BULLETIN

Federation of Tax Administrators • 444 North Capitol Street, N.W., Washington, D.C. 20001 • (202) 624-5890

B-112
October 18, 1990

FTA REVENUE ESTIMATING AND TAX RESEARCH CONFERENCE
Summary of Proceedings

To State Tax Administrators:

SUMMARY

The 45th Annual Revenue Estimation and Tax Research Conference was held from September 30th through October 3, 1990 in San Francisco, California. This Bulletin summarizes a number of the papers presented at the conference. Proceedings of the conference are not published; readers are asked to contact FTA for papers in which they are interested. A listing of the papers currently available from FTA is appended.

The 45th annual FTA Revenue Estimating and Tax Research Conference was held in San Francisco, California from September 30th through October 3, 1990. Presiding over the conference was Robert Affleck, Director of Research of the California Franchise Tax Board and Chair of the FTA Research Section. The conference was hosted by the Franchise Tax Board and its Executive Officer Gerald H. Goldberg.

The conference examined important issues facing state revenue estimating and tax research officials today. The major economic forecasting firms presented their projected outlook for the U.S. economy as a whole, the geographic regions and various industrial sectors. The conference attendees were also kept up-to-date on the latest news from the Budget Summit between the Administration and Congress, which was being held at the same time. Also included were discussions of data generation and tax modeling activities, revenue estimating issues, and tax compliance research by the different states. In addition, the attendees were given the chance to discuss revenue estimating and research experiences among their colleagues in smaller regional roundtable groups. The final day of the conference saw discussion on various topics including the impact of the Pacific Rim countries, state taxation of financial institutions, the effects of federal excise tax changes on state revenues, and real estate transfer taxes.

Economic Outlook

Cynthia Latta of DRI McGraw Hill and Nariman Behravesh of Oxford Economics USA presented their forecasts for the U.S. economy. Neither forecast explicitly accounted for the recent run-up in oil prices due to the August invasion of Kuwait by Iraq. Both individuals noted, however, that the U.S. economy is better able to absorb these shocks and avoid a recession than it was in the 1970's. Still, a worsening situation in the Middle East could further increase oil prices and raising the probability of a recession in an already weak economy. Even before the recent oil price shock, the forecasters noted the economy was slowing. Following a 2.5 percent growth rate in 1989, they expect the economy to grow about one percent or less in

1990 with a modest improvement in 1991. While the export boom that drove the economy in the late 1980's is over, they both noted a lower value of the dollar and strong economies in other countries will lead to an increase in exports (although not the boom of 1988).

Behravesh also discussed how the U.S. economy has become more resistant to outside oil shocks. He noted that the oil crises of 1975 and 1979 lead to a wealth transfer to oil exporting countries, totalling 2 percent of the importing nations' gross domestic product. However, with the increased efficiency in the oil consuming countries, an equivalent oil price increase today ($40-$50 per barrel) would lead to less than a 0.5 percent wealth transfer. Over the long term, he sees lower inflation during the 1990's, with exports continuing to drive growth as the U.S. becomes more integrated in the world economy.

Latta, emphasizing the impact on the different sectors of the economy, pointed out the grim financial outlook for the states. She expects the economic slow-down to affect all three major tax sources. The rate of growth in personal income is expected to continue to slow, increasing in real terms by less than one percent during 1991. Retail sales are forecasted to remain sluggish. Corporate profits, following a decline in FY1990, are expected to grow slowly in the early 1990's. Meanwhile, growth in medical care and rising unemployment will put added pressure on state budgets. In presenting the forecast for selected industries, she expects the decline in the home construction industry to continue as the excess supply shrinks to meet a smaller home buying population. Investment in new machinery will also slow as the stock of industrial equipment has caught up with demand.

Thomas Swanstom, chief economist for Sears Roebuck and Co., presented his outlook for retail sales. While many news stories have painted a gloomy picture of retail trade, he points to strong retail sales figures reported by major chain stores. He does note that consumer durables have been weak, due to declining consumer confidence and a weak housing market. Retail sales in some regions -- notably the Northeast -- have been weaker than the rest of the nation. He also noted that computer sales were off in 1990, but expects them to rebound in 1991. Altogether, he forecasts a slow, but increasing, economy with the inflation rate falling.

Douglas Drake of the Michigan Department of Management and Budget presented his forecast of automobile sales and production. Citing lower disposable income growth and rising gasoline prices, he forecasts declining motor vehicle sales in 1990-91. He presented data on the capacity utilization of light vehicle assembly plants and their location in the country and listed 18 plants in 7 states and 3 Canadian providences that have a chance of being shut-down during the next two years. Revenue estimators in these state will need to investigate the effects of such closures in making their forecasts.

John Kort discussed a Bureau of Economic Analysis (BEA) project that estimated regional trends in employment, income and population to the year 2000. The estimates represent baseline trends and do not reflect any policy change or economic shock (e.g., recent oil price increase). Overall, the BEA projects employment growth to slow from 1.92 percent in the 1980's to 1.12 percent in the 1990's, earnings from 2.02 percent to 1.94 percent, and personal income from 2.56 percent to 1.96 percent. After converging toward the national average, personal income in the different census regions has begun moving away from the U.S. average during the 1980's. Kort pointed out that this trend is expected to reverse in the 1990's with personal income expected to become more equal among census regions.

Federal & State Fiscal Outlooks

Kathleen O'Connell with the U.S. Congressional Budget Office discussed how they revised the federal revenue estimates to take into account current collection trends. Gerald Miller, director of the National Association of State Budget Officers (NASBO), discused the fiscal condition of the states as included in the 1991 budgets.

According to Miller, the period from 1983-1989 was one of strong growth at the state level, with budgets increasing in real terms at a rate of 3.5 percent annually. As a result, states had the highest ever ending balances in 1989 totalling $12.5 billion, or 4.8 percent of expenditures. However, the slow down in economic growth in 1990 hit many states hard, as actual tax collections were below original forecasts in 28 states. The slow down in revenue growth caused many states to draw down balances from previous years, leading to a total state operating deficit of $3.5 billion. In their 1991 budgets, 36 states have increased taxes raising an estimated $10.3 billion in new revenue. However, he notes that the weak economy is further eroding many states fiscal condition as current collections are coming in below projections. As a result, many states have begun revising their revenue estimates downward and adn have or can be expected to reduce enacted budgets.

Kathleen O'Connell noted a similar trend in forecasting federal tax collections. Federal forecasts for 1988 and 1989 collections were $9 billion and $8 billion under actual collections, respectively. Meanwhile, the weakening economy caused tax collections to slow and led to a $22 billion downward revision in the CBO's summer forecast of 1990 compared with their winter projections. While most of the revisions were classified as technical corrections caused by the lower than anticipated tax collections, she noted that the change in economic conditions may explain most of this correction once more data become available. The personal income tax estimate required the largest adjustment -- revised downward by $22 billion -- while the corporate tax estimate was revised downward by $3 billion. Altogether, the CBO is projecting total revenue of $1,040 billion for FY 1990, with the final data not becoming available until late October.

The keynote luncheon address was delivered by John Shannon, senior fellow with the Urban Institute and former Executive Director of the Advisory Commission on Intergovernmental Relations. He discussed discussed trends in intergovernmental relations and competition among federal and state governments over time. He noted that over the course of history, states have at times been in the dominant position and that other times, particularly in times of war and since World WarII and the Korean War, the federal government was the preeminent player in the intergovernmental arena. The federal retrenchment of the late 1970's and 1980's, coupled with the fiscal straits in which the federal government finds itself, has led to a period of relative balance in power among the levels of government. He notes, however, that it is a very competitive situation -- one he terms "fend for yourself federalism.

Federal Activities

Patrick Driessen, an economist with the Joint Committee on Taxation, discussed some of the work his office has done to support the budget summit participants. Gerald Miller (NASBO) discussed some proposals in the agreement with the greatest impact on state finances. While the final federal budget package may deviate from the summit agreement, a brief discussion of the issues presented at the conference may still prove helpful.

The Joint Committee on Taxation (JCT) is the agency responsible for estimating the revenue impact of the different tax proposals before Congress. Driessen pointed out how some of the different issues affected the type of analysis performed this year. Congress, reflecting the renewed interest in the progressivity issue, required the Joint Committee to estimate the distributional effects of each tax proposal by income class. Driessen particularly addressed the estimates (and difficulties in arriving at such) underlying the small business incentives and the proposal to disallow the deduction of interest on corporation tax deficiencies.

The budget agreement included several proposed changes that could adversely affect state finances. Gerald Miller noted that the proposed excise tax increases would affect states' collections from the same source, referring the attendees to Billy Hamilton's presentation during the conference. (See below.) The proposal to reduce itemized deductions for households with AGI over $100,000 may affect some states' income tax revenue depending on how they conform to the federal tax. The summit agreement would also extend social security payments to state and local employees not covered by a state pension plan, and increase some Medicaid program costs. These would require an increase in state spending which many states cannot afford. Another proposal limiting the interest deduction on deferred federal taxes would speed-up some federal collections and may also speed-up state tax payments.

Current Issues in State Finance

During the final day, the conference participants heard talks on several issues of importance to state revenue estimators. Ramon Moreno, an economist with the San Francisco Federal Reserve Bank, discussed the rising influence of the Pacific Rim countries on the U.S. economy. He noted that the rapid growth of the Pacific Rim counties has lead to a shift in international trade from the Atlantic to the Pacific coast. While Great Britain is still the largest foreign holder of U.S. assets, Japan now ranks second. The result has been increased competition making U.S. firms more competitive and spurring many discussions among state officials on improvements to education. However, the changing world economy has also hurt some industries, costing jobs and tax revenues in some regions, while also making U.S. more vulnerable to shocks in the world financial markets. Overall, he concludes that increased world trade has improved U.S. economic growth, noting that the only countries declining economically have been those that are closed to world trade.

Dan Bucks, Executive Director of the Multistate Tax Commission, called for an increase in cooperation among tax departments in conducting research on interstate and multistate issues. He pointed out how the U.S. economy is shifting toward a more interstate and international market making it difficult for any single state to fully understand its tax base. He lists 7 trends that have undermind individual state revenue estimations and tax collection efforts: (1) The shift to service oriented economy whose consumption may be in more than one state. (2) The shift to a global economy leading to complex issues such as nexus, transfer pricing etc. (3) Smaller companies are increasingly operating in a interstate environment greatly increasing compliance costs. (4) Business have developed more complex corporate organizations that the current tax system does not address. (5) Growth of intangibles which easily cross state borders. (6) Growth of telecommunications has lead to businesses operating in a state without any physical presence. (7) The increase in large conglomerates who operate more than one type of business that states tax differently (i.e. retail, finance or telecommunications). Bucks believes that only by sharing of information and working together, can states solve these problems and forestall federal government intervention.

Recent trends in deregulation and increased interstate banking have caused problems in the way some states tax financial institutions. William Fox from the University of Tennessee discussed these trends and possible solutions. He notes that deregulation has resulted in non-bank corporations entering the financial market, while banks are expanding into other types of businesses. In addition, the growth of branchless and interstate banking (credit cards) has led to a more mobile financial sector which can move to states with favorable tax laws. The solution, according to Fox, would be to use a franchise tax based on income and a destination principle. His ideal tax would define the situs as to where the loan proceeds are applied if it can be determined, or the location of the collateral. A single factor apportionment formula basesd on receipts would be used to keep financial institutions from moving property and payroll to low tax states. And finally, combined reporting could be used to provide consistent data for the different states, greatly easing enforcement. He believes that this type of tax would not drive banks to other states, while raising sufficient revenues from financial institutions.

Billy Hamilton present the results of the study KPMG Peat Marwick developed for the National Conference of State Legislatures on state revenue losses from federal excise tax increases. Increases in federal excise taxes would raise the price to consumers causing them to reduce the amount they purchase. Since most states impose excise taxes on consumption volume, rather than a value basis, the reduction in sales could cost the states $6 billion over a five-year period. An increase in the gasoline tax would prove the most costly, accounting for $4 billion of the total loss.

Finally, Jeff Clark with the Delaware Division of Revenue discussed their analysis of real estate transfer taxes. While these taxes are relatively minor revenue sources for many states, some have expressed concern that they produce greater market distortion in the housing industry. The author analyzed transfer taxes based on the hypothesis that they are alternatives to the conventional property tax. By examining the present value of transfer and property taxes, he finds that transfer taxes are more progressive than property taxes. He concludes by encouraging more states to examine this tax in more detail.

Other Topics

On Tuesday, participants were able to attend several concurrent break-out sessions dealing with special topics of revenue estimating, data generation, tax modelling and tax compliance. Tax modelling issues discussed included testing the sensitivity of Hawaii tax receipts to global economic changes, microsimulation modelling on personal computers, menu systems for tax modelling, and the Texas sales tax model. Data generation issues included enhancing tax return data files, the availability of 1990 census data, and extrapolation of individual income tax data bases.

Revenue estimating topics were presented dealing with federal and state income tax trends as well as tracking and monitoring state revenue estimates. Also discussed were Ontario's corporate revenue estimating techniques, analyzing the New York City corporate tax shortfall and using financial return data in estimating corporate tax receipts. Due to the growing interest in taxing services, one session examined these issues with New York and Massachusetts discussing their experiences. Others talked about their experiences in estimating sales tax revenues. Compliance research was discussed by several speakers from the IRS, GAO, JCT, and Washington Department of Revenue.

Further Information

FTA does not publish the proceedings of the Revenue Estimating and Tax Research Conference. Interested persons, however, may obtain copies of papers presented at the conference from FTA if a complete paper was submitted. Listed below are the papers which can be obtained from FTA. If there were topics listed for which no paper appears, and you wish further information, please contact us and we can put you in touch with the presenter.

CONFERENCE PAPERS

Cynthia Latta, DRI/McGraw Hill, "The U.S. Economic Outlook For the Early 1990's," tables accompanying discussion.

Cynthia Latta, DRI/McGraw Hill, "The Outlook for the Northeast in the Early 1990's," tables accompanying discussion.

Thomas Swanstrom, "Outlook for Retail Sales," tables accompanying discussion.

Douglas Drake, Michigan Department of Management and Budget, "The Automotive Outlook," tables accompanying discussion.

John Kort (with Kenneth Johnson and Howard Friedenberg), "Regional and State Projections of Income, Employment, and Population to the Year 2000," reproduced from Survey of Current Business, BEA, May 1990.

Kathleen O'Connell, Congressional Budget Office, "Recent Developments in Federal Revenue Estimates."

John Shannon, The Urban Institute, "Intergovernmental Competition: American Federalism's Invisible Stabilizer."
Billy Hamilton, KPMG Peat Marwick, "The Effect on Federal Excise Tax Changes on the States."
Jeff Clark, Delaware Division of Revenue, "Realty Transfer Taxation."
Lee McPheters, Arizona State University, "Job Growth Update -- Ranking the States & MSAs."
Jim Benson, Minnesota Department of Revenue, "Microsimulation Modelling on a Personal Computer," outline of remarks.
David Bidner, Ontario Ministry of Treasury and Economics, "Ontario Corporations Tax Revenue Forecasting," tables accompanying discussion.
Stanley Chervin, Tennessee Department of Revenue, "Estimates of Monthly Retail Sales -- Flash Versus Lagged Estimates."
Eric Cook, Price Waterhouse, "Extrapolation of Individual Income Tax Data Bases," tables accompanying discussion.
Patrick Driessen, Joint Committee on Taxation, "Estimating Compliance Proposals in the Transfer Pricing Area."
Steven Galginaitis, KPMG Peat Marwick, "Menu Systems for Tax Modeling: Opening the Door to More Users."
Laird Graeser, New Mexico Taxation & Revenue Department, "Sales and Use Taxes -- Gross Receipts Taxes -- Trends."
Rita Grieco, U.S. General Accounting Office, "Estimating Enforcement-Related Revenues: The GAO Work," outline of remarks.
William Lefbom, Internal revenue Service, "Overview of the IRS's Taxpayer Compliance Measurement Program."
Thomas Neubig, Price Waterhouse, "Using Financial Return Data in Estimating Corporate Tax Law Changes and Receipts," tables accompanying discussion.
Stephen Pollock, KPMG Peat Marwick, "Enhancing Tax Return Data Files: Practical Solutions."
Brad Reynolds, Texas Comptroller of Public Accounts, "Sales Tax estimation Model -- State of Texas," tables accompanying discussion.
George Sweeting and Kathy Barnett, New York City Department of Finance, "Analyzing the Corporate Tax Shortfall -- the Case of New York City," tables accompanying discussion.
Brad Williams, "Recent Trends in California Income Taxes," tables accompanying discussion.
Bob Zuraski and Hy Sanders, Coopers & Lybrand, "Problems in the Estimation of Sales Taxes on Services."