

Forecasting Federal Actions: Unraveling the April Surprise

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[State and Local Finance Initiative](#)

Urban-Brookings Tax Policy Center



Revisiting 2012

- Economy still weak
 - Few states had recovered employment peak
 - 20 states had not recovered peak tax revenue
- Federal Spending
 - Government shutdown fall 2012
 - Austerity
- **Looming Fiscal Cliff – 12/31/2012**

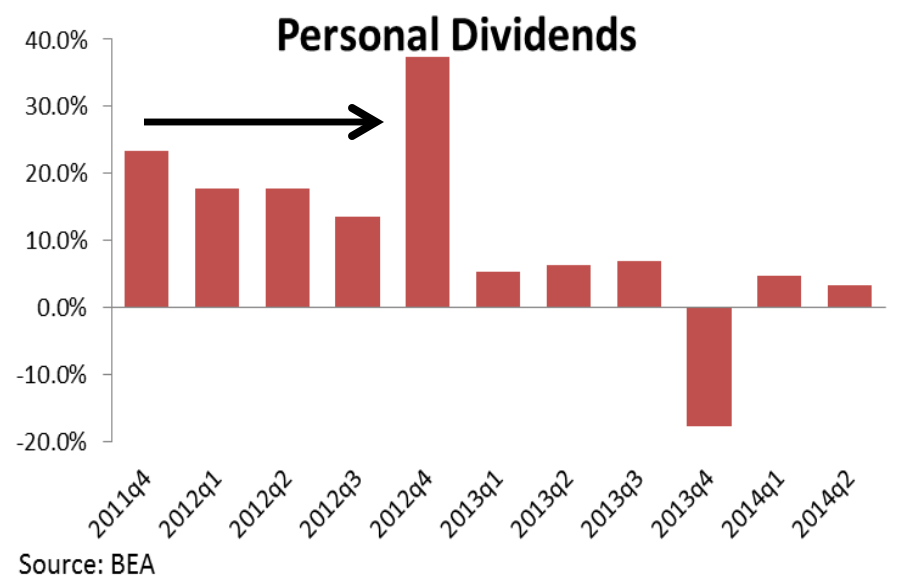
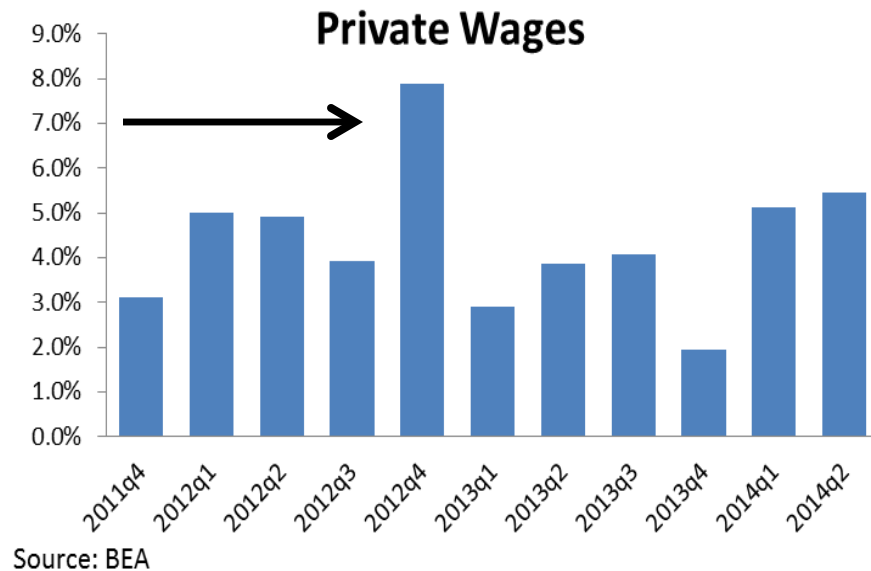
Fiscal Cliff: Federal Tax Uncertainty

	<u>2012</u>	<u>2013</u>	<u>2013 w Affordable Care Act</u>	<u>Current Law 2013</u>
Top rate on ordinary income	35	39.6	43.4	43.4*
Top rate on capital gains income	15	20	23.8	23.8
Top rate on dividends	15	39.6	43.4	23.8

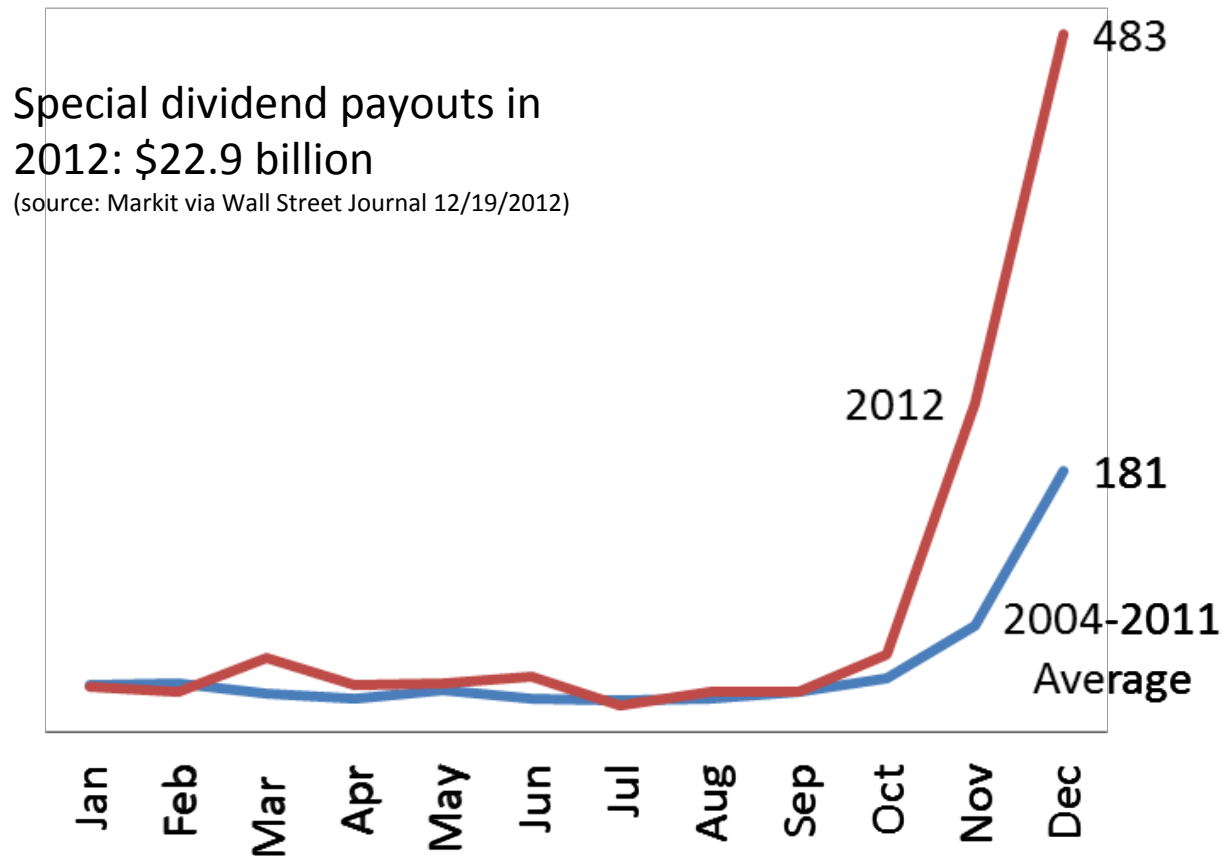
* The 3.8 percent tax applies to the smaller of investment income and the excess of AGI over the thresholds—\$250,000 for married couples filing joint tax returns and \$200,000 for others. Limiting the investment subject to tax in that way prevents taxpayers from facing substantial tax increases over a short income range at the threshold. (TPC 2012)

Tax Year 2012 Ended With a Bang

- IRS Data from 2012:
 - Capital Gains Income increased 65% in 2012
 - Dividend income increased 34% and qualified dividend income grew by 44 percent
- BEA Quarterly Data:
 - 2012q4 private wages grew 7.9% (Bonuses?)
 - Personal Dividends grew by 37.5%



Year-end Dividend Announcements Soar



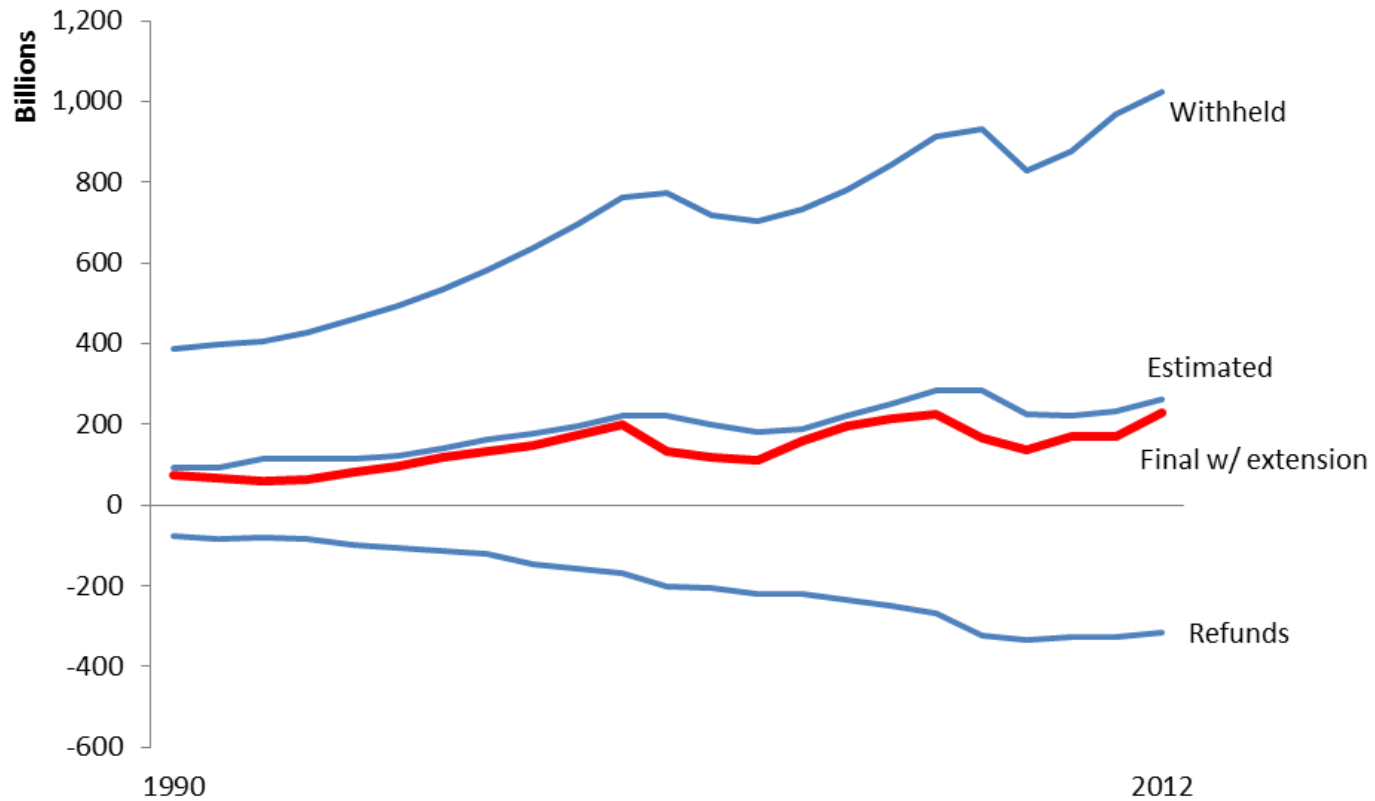
Source: S&P Dow Jones Indices

Capital gains strong in 2012



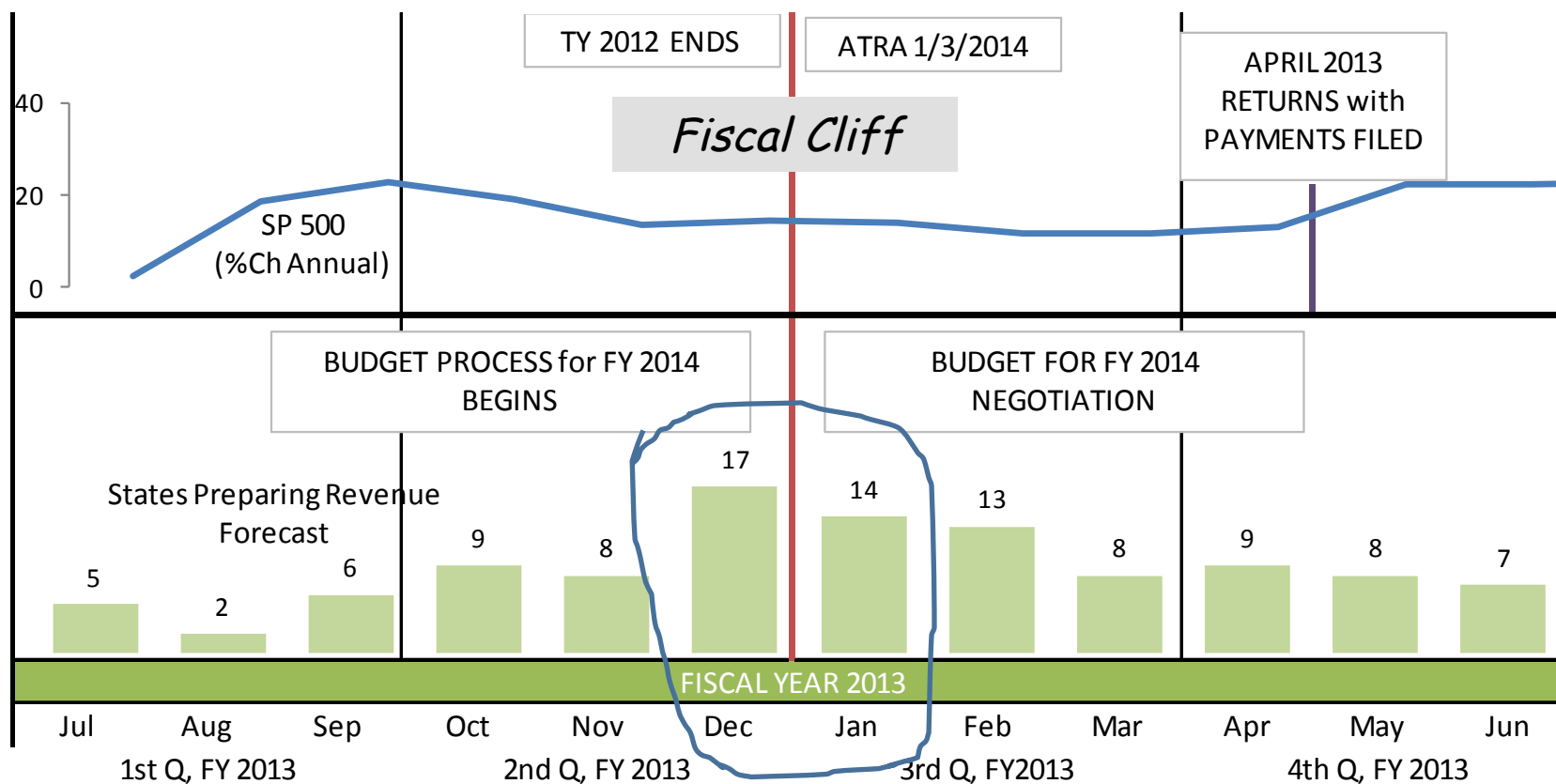
Source: CBO February 2014 Budget and Economic Outlook; Standard & Poors; Author's calculation

Federal Income Tax Payments



Source: IRS

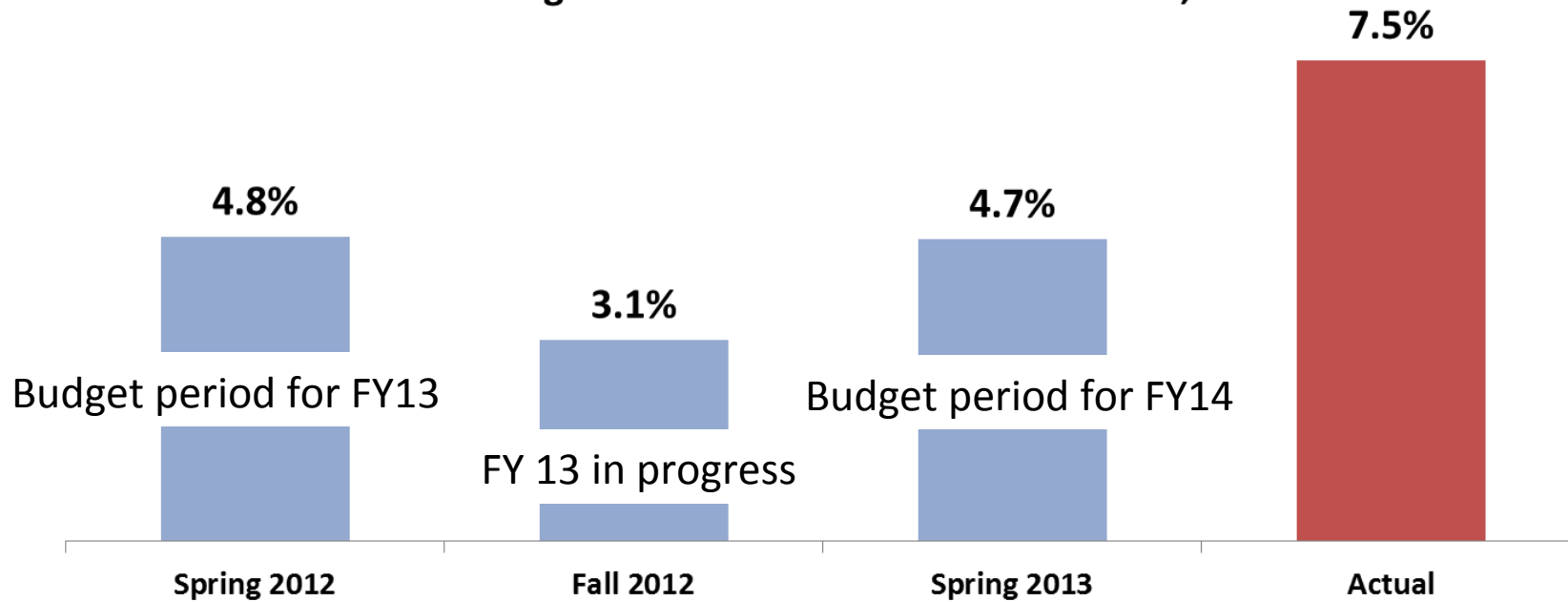
Timing All Wrong for States



- Most states have to prepare revenue forecast in Fall and Winter for budget season
- Budget is negotiated (and often passed) before April returns are known

April 2013 Surprise

Forecasting State Personal Income Tax Growth, FY 2013



Note: California and states without income taxes are excluded.

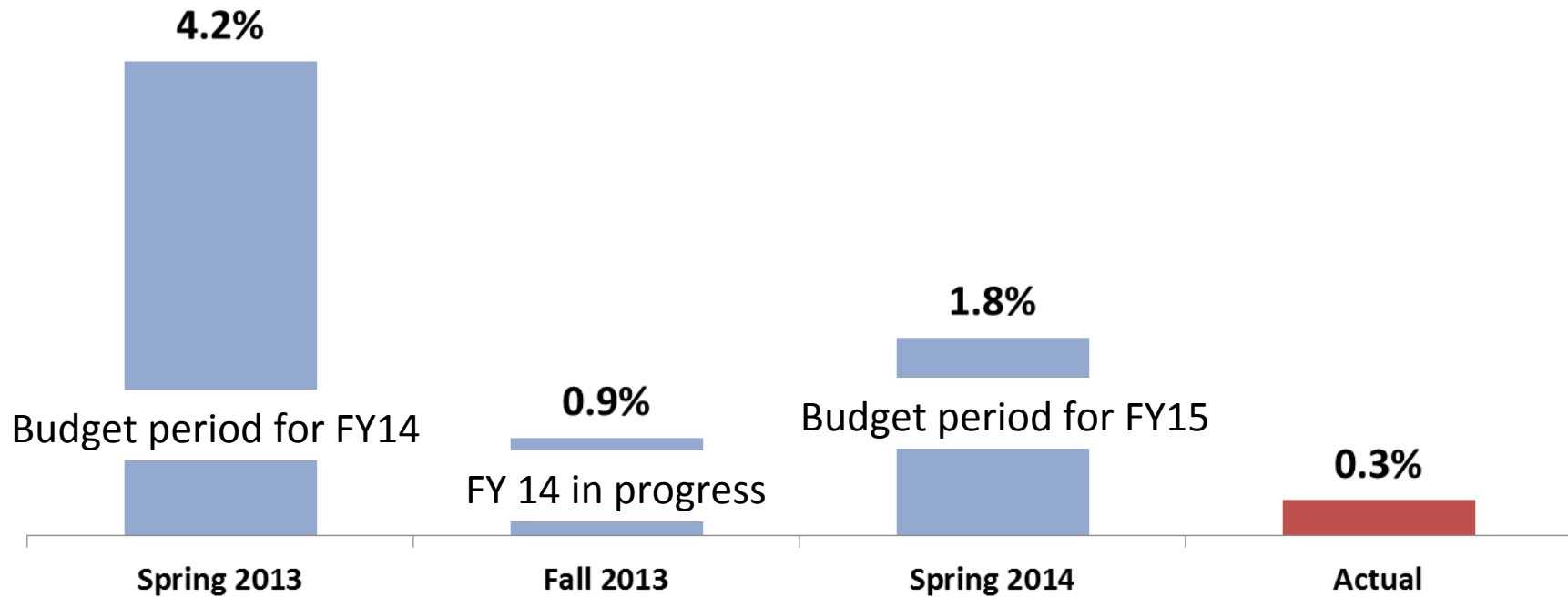
Source: NASBO Fiscal Survey Of States

What did they do with the \$\$

- Because of the timing, most of the money went straight to fund balance reserves
- May have offset planned reserve spending in FY 13
- One-time nature of increase downplayed
- Minimized initial effects of rate cuts

April 2014 “Surprise”

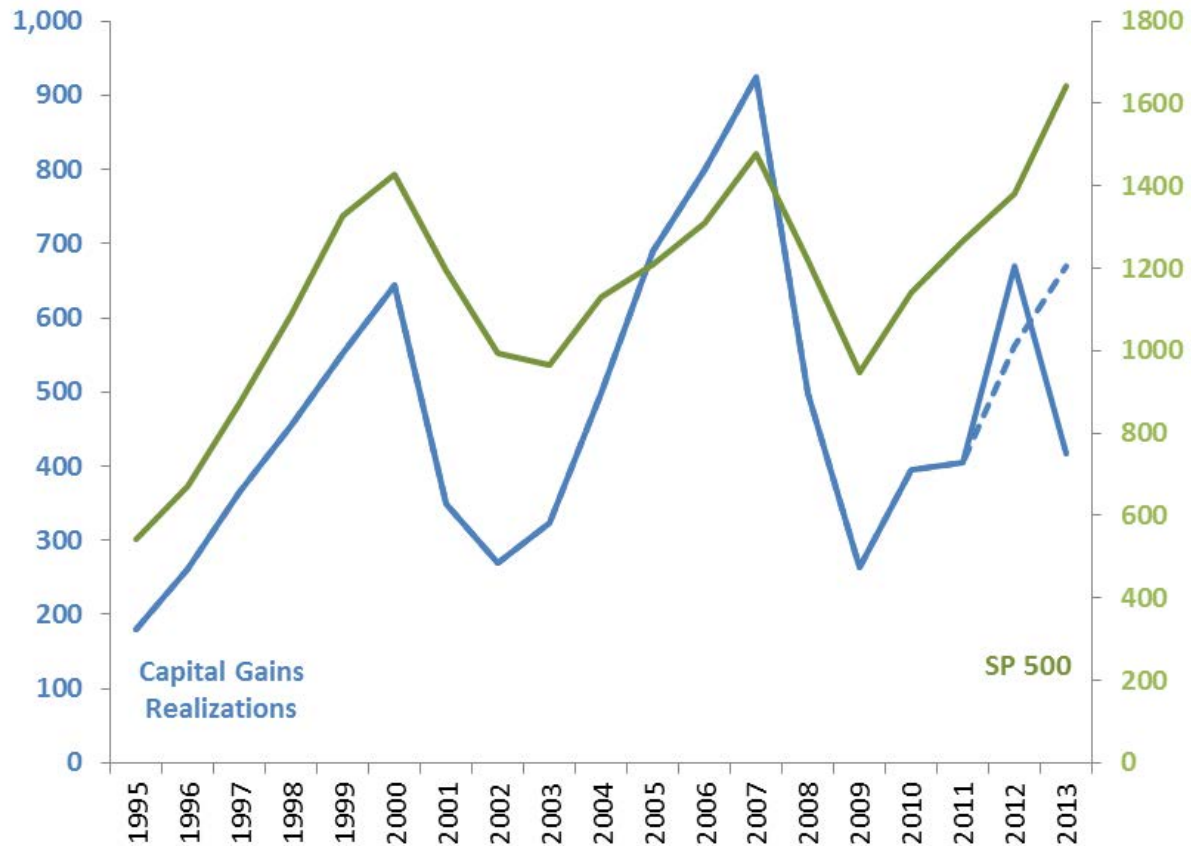
Forecasting State Personal Income Tax Growth, FY 2014



Note: California and states without income taxes are excluded.

Source: NASBO Fiscal Survey Of States ; Author calculation for actual.

What happened in 2014?



Source: CBO February 2014 Budget and Economic Outlook; Standard & Poors; Author's Calculation

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What to do?

- Forecasting
 - Multiple models
 - Frequent estimates
 - Data
 - Know your investment community
- Advising
 - Rainy day fund
 - Warn more explicitly of downside risks

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