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# April Is the Cruelest Month

## *Personal Income Tax Revenues Portend Deepening Trouble for Many States*

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HIGHLIGHTS

- State personal income tax collections fell by 26 percent, or $28.8 billion, in January-April of 2009, compared to the same period a year earlier. Thirty-four of 37 reporting states saw declines.
- Severe personal income tax revenue shortfalls were mostly due to the April 15 deadline for tax returns. April collections represented the bulk of the decline, with states collecting $18.2 billion less in April 2009 compared to April 2008.
- Both estimated payments and income tax returns dropped by over 30 percent in January-April of 2009, while withholding dropped by 6.9 percent.
- The sharp declines in personal income tax collections will punch still deeper holes in the budgets of many states. This increases the risk that state budget agreements for 2009-10 will not close budget gaps completely, and that states will need to make midyear budget cuts.
- These new data on income-tax revenues also make it likely that states will be forced to consider further spending and revenue actions in 2010, and will confront large budget gaps when federal stimulus assistance ends in 2011.

The April 15 deadline for personal income tax returns brought very bad news for many states. Personal income tax collections have been falling for several quarters. As we predicted in a previous report, tax returns on 2008 income that were filed in April show huge declines, likely due to stock-market-driven declines in investment income and declines in bonus payments.[1]

Preliminary data show deep declines in overall personal income tax revenues in nearly every reporting state. These declines signal continued difficult fiscal challenges ahead, particularly for the states that rely most heavily on personal income taxes.

The April-June quarter is an important quarter for personal income tax revenue collections and can be very volatile. In the April-June 2006 quarter, the growth rate, compared to a year earlier, was close to 18.8 percent. The year-over-year growth rate was 8.9 percent in April-June 2007 and 7.4 percent in April-June 2008. Looking at the most recent recession years, personal income tax revenue declined by only 1.4 percent in April-June 1993 and by a dramatic 22.3 percent in April-June 2002. Given the severe declines in April 2009 personal income tax collections, we expect that the April-June 2009 quarter will be even more dramatically negative than the April-June 2002 quarter.

To gain early information on personal incomes tax revenues, Rockefeller Institute staff collected statistics from 37 of 41 states that have a broad-based personal income tax. The data cover different components of personal income tax including withholding, tax returns, declarations of estimated taxes, and refunds.

April and May are critical months for personal income tax receipts as individual income tax returns are due and most income tax refunds are processed in these two months.[2] In this report we discuss revenue collections for the month of April, as well as for the period January through April. The figures for April alone should be viewed cautiously as the picture may be distorted due to various factors, including changes in processing times from one year to another. The final picture on personal income tax receipts will become clearer when May receipts are recorded. In this report we discuss preliminary data on May receipts for a limited number of early reporting states.

**Table 1. Percent Change in Personal Income Tax**

| State | PIT as % of Total Taxes, FY 2008 | PIT % change, Jan.-April 2008-09 |
|---|---|---|
| Arizona | 25.3% | -54.9% |
| South Carolina | 39.5% | -38.6% |
| Michigan | 28.7% | -34.4% |
| California | 47.5% | -33.8% |
| Vermont | 24.5% | -33.1% |
| New York | 55.9% | -31.8% |
| Rhode Island | 39.5% | -30.4% |
| New Jersey | 41.2% | -30.1% |
| Massachusetts | 57.2% | -28.5% |
| Idaho | 39.4% | -28.3% |
| Ohio | 38.9% | -27.8% |
| Oregon | 68.5% | -27.0% |
| ***United States*** | ***35.9%*** | ***-26.0%*** |
| Connecticut | 52.4% | -25.9% |
| Maine | 39.3% | -25.9% |
| Colorado | 52.7% | -25.4% |
| Wisconsin | 44.0% | -22.8% |
| Delaware | 34.4% | -22.5% |
| Georgia | 48.6% | -20.9% |
| Minnesota | 42.5% | -20.8% |
| North Carolina | 48.3% | -19.8% |
| Hawaii | 30.0% | -19.2% |
| Oklahoma | 32.9% | -19.1% |
| Arkansas | 31.1% | -18.6% |
| Maryland | 47.2% | -18.0% |
| Virginia | 54.9% | -17.0% |
| Pennsylvania | 32.4% | -16.6% |
| Indiana | 32.4% | -16.0% |
| Nebraska | 41.3% | -15.4% |
| Illinois | 35.4% | -10.7% |
| Montana | 35.4% | -8.9% |
| Iowa | 41.3% | -7.0% |
| Louisiana | 28.8% | -3.8% |
| Kansas | 41.1% | -0.6% |
| West Virginia | 31.1% | -0.3% |
| Utah | 43.6% | 4.4% |
| Alabama | 33.9% | 11.1% |
| North Dakota | 13.7% | 15.5% |
| Missouri | 46.7% | ND |
| Kentucky | 34.6% | ND |
| Mississippi | 23.4% | ND |
| New Mexico | 21.4% | ND |

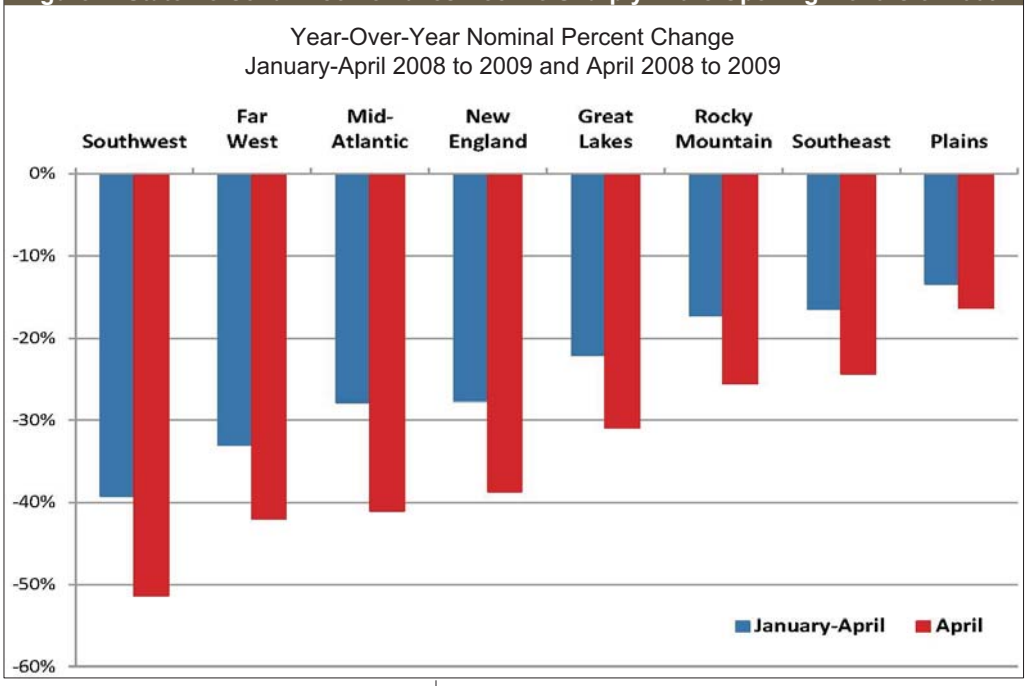
## Personal Income Tax

Total personal income tax collections in January-April 2009 were 26 percent, or about $28.8 billion below the level of a year ago in states for which we have data. In April 2009 alone (April being the month when many states receive the bulk of their balance due or final payments), personal income tax receipts fell by 36.5 percent, or $18.2 billion.

Personal income tax receipts in the first four months of calendar year 2009 were greater than in 2008 in only three states — Alabama, North Dakota, and Utah. However, preliminary May numbers for Alabama show that personal income tax collections are considerably weaker, with a 7.3 percent decrease in net personal income tax collections in January-May of 2009 due to substantially more refunds issued in May. In addition, conversations with Alabama government officials indicate that once all the refunds are processed, the state likely will see further declines in personal income tax collections. Table 1 shows the percent change in state-by-state personal income tax revenue for January-April of 2009 compared to the same period of 2008, ranked by percent change in revenue. Table 1 also shows state reliance on personal income taxes as a share of total taxes. In FY 2008, personal income tax revenue made up over 50 percent of total tax collections in six states — Colorado, Connecticut, Massachusetts, New York, Oregon, and Virginia. Personal income tax revenue declined dramatically in all six of these states for the months of January-April of 2009 compared to the same period of 2008. Among all 37 early-reporting states, the largest decline was in Arizona, where collections declined by nearly 55 percent. The severe and widespread year-over-year declines in personal income tax collections in January-April are a troubling harbinger for many states for the rest of the year.

As Figure 1 shows, all regions saw declines in personal income tax revenues both in April and in January-April collections (for state-by-state patterns see Table 1 and Table 2). The Southwest region was the weakest by far in terms of personal income tax revenue collections. (Revenue receipts are missing for New Mexico, but the picture for the Southwest region will not change much once its numbers become available due to the state's low share of receipts in the region.) The Plains region saw the smallest decline, although this may change once numbers become available for Missouri.

**Figure 1. State Personal Income Taxes Decline Sharply in the Opening Months of 2009**




## Withholding

Withholding is a good indicator of the current strength of personal income tax revenue because it comes largely from current wages and is much less volatile than estimated payments or final settlements. Withholding tax collections, influenced by the recent drop in employment, were off by 6.9 percent during the first four months of 2009. During April alone, withholding tax collections declined by 2.2 percent compared with 2008. Only five of 37 reporting states had increases in withholding for the January-April months. The five states reporting growth in withholding taxes for the first four months of 2009 are Arkansas, Iowa, North Dakota, West Virginia and Utah. Arizona, Louisiana, New Jersey and New York had the largest declines in withholding tax collections, with over a 10 percent drop for January- April of 2009.

## Estimated Payments

The highest-income taxpayers generally make estimated tax payments (also known as declarations) on their income not subject to withholding tax. This income often comes from investments, such as capital gains realized in the stock market. The first payment for each tax year is due in April in most states and the second, third, and fourth are generally due in June, September, and January. The early payments often are made on the basis of the previous year's tax liability and may offer little insight into income in the current year. It is not safe to extrapolate trends from the first payment, or often even from the first several payments. In the 35 states for which we have complete data, these payments were down by 30.4 percent for the January-April months of 2009, and by 41 percent in April. Arizona, Colorado, Indiana, and New York had the largest drops in estimated payments, all declining more than 37 percent for the January-April period.

**Table 2. Percent Change in State Personal Income Taxes**

Tax Revenue by Major Components of Personal Income Tax, Early Reporting States
January-April 2008 to 2009, % change

| | Withholding | Estimated | Final Payments | Refunds | PIT |
|---|---|---|---|---|---|
| **United States** | **(6.9)** | **(30.4)** | **(30.4)** | **10.1** | **(26.0)** |
| **New England** | **(4.5)** | **(28.9)** | **(39.0)** | **16.2** | **(27.6)** |
| Connecticut | (6.0) | (24.3) | (37.2) | 14.1 | (25.9) |
| Maine | (0.2) | (22.5) | (37.8) | 11.1 | (25.9) |
| Massachusetts | (4.3) | (31.8) | (41.4) | 18.9 | (28.5) |
| Rhode Island | (4.9) | (33.4) | (35.6) | 6.2 | (30.4) |
| Vermont | (1.6) | (25.6) | (30.5) | 27.8 | (33.1) |
| **Mid-Atlantic** | **(10.1)** | **(35.5)** | **(33.4)** | **9.6** | **(27.8)** |
| Delaware | (5.5) | (17.8) | (52.8) | 3.1 | (22.5) |
| Maryland | (1.7) | (25.5) | (24.0) | 8.5 | (18.0) |
| New Jersey | (11.7) | (25.2) | (34.0) | 20.8 | (30.1) |
| New York | (14.5) | (39.0) | (36.8) | 5.3 | (31.8) |
| Pennsylvania | (0.8) | (25.6) | (33.5) | 32.9 | (16.6) |
| **Great Lakes** | **(5.3)** | **(30.9)** | **(22.8)** | **15.8** | **(22.0)** |
| Illinois | (5.0) | (26.0) | 23.4 | 11.8 | (10.7) |
| Indiana | (5.9) | (43.3) | (13.1) | 3.4 | (16.0) |
| Michigan | (6.8) | (23.5) | (28.6) | 20.1 | (34.4) |
| Ohio | (7.6) | (31.3) | (35.3) | 11.6 | (27.8) |
| Wisconsin | (1.1) | (30.6) | (19.9) | 20.7 | (22.8) |
| **Plains** | **(0.7)** | **(20.3)** | **(6.4)** | **16.2** | **(13.4)** |
| Iowa | 2.4 | (1.5) | 0.1 | 21.3 | (7.0) |
| Kansas | (0.2) | (20.9) | 38.4 | 22.7 | (0.6) |
| Minnesota | (2.9) | (25.5) | (21.2) | 16.6 | (20.8) |
| Nebraska | (1.0) | (19.5) | (18.4) | 2.6 | (15.4) |
| North Dakota | 14.1 | 5.2 | 19.0 | 6.0 | 15.5 |
| **Southeast** | **(5.4)** | **(20.1)** | **(29.7)** | **0.1** | **(17.1)** |
| Alabama | (5.8) | (23.4) | 0.9 | (46.1) | 11.1 |
| Arkansas | 2.0 | (23.8) | (6.6) | 43.2 | (18.6) |
| Georgia | (5.5) | (24.2) | (38.7) | 5.6 | (20.9) |
| Louisiana | (15.9) | 23.0 | 14.4 | 18.7 | (3.8) |
| North Carolina | (8.1) | (32.0) | (36.3) | (18.5) | (19.8) |
| South Carolina | (4.8) | (31.1) | (18.7) | 7.0 | (38.6) |
| Virginia | (2.5) | (9.8) | (37.7) | 12.2 | (17.0) |
| West Virginia | 1.2 | 74.0 | (9.6) | 28.3 | (0.3) |
| **Southwest** | **(9.5)** | **(35.0)** | **(34.0)** | **11.5** | **(39.3)** |
| Arizona | (13.0) | (43.4) | (40.2) | 12.5 | (54.9) |
| Oklahoma | (4.8) | (26.9) | (13.9) | 9.2 | (19.1) |
| **Rocky Mountain** | **(0.5)** | **(31.3)** | **(15.9)** | **3.8** | **(14.9)** |
| Colorado | (2.0) | (37.8) | (26.6) | 19.9 | (25.4) |
| Idaho | (8.8) | ND | (29.6) | 5.9 | (28.3) |
| Montana | (0.9) | 18.5 | (27.6) | 1.4 | (8.9) |
| Utah | 2.9 | ND | (7.6) | (20.4) | 4.4 |
| **Far West** | **(8.2)** | **(29.1)** | **(36.8)** | **12.0** | **(33.0)** |
| California | (8.8) | (29.4) | (37.1) | 11.8 | (33.8) |
| Hawaii | (3.7) | (30.4) | (8.7) | 5.8 | (19.2) |
| Oregon | (4.8) | (24.4) | ND | 16.8 | (27.0) |

**Source:** Individual state data, analysis by Rockefeller Institute.
**Notes:** Data is missing for Kentucky, Mississippi, Missouri, and New Mexico.
ND - no data.

## Final Payments

Final payments with personal income tax returns were down by 30.4 percent through April, and down 33.7 percent in the month of April alone. Payments with returns in January-April 2009 exceeded 2008 levels in only six of 36 reporting states. Arizona, Delaware, and Massachusetts had the largest declines in final payments, with over 40 percent for January-April of 2009.

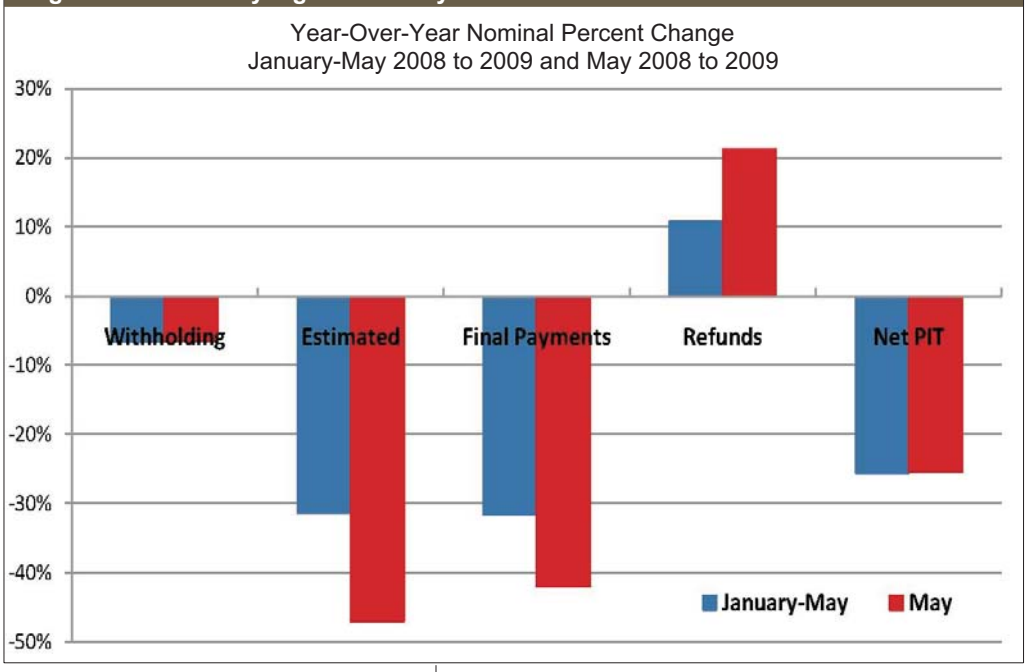
## Refunds

The amount of personal income tax refunds processed by states increased by 10.1 percent through April, and 15.4 percent in the month of April alone. In total, 37 reporting states have paid out about $3.2 billion more in refunds in January-April of 2009 than in 2008. In April 2009 alone, the 37 reporting states paid about $1.6 billion more than in April of 2008. Only three states of 37 reporting states returned less personal income tax refunds to taxpayers in the January-April months of 2009 compared to the same period of 2008, while nine states returned over 20 percent more in personal income tax refunds for the same period. The picture will become clearer once data for May refunds become available. We know that some states had delayed refunds due to the current recession, while others were actually able to process refunds faster than in previous years due to more taxpayers filing taxes electronically.

## The Outlook

April was a cruel month for many states. Personal income tax revenue collections sharply declined in almost every state in the

**Figure 2. Preliminary Figures for May Show Further Declines in Personal income Tax**




January-April period of 2009, compared to a year earlier. In the month of April alone, 37 early reporting states collected about $18.2 billion less in personal income tax revenues compared to the same month of 2008. This $18.2 billion is close to the $20 billion shortfall that states experienced in overall tax revenue collections in the first quarter of calendar year 2009. According to a recent report by the National Conference of State Legislatures, "In comparing personal income tax collections through April 2009 to the latest estimate, more than half the states were below target."[3] This is particularly bad news for the states that rely most heavily on personal income tax. A number of states already have enacted or recommended increases in personal income tax rates and other revenue-raising steps such as reductions in tax credits. Such proposals would increase personal income tax collections by more than $7 billion in two states alone: $4.7 billion in California and $2.9 billion in Illinois.[4]

Preliminary May 2009 data from 34 early reporting states indicate further declines in personal income tax revenue collections. As Figure 2 shows, collections from major components of personal income tax continued to decline nationwide. Thirty of 34 early reporting states saw further declines in personal income tax collections in May 2009 compared to May 2008.

Given the ominous picture of personal income tax collections, deeper overall revenue shortfalls and further deterioration in states' fiscal conditions are likely on the way for most states for the April-June quarter of calendar year 2009.

## What a Bad April Does to Budget Forecasts

More than any other month, income tax shortfalls for April can lead states to experience massive budget problems.

In most months, the bulk of state income tax revenue comes from withholding taxes on wages. Because wages are the most significant part of the income tax, even small percentage shortfalls in withholding can accumulate over time and lead to large reductions in revenue forecasts. But it is unusual for a single month to swing these estimates dramatically — more likely, revenue estimates will be reduced significantly after an accumulation of

evidence from employment data, wage data, and withholding collections warrants it. Huge month-to-month fluctuations in withholding tax collections are not typical, and when they occur often they are attributable to technical factors such as the number of payment days in a month, and do not necessarily indicate a huge recurring shortfall.

But income tax payments related to nonwage income are far more volatile and a single month — if it is April — can be far more telling. During the course of the calendar year, taxpayers with significant nonwage income such as capital gains make payments generally in April, June, and September, and then in January of the new year. These payments are based partly on minimum requirements under the law, partly on tax liability in the prior year, and partly on habit and inertia. They tend to be "sticky" — often not changing by as much as the underlying income changes. Then, taxpayers settle up with the government in April when they file their tax returns.

This is all fine when the underlying income does not change very much. Final payments in April may be up or down more than the underlying nonwage income, but not enough to be of great consequence to the state budget.

However, not only are April payments related to nonwage income volatile, but the underlying income itself is volatile. For reasons we have discussed elsewhere, including a dramatic decline in the stock market in 2008 and other factors, huge percentage reductions in nonwage taxable income were likely for 2008 tax year payments made in 2009. While most states understand this, they cannot predict the magnitudes of these declines with any precision. State budget forecasters have pretty good estimates of what wages were in 2008 from economic data collected by government agencies, but they do not have comparable data telling them how much nonwage income subject to income tax people received in 2008. Budget forecasters have external indicators such as stock market values and broad economic measures, which go into models they use to predict nonwage income subject to tax, but the models simply are not able to predict this income with the confidence that forecasters and policymakers would like.

So the estimates of nonwage income subject to tax that state officials made over the past year were fraught with uncertainty. It now appears that these income sources have declined by far more than many forecasters expected. Furthermore, because estimated payments during the course of 2008 were likely to have been "sticky," not fully reflecting the declines in nonwage income, "settling up" tax payments in April were at risk of falling very dramatically. That appears to be exactly what has happened.

Shortfalls of this nature are particularly bad news for state budget forecasts. In the typical state, most of the payments related to tax returns are processed in April and early May. Because these payments are largely in hand (or not) by late May, as revenue analysts analyze the data they are likely to conclude the declines are

not due to technical factors (as might be the case with a large year-over-year decline in withholding) and are more likely to reflect bona fide unanticipated declines in 2008 nonwage income. Forecasters then extrapolate information from April and May to take account of straggling payments in coming months associated with extensions on tax returns and other similar payments. This will increase the shortfall for the year as a whole beyond what occurs in April and May. In addition, if nonwage income for 2008 was below expectations, forecasters often will conclude that nonwage income for 2009 will be lower as well (even if it grows at the same rate as expected before, the level in 2009 will be lower than expected before). This bodes ill for estimated payments during 2009 and for final payments on 2009 income in April and May of 2010.

For these reasons, after careful analysis of results in April and May, and of underlying economic fundamentals, a large April income tax shortfall can balloon into a budget shortfall for the period in question that is two or three times (or more) as large as the April shortfall. It is clear that state income tax revenue in April and May has fallen short of what states expected by many billions of dollars. Exactly how that will translate into new budget shortfalls is not clear, but budget gaps are likely to have increased by several multiples of the amount by which tax revenue has fallen short. Many states have begun revising their budget forecasts so that elected officials can take the new shortfalls into account as they finalize their budgets. This is the phenomenon we have seen over the last several weeks in many states.

In February, we examined what state revenues and budgets will look like when the current federal stimulus assistance expires in 2011-12.[5] That report presented two scenarios — a "low-gap" picture under which current fiscal troubles for states would be slightly less severe than the sharp 2001 crisis, and a "high-gap" scenario in which 2009 through 2011 would bring much greater fiscal strain. The information we now have on April and May revenues paints a picture more consistent with our "high-gap" scenario. While it is too early to make detailed predictions, there is little question that states will face very large budget gaps when the stimulus assistance ends, unless they adopt significant and recurring spending cuts or tax increases between now and then.

## What a Bad April Does to State Budget Processes

An April income tax shortfall comes at the worst time of year for two reasons.

First, by the time it is recognized in late April or mid-May, it is just 6-10 weeks before the end of the fiscal year for 46 states. For states without large cash balances, this can create a cash flow crunch or even a cash flow crisis. There is not enough time to enact and implement new legislation cutting spending, laying off workers, raising taxes, or otherwise obtaining resources sufficient to offset the lost revenue before the June 30 end of the fiscal year. As a result, a state without sufficient cash on hand to pay bills must resort to stopgap

measures to "roll" the problem into the future.

For example, Kansas slowed the payment of income tax refunds and delayed aid payments to local school districts. Other states have taken similar measures. These actions do not save any money — the state still has to pay refunds and school aid early in the new fiscal year — but they do avert a cash flow crisis. But the size of the budget problem for the next fiscal year is larger and greater action is needed to close that gap. (The cash-flow problem in California is so severe that it will require extraordinary legislative action so the state can be in a position to issue short term debt and obtain other funds that will allow it to pay bills in late June and July.)

Second, the increased budget problems caused by an April income tax shortfall come late in the fiscal year and late in the budget process — often as states are supposed to wrap up their budget negotiations. It takes time for revenue analysts to evaluate the shortfalls, for budget forecasters to revise their forecasts, and for elected officials to come to grips with the magnitude of the new problem they face. The new bad news for elected officials can unsettle carefully balanced gap-closing plans already tentatively negotiated. Since the budget actions included in these tentative plans presumably were the most attractive options available to them, almost by definition actions to close new budget gaps will be much more difficult. New options also may be less enduring, including nonrecurring resources and other techniques that do not solve the gaps in an ongoing way. All of this makes it hard for budget negotiators to reach agreements that will fully close the new budget gaps. It raises the risk that the newly adopted budget will take an optimistic view of the year ahead and may unravel as the year progresses, requiring midyear cuts. And because those solutions that are adopted may be nonrecurring in nature, it raises the risk that states will face larger gaps for 2010-11 when such nonrecurring resources go away.

## Endnotes

1 See Lucy Dadayan and Donald J. Boyd, "Personal Income Tax Revenue Declined Sharply in the First Quarter." The Nelson A. Rockefeller Institute of Government, May 13, 2009.

2 Individual income tax returns are due on April 15 in 35 out of 41 states that have broad-based personal income tax. The remaining six states have individual income tax return due dates later than the usual April 15. Those states are: Arkansas (May 15), Delaware (April 30), Hawaii (April 20), Iowa (April 30), Louisiana (May 15), and Virginia (May 1).

3 See National Conference of State Legislatures, "State Tax Performance Through April 2009," June 2009.

4 See National Governors Association and National Association of State Budget Officers, "State Fiscal Survey of States." June 2009.

5 Donald J. Boyd, "What Will Happen to State Budgets When the Money Runs Out?" The Nelson A. Rockefeller Institute of Government, February 19, 2009.

## About The Nelson A. Rockefeller Institute of Government's Fiscal Studies Program

The Nelson A. Rockefeller Institute of Government, the public policy research arm of the State University of New York, was established in 1982 to bring the resources of the 64-campus SUNY system to bear on public policy issues. The Institute is active nationally in research and special projects on the role of state governments in American federalism and the management and finances of both state and local governments in major areas of domestic public affairs.

The Institute's Fiscal Studies Program, originally called the Center for the Study of the States, was established in May 1990 in response to the growing importance of state governments in the American federal system. Despite the ever-growing role of the states, there is a dearth of high-quality, practical, independent research about state and local programs and finances.

The mission of the Fiscal Studies Program is to help fill this important gap. The Program conducts research on trends affecting all 50 states and serves as a national resource for public officials, the media, public affairs experts, researchers, and others.

This report was researched and written by Senior Policy Analyst Lucy Dadayan and Senior Fellow Donald J. Boyd. Michael Cooper, the Rockefeller Institute's director of publications, did the layout and design of this report, with assistance from Michele Charbonneau. Robert B. Ward, deputy director of the Institute, directs the Fiscal Studies Program.

Additional information is available at www.rockinst.org.