. The corporation tax missed estimates by $89.8 million, or 33.5 percent.

For the fiscal year that started July 1, state revenues are $542.9 million, or 1.9 percent, greater than estimated, with strong collections from the personal income tax erasing shortfalls in the retail sales and use tax and the corporation tax. Revenues from the personal income tax are running $840.7 million, or 4.3 percent, above expectations for the fiscal year so far. Retail sales and use taxes have fallen short by $381.1 million, or 5.5 percent, while the corporation tax to date has brought in $190.4 million, or 11.5 percent less than expected.

Total revenue in October of $6.4 billion was 5.7 percent higher than a year ago, with both the personal income tax and the retail sales and use tax outstripping last year’s collections. Compared to the first four months of the prior fiscal year, revenues to date of $29.8 billion are 7.1 percent higher.

This month’s edition of the Controller’s California Fiscal Focus examines whether growing income inequality will lead to geographic disparities and new challenges for policymakers.

The state ended October with unused borrowable resources of $20.4 billion — $2.2 billion, or 12.4 percent, greater than projections. This is money available to the General Fund, the source of most state spending, from other funds to even out variability in revenue and disbursement patterns. For the first time in 15 years, these special fund monies appear to be sufficient to meet the cash flow needs of the General Fund without the state having to seek external loans, such as revenue anticipation notes.

For more details, read the monthly cash report.
From the pope to French economist Thomas Piketty, people are talking about income differences. Last month, University of California, Berkeley professor Robert Reich published a book outlining the societal stresses associated with the widening gap. In the U.S. since 1977, these disparities have grown in many states, including California.

A study conducted by the Center on Budget and Policy Priorities compared average household incomes in 1977-79 and 2005-07, after indexing all incomes to 2009 constant dollars. The Center grouped average household income by quintile cohorts and the top 5 percent cohort. Researchers then compared the averages for 1977-79 to 2005-07.

For the U.S. as a whole, the Center showed that the average household income in the poorest quintile experienced real income growth of about 6.9 percent for the 30-year period. The middle quintile grew more, about 26.9 percent, while the top 5 percent experienced even greater growth of 114.9 percent.

The poorest Californians saw their income grow at about half the national rate for that cohort while the income of the richest Californians increased slightly faster than the national average. Real household incomes grew by an

(See INCOME DISPARITY, Page 5...)
Taxpayers across the country have now filed two of their four estimated payments for the 2015 tax year. Most states report significant year-over-year increases in tax revenue attributable to investment income, with a median gain of 13.4 percent. Of the 39 states reporting estimated payments, only Louisiana and Rhode Island saw a decrease. At the high end, Kansas and New York recorded increases over 26.0 percent (Figure 2). California reported an increase of about 17.8 percent.

Do increases like this mean that taxpayers are anticipating higher tax liabilities on investment income in 2015? Maybe not, according to a recent study by the Rockefeller Institute. During the base period in the first half of 2014, taxpayers may have been anxious about taking investment gains until (See ESTIMATED PAYMENTS, Page 5...
January. The shortfall stayed in the range of $10.0 billion until the state received revenue from April 15th personal income tax returns. The cumulative deficit began to improve, but did not break through to positive territory until May 2014, two months before the end of the fiscal year (Figure 3).

Generally, the deep monthly deficits in September, October, November, December, March, and April posed the greatest cash challenges. Assuming the state’s revenue payment schedules do not change during the year, budget managers can meet these challenges through short-term borrowing or changing the timing of disbursements.

If the state had delayed monthly disbursements of $2.5 billion from September, October, and November until 2014, it could have limited the depth of the cash deficit to $10 billion.

The October issue of *California Fiscal Focus* noted that differences in monthly spending and revenue patterns caused the state to run daily cash deficits for the first five months of the 2013-14 fiscal year.

These daily cash deficits accumulated so that, after August, the cumulative shortfall was consistently more than $5.0 billion, growing to $15.0 billion in November before shrinking temporarily to less than $5.0 billion in January. The shortfall stayed in the range of $10.0 billion until the state received revenue from April 15th personal income tax returns. The cumulative deficit began to improve, but did not break through to positive territory until May 2014, two months before the end of the fiscal year (Figure 3).

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Congress clarified its intentions on changing federal tax law. Later in the year, as taxpayer anxiety abated (and the stock market improved), estimated payments did increase. Consequently, the large year-over-year change in early estimated payments may reflect unusually low activity in the first six months of 2014, and may not be an indicator of the relative strength of 2015 in total.

However, should estimated payments remain strong for the rest of the year, the state can expect improved revenues associated with investment income such as capital gains. The Governor’s Department of Finance estimates that taxes attributable to capital gains for the 2014 tax year were $11.9 billion.

With real incomes of the state’s wealthiest citizens growing so much faster, the tax burden for the wealthiest citizens is likely to grow commensurately. Could the state’s increasing reliance on the wealthiest taxpayers lead to greater year-over-year revenue volatility? Could these increasing tax burdens lead to calls for tax reductions or comprehensive tax reform?

Will the growing income gap lead to calls for expanding income-transfer programs such as the state Earned Income Tax Credit or Medi-Cal?

If the income differential manifests itself among regions, will policymakers face pressures to target state assistance to some cities and counties over others?

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