Federal Tax Policy Uncertainty and State Revenue Estimates

Unraveling the April Surprise

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April is the most important month of the year for individuals who owe federal and state income taxes. All US taxpayers must file a federal tax return (or file for an extension and make tax payments) by April 15th, and most of the 44 states that levy a personal income tax require their returns at the same time.[1] Though many taxpayers have taxes withheld from wages and others make quarterly estimated tax payments during the year, April is the time to true up— taxpayers make final payments or claim refunds.

For another year, Congress waited until the end of the calendar year to reinstate provisions that will affect taxpayers for 2014.[2] With the addition of Affordable Care Act subsidies and penalties and extenders, filing 2014 taxes will be even more complicated. The late federal action introduces uncertainty into tax planning for individuals. Because most states base their income tax on the federal law, this also translates into uncertainty for states. How much or how little income tax revenues states collect often depends on both new federal actions and taxpayer reactions, with most of the effect showing up in returns filed in April.

April is also the most important month for governments that rely on income taxes as a major source of revenue. Because personal income tax receipts account for about 45 percent of federal government receipts and more than 33 percent of state tax revenue, what happens in April has a major impact on these governments' fiscal positions and their ability to provide services through the end of the year. For example, California treasurer's office releases daily updates on tax revenue receipts during April.[3] Such is the significance of the revenue collected at this time of year.

Unfortunately, April is also the most unpredictable month for income tax revenue. Revenue estimators at federal and state levels are familiar with the "April surprise" phenomenon. In short, end of year economic events as well as last minute changes to federal tax and spending policies can significantly affect state income tax revenues forecast six months earlier. The past two Aprils produced even larger surprises than usual. A confluence of events in 2012 compounded the normal uncertainty in 2013. A rocky economic recovery, new federal budget cuts, and uncertain federal tax policy created a confusing economic environment for state revenue estimators as well as investors and businesses. The timing of state budget cycles also added to this unpredictability: the taxpayer responses to December federal actions happened long after states had proposed and passed budgets. As we approach yet another April following last minute federal tax extenders, it is useful to examine how mismatched timing of events affected state budget outlooks and glean any lessons for going forward (Joint Committee on Taxation 2015).[4]

Background

January 2012 was a month of cautious optimism about the economy. The stock market, measured by the S&P 500 index, had almost recovered its 2007 peak. Employment, income, and wages had not recovered completely in most states, but they were moving in the right direction. State tax revenue had rebounded to pre–Great Recession levels in more than half of the states.

Against this backdrop, state revenue estimators projected modest economic growth in 2012 and 2013 but slower than historic averages. Economists in Arizona, one of the states hit hardest by the 2007 recession, reported that the "recovery has begun, but the pace is painfully slow" (Vest 2012, 1). California analysts forecast personal income growth of about 4 percent in 2013, rising to 5 percent by 2014, but they expected that employment would not recover until 2016 (State of California 2012). This slow return to normal was typical of most states as the country emerged from the Great Recession.

But the projections' optimism was tempered by warnings. One concern was that the Eurozone seemed to be teetering on the brink of dissolution. Another concern was the possibility of significant cutbacks in federal spending. The Budget Control Act of 2011 had convened a special joint "super committee" to come up with solutions to the growing federal budget deficit. The act contained a poison pill of draconian budget cuts (sequestration) scheduled to begin in 2013 if the super committee failed. When the committee did indeed fail to reach an agreement, those budget cuts loomed ahead.[5]

Though many states highlighted these risks in their budget projections, only a few built them into their forecasts. Even the federal sequester was seen primarily as a risk only to states and regions with high concentrations of federal government activity, such as the Washington, DC, metro area.

The Fiscal Cliff

As 2012 continued, another risk appeared on the horizon: the federal fiscal cliff. Barring congressional action, the combination of the automatic spending reductions specified by the Budget Control Act, a scheduled reduction in Medicare payment rates for physicians, and expiration of many tax cuts enacted since 2001 would take effect on January 1, 2013, significantly tightening the federal budget.[6] The Congressional Budget Office (CBO) estimated that the combined spending cuts and tax increases would total $500 billion in fiscal year (FY) 2013 and another $682 billion in FY 2014. CBO concluded that that amount of fiscal tightening would cause real GDP to drop by 0.5 percent in 2013 and the unemployment rate to rise to about 9.0 percent by the fourth quarter of that year, conditions that could bring about another recession (CBO 2012b).[7]

The failure of the super committee and the chasm between the political parties about future tax and spending policy greatly increased the possibility that the government would topple off the fiscal cliff. State revenue estimators were left to guess what the federal government would do.

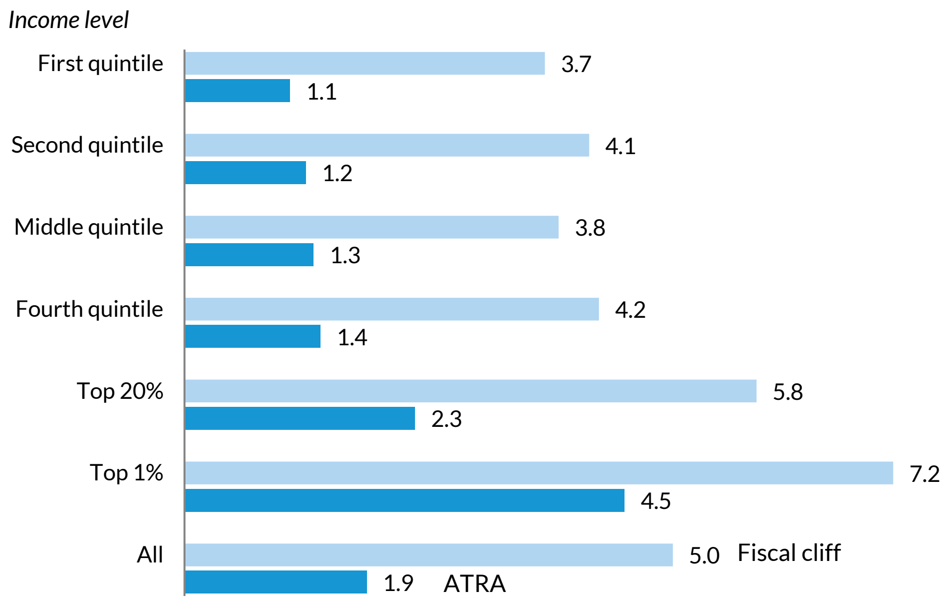
The scheduled expiration of several tax cuts was the major component of the fiscal cliff. Reductions in tax rates and expansions of tax deductions and credits originally enacted in 2001, 2003, and 2009 had been extended for two years in 2010 but were set to expire after 2012.[8] A temporary reduction in the Social Security payroll tax rate also was scheduled to expire after 2012.

In addition, new taxes were coming online. The Patient Protection and Affordable Care Act of 2009 (ACA) included a 3.8 percentage point tax on investment income for high-income taxpayers and a 0.9 percentage point increase in the Medicare payroll tax for high earners, both starting in 2013. As a result, taxes were scheduled to increase for most everyone, but particularly for high-income taxpayers, beginning on January 1, 2013. The average tax rate was estimated to go up almost 6 percentage points for the 20 percent of tax units with the highest income and by even more for the top 1 percent of tax units (see figure 1).

FIGURE 1

Estimated Change in Average Federal Tax Rate by Cash Income Percentile

2013 fiscal cliff and American Tax Relief Act of 2012



Source: Urban-Brookings Tax Policy Center Tables T12-0208 to T12-0216 and T13-0004 to T13-0010.

Tax policy was front and center in spring 2012 for both major political parties. During the Republican primary debates, there was no question that all of the expiring provisions should be made permanent and the debate was only about by how much more to cut taxes. On the Democratic side, President Obama's budget recommended letting just the top income tax rates return to their 2000 levels and adding further tax increases for high-income taxpayers (Office of Management and Budget 2012).

Over the summer of 2012, the Democratic-controlled Senate passed the Middle Class Tax Cut Act, which would have increased the tax rate on capital gains for high-income taxpayers and extended for an additional year all of the expiring tax cuts except the reduction of the top two rates.[9] Meanwhile, the Republican-controlled House passed their early version of the American Taxpayer Relief Act (ATRA), which would have extended all of the tax cuts for another two years.[10]

President Obama's reelection and Republican's maintaining control of the house made the future of the tax cuts uncertain. With the fiscal cliff just two months away, the President, the Senate, and the House had to reconcile their differences to prevent steep tax increases for virtually all American households.

Congress Steps Back from the Cliff

Congress passed the American Taxpayer Relief Act of 2012 (ATRA) in early January 2013, narrowly avoiding the fiscal cliff. ATRA permanently extended most of the tax cuts scheduled to expire, but left in place provisions affecting high-income taxpayers and let the temporary payroll tax reduction expire (see figure 1). ATRA also delayed some of the automatic spending cuts required by the Budget Control Act and a mandated reduction in Medicare payments to physicians.

Too Late for Investors

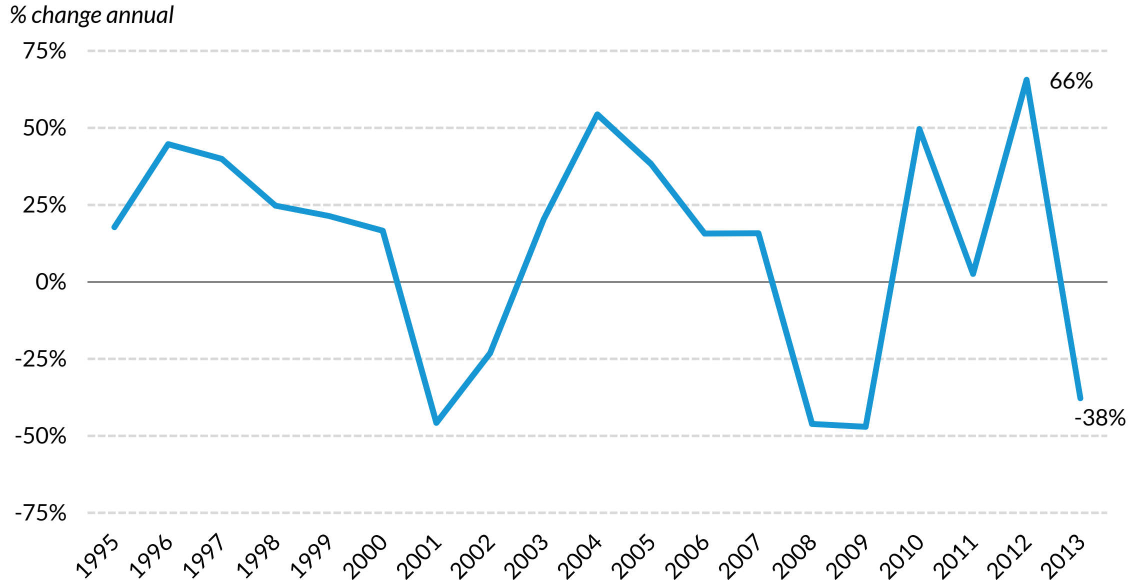
In the fall of 2012, before ATRA was enacted, companies and investors saw the fiscal cliff looming and the strong likelihood of higher tax rates. They began to act, shifting hundreds of billions of dollars of income from future years into 2012, mostly in three ways: bonuses, personal dividends, and capital gains realizations.[11]

- **Bonuses.** Many companies, particularly financial companies, pay out bonuses as part of wages at the end of the year. In normal years, employees might receive those bonuses at the beginning of the year. In 2012, however, with the specter of increased tax rates for high-income earners, companies shifted bonus payments from 2013 to 2012.[12] (For example, a bonus paid in 2013 would be subject to a top marginal rate of 41.95 percent without ATRA compared with 36.45 percent if paid in 2012.) The Bureau of Economic Analysis estimated the shifting of these bonuses increased wages in December 2012 by $15 billion, contributing to an annualized growth rate of 2.6 percent in personal income (and a consequent 3.6 percent decline in January 2013).

- **Capital gains.** In the fall of 2012, the economic outlook was still cautiously optimistic. Nervous investors who were already predisposed to sell appreciated stocks before a potential market fall found in the looming tax hike the nudge they needed. According to CBO, capital gains realizations were 66 percent higher in 2012 than 2011 (2014). (Capital gains also increased in 2010 when there was also uncertainty about the capital gains rate but the resurgent stock market following the recession played a larger role.) The capital gains shift was a one-time event: despite continued strength in the stock market in 2013, capital gains realizations declined almost 40 percent (figure 2 and figure 3).

FIGURE 2

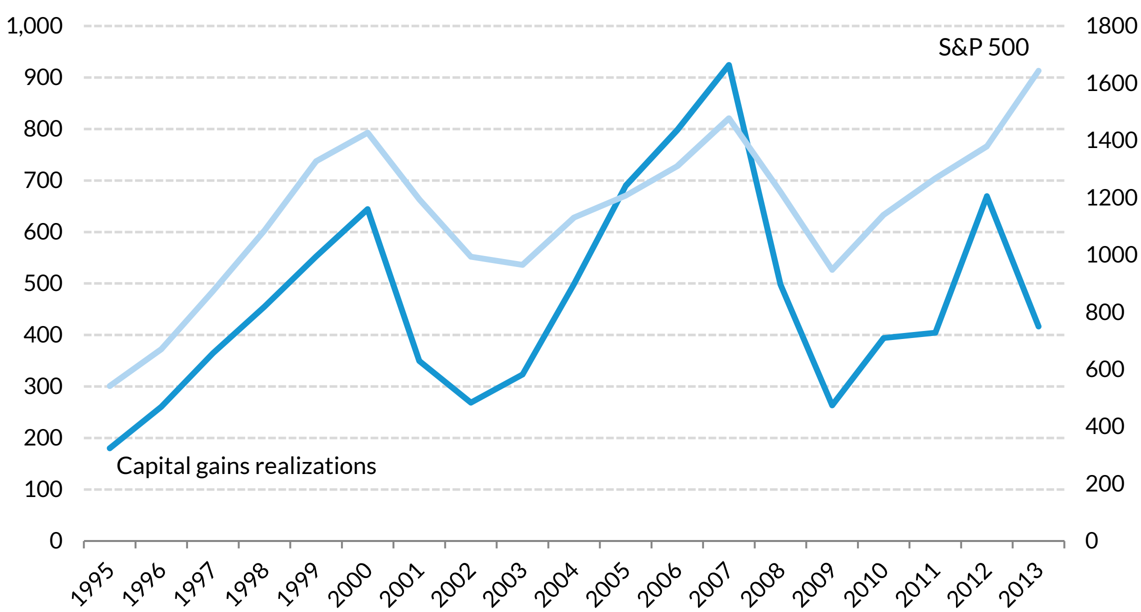
Capital Gains Realizations



Source: CBO, 2014.

FIGURE 3

Capital Gains Realizations and Stock Market Price

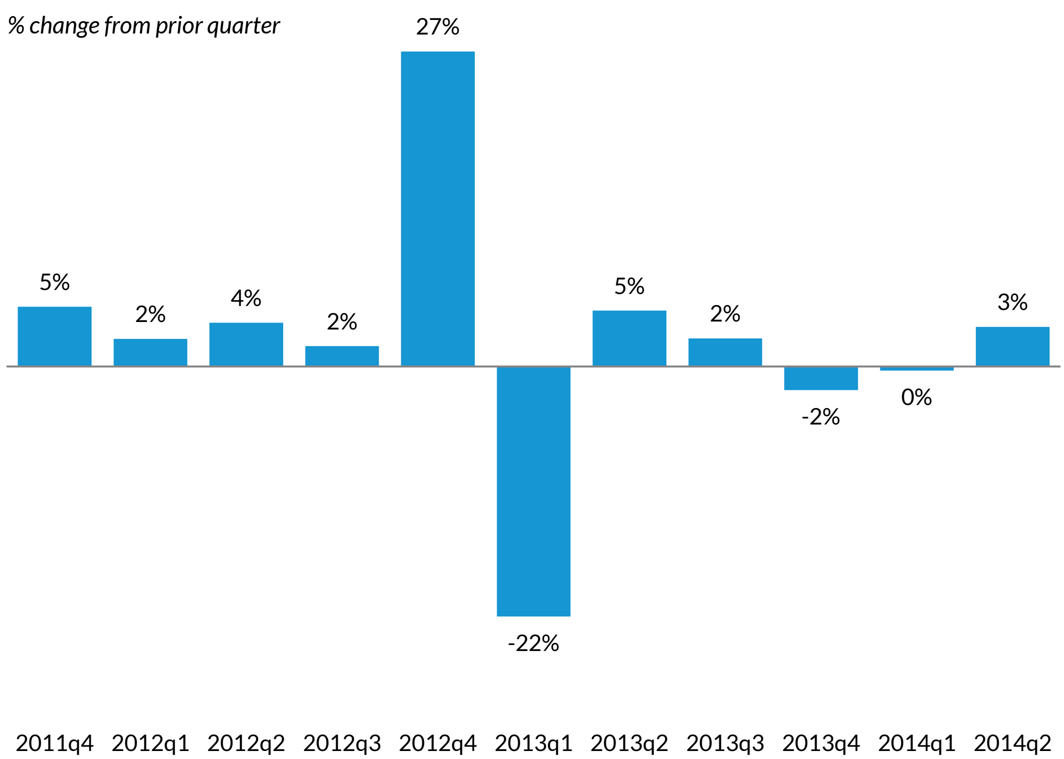


Source: CBO, 2014; S&P 500.

- **Personal dividends.** At the end of 2012, the potential tax increase for dividend income in 2013 was much larger than for regular income or capital gains. Before 2003, dividends and interest income were taxed at the same rates as regular income, with a top rate of 39.6 percent.[13] As a result of the 2003 tax cut legislation, dividends were taxed at the same lower rates as capital gains—with a top rate of 15 percent. Beginning in 2013, the combination of the expiration of the lower tax rates and an additional 3.8 percent tax on investment income for high-income taxpayers enacted by the ACA meant that the top tax rate on dividends could rise to 43.4 percent (39.6+3.8), nearly three times the top rate in 2012. The response to this potential increase was clear in the 2012 tax return data: dividends reported on 2012 tax returns were 34 percent higher than 2011.[14] Much of the increase was from one-time special dividend payments separate from normal quarterly dividends: the number of special dividends paid out, mostly in the fourth quarter of 2012, was almost twice the eight-year average and unique to 2012 (figure 4 and 5). The Bureau of Economic Analysis estimates that special dividend payments boosted personal income by $291 billion in 2012.[15]

FIGURE 4

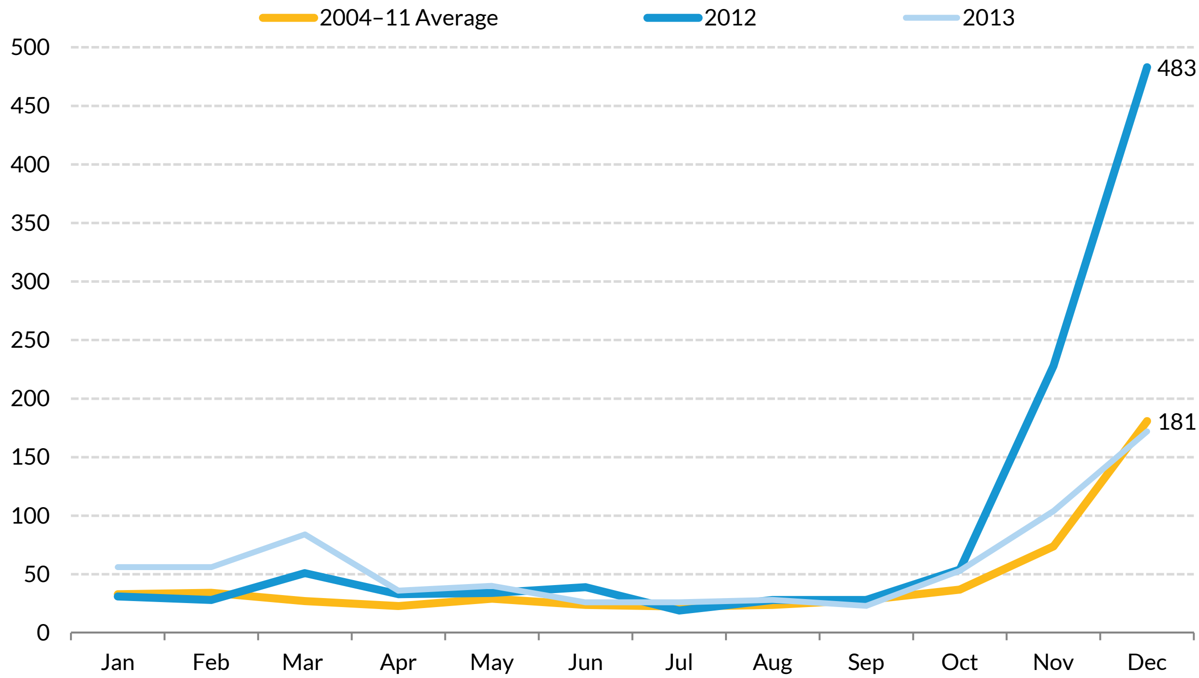
Personal Dividends



Source: Bureau of Economic Analysis.
Note: Seasonally adjusted annualized data.

FIGURE 5

Special Dividends Issued in 2012 Compared with Annual Average



Source: S&P 500 and Dow Jones Indices.
Notes: The total number of special dividends in 2012 was 1,056 compared with an average annual total of 536.

Too Late for Revenue Estimators

Although revenue forecasters expected employers and employees to pull income forward from 2013 to 2012 to avoid the ACA surtax, many experts underestimated the total income shift because they believed that many of the 2001 and 2003 tax cuts would be extended.[16] Because the shift that occurred was in response to federal policy uncertainty, it was not evident from fall 2012 economic data. Although some forecasters did project what would happen to the economy if the federal government went over the fiscal cliff, the projections were compared with a baseline of continued 2012 policies. There was no forecast of going right up to the cliff and stopping.

For state revenue estimators, uncertainty at the end of 2012 was made worse because of the timing of state budget cycles. In most states, the fiscal year spans two calendar years running from July 1st to June 30th; only four states and the District of Columbia use other fiscal years.[17] FY 2013 was thus already well underway in the fall of 2012 and estimators were forecasting revenues for the remainder of the current FY as well as the next FY (also known as the "budget" year; figure 6). (Some states have biennial budgets, which require at least a two-year forecast.) In formulating FY 2014 budgets during the fall of 2012, analysts in many states assumed that there would be no fiscal cliff. For example, Indiana's

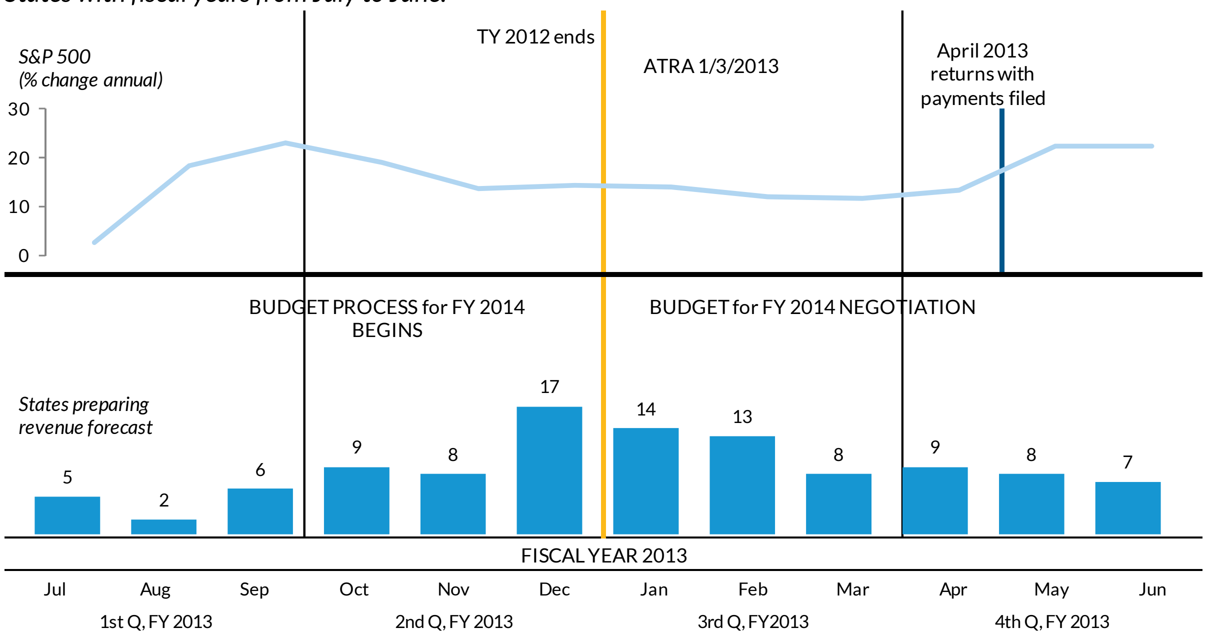
2012 revenue estimate methodology explicitly assumed that a deal extending the tax cuts for all but high-income taxpayers would be struck by the end of the year (State Budget Agency 2012).[18]

Another factor exacerbating the consequences of revenue uncertainty for states was balanced-budget requirements. Every state except Vermont must pass a balanced budget, which means any one-time reduction in revenue must be matched by an offsetting change in expenditures or movement of funds out of rainy day funds. Unanticipated movement of income between fiscal years increases the likelihood of errors in both years.

FIGURE 6

Timeline of Fiscal Year 2013

States with fiscal years from July to June.



Source: S&P 500.

Notes: Blue columns indicate the number of states preparing revenue forecasts in that month. Several states prepare more than one forecast per year so column numbers do not add up to 50 states and the District of Columbia. TY = tax year.

Understanding the uncertainty revenue estimators faced in the fall of 2012 also requires understanding how the personal income tax is collected (figure 7). Most revenue comes from withholding from wage and salary income; it also comes from quarterly estimated payments throughout the year and final payments with tax returns.[19] The final quarterly payment in January is usually adjusted up or down to avoid over- or under-payment of total annual taxes unless protected by safe harbor provisions, which vary by state.[20]

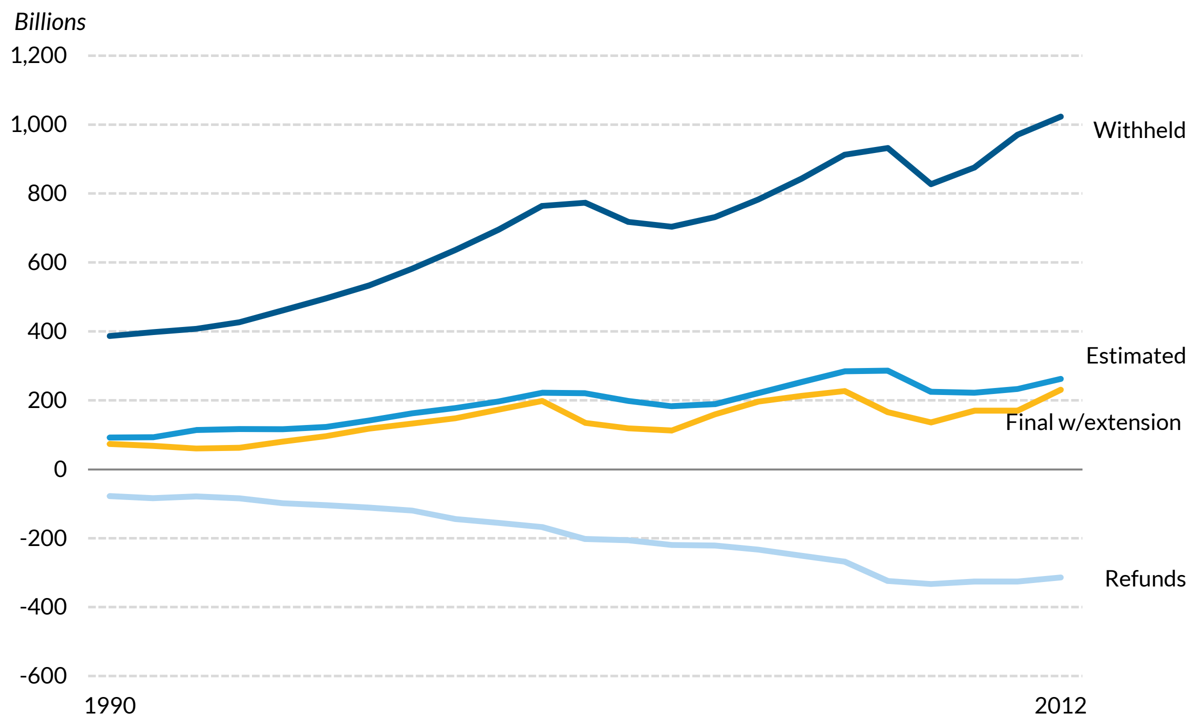
Taxpayers receive refunds, or “negative” payments, mostly from February to April if they paid excess withholding or are due refundable credits. But some taxpayers still owe tax and make final payments, including payments filed with extensions, when the tax year return is filed or extended, close to the deadline in April. Capital gains realizations, special dividend payments, distribution payments to partners, and other tax related activities that happen in December are reflected in the final quarterly payment in January and on the final return before April.

In normal years, a stock market price index like the S&P 500 is a reasonable guide to the expected amount of realized investment income (capital gains and dividends). In fact, many states use this index to forecast the nonwithheld portion of their state income tax (Francis 2012). At the federal level, CBO uses the index as a driver for the current year estimate but uses a different model to forecast future years (Kim, Miller, and Ozanne 2004).

In 2012, stock market performance was positive and there was no indication of the kind of sell-off that occurred in 2008 and 2009. The standard deviation of monthly S&P 500 levels was average, suggesting a normal level of capital gains realizations. However, investment income was much stronger than the market index supported. Enter the fiscal cliff.

FIGURE 7

Components of Federal Income Tax Payments



Source: Internal Revenue Service.

The April Surprise

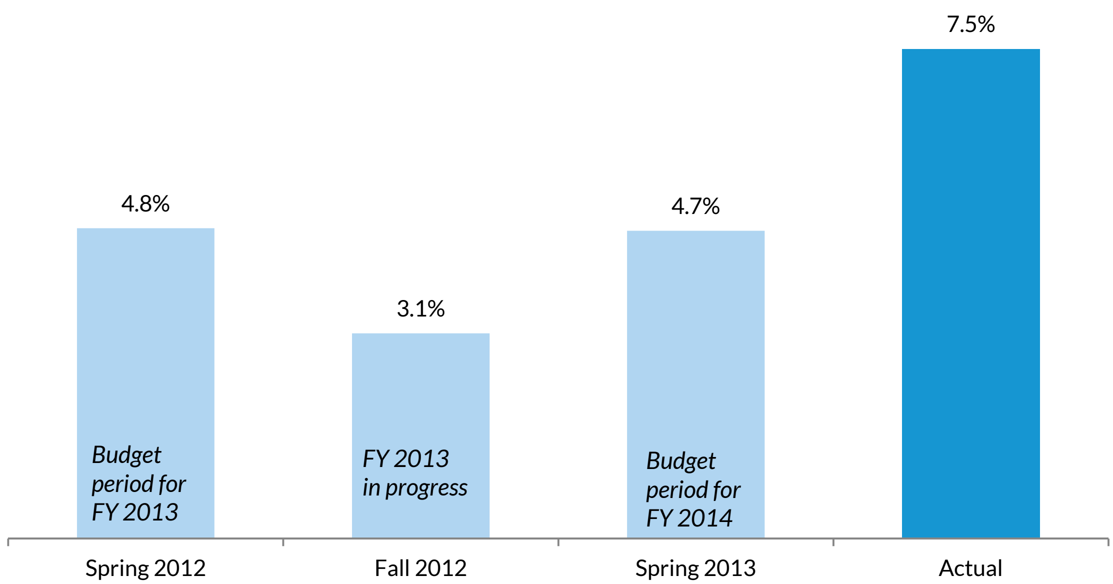
Final tax returns started arriving to state tax agencies in April 2013. Because of standard lags in tax return processing, the data on final returns filed in the first weeks of April 2013 were generally not available to state revenue estimators until early May, near the end of FY 2013. So, despite early warnings, the magnitude of the investment income shift from tax year 2013 to 2012 was only fully understood when FY 2013 was nearly over.

At that time, most states with income taxes were positively surprised. In total, states collected $14.7 billion more personal income tax revenue than their budgeted estimates for FY 2013 (NASBO 2013b and 2014b). Because this windfall came late in the fiscal year, the additional revenues were generally not spent but instead went to reserves or rainy day funds.

Unexpected gains were also widespread. Almost every state met or exceeded its budget estimate of personal income tax revenue for FY 2013 (figure 8).[21] Only Indiana (which provided a large tax rebate), New York, and Oregon collected less than their original estimates. North Dakota was well above its estimate because of increased oil activity in the state combined with its biennial budgeting.[22]

FIGURE 8

State Forecasts of Personal Income Tax Growth from FY 2012 to FY 2013



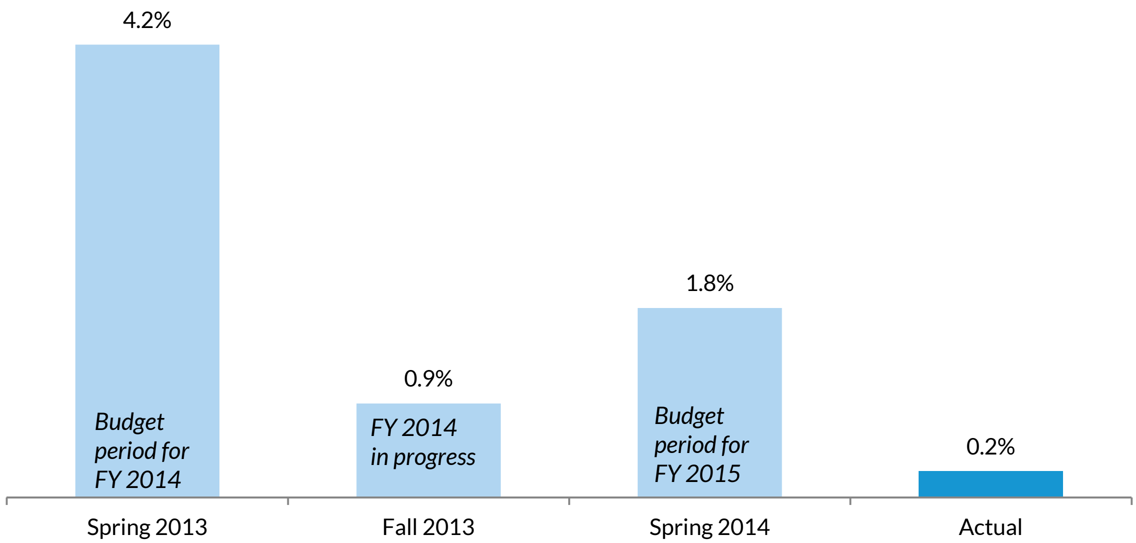
Source: NASBO 2012a, 2012b, 2013a, 2014a.

Notes: States without broad-based income taxes excluded. California excluded because of the size of its income tax..

By the time the 2013 April surprise was recognized (in May of 2013), most states had already completed their budgets for FY2014, which would start in June 2013. Forecasts used in FY 2014 budgets were prepared during the winter of 2012–13. Thus, even though estimators may have known the fiscal cliff's outcome, they could not have known the extent of the shift in income from 2013 to 2012. Several news reports had mentioned special dividends issued in anticipation of higher tax rates. However, dividends are a small share of total income and because they grow slowly over time and do not exhibit significant variation, they are generally not explicitly built into estimation models.[23] Rather than volatile revenues, in the spring of 2013 most state revenue forecasters assumed strong personal income tax growth would continue for FY 2014, suggesting they believed the strength in FY 2013 receipts reflected strength in the underlying economy and not a one-time event driven largely by political factors.

FIGURE 9

State Forecasts of Personal Income Tax Growth from FY 2013 to FY 2014



Source: NASBO, 2013a, 2013b, 2014a, 2014b.
Notes: States without broad-based income taxes excluded. California excluded because of the size of its income tax.

As they recognized their additional revenue in FY 2013, states did adjust their FY 2014 estimates, assuming a portion of the revenue was indeed a one-time phenomenon (figure 9). However, states varied in how much they attributed to permanent versus transitory factors. For example, California assumed that 20 percent of tax year 2013 capital gains were shifted to 2012 (box 1). According to the National Association of States Budget Officers' fall *Fiscal Survey of the States*, 31 states decreased and 10 states increased their FY 2014 estimates (2013a).[24]

As clear as it is now that fiscal cliff revenue should have been considered one time, the economic data at the time did not necessarily support that conclusion.[25] The combination of an improving gross domestic product and a soaring stock market made state estimators more bullish than bearish. Arizona, for example, explicitly accounted for the fiscal cliff shift in capital gains but increased the forecast of capital gains because of the stock market boom (Joint Legislative Budget Committee 2014b). In all, by spring in 2014, 24 states had increased their estimates while 17 had reduced theirs.

However, wage growth, an important driver of withholding that makes up the bulk of income tax revenue, was increasing more slowly. After growing 4.5 percent in 2012, wages rose only 2.8 percent in 2013 and 3.5 percent in the first quarter of 2014. In late 2011 and early 2012, wages were forecast to grow by about 4 percent in 2013. In Maryland, for example, the December 2012 official forecast of FY 2014 withholding was $250 million lower than the revised forecast in December 2013.[26]

The result of the uncertainty was an underestimate of revenues for FY 2013 and an overestimate for FY 2014 (figure 10). Several states also enacted changes to their income tax in 2013, adding additional layers of uncertainty. Kansas reduced its top tax rate from 6.45 percent to 4.9 percent, exempted most business income, and limited itemized deductions—three changes that made their tax year 2013 revenue estimate more difficult to determine, particularly for high-income taxpayers. Arizona passed a partial exemption of capital gains that allowed taxpayers to deduct 10 percent of net capital gains reported in 2012 and 2013 (Joint Legislative Budget Committee 2014a). California and Minnesota, on the other hand, raised taxes. California raised its income tax rates from 10.3 percent to 12.3 percent and had other events complicating the forecast (see box 1). Minnesota added a new top rate of 9.85 percent on income over $250,000 (married filing jointly).[27]

BOX 1

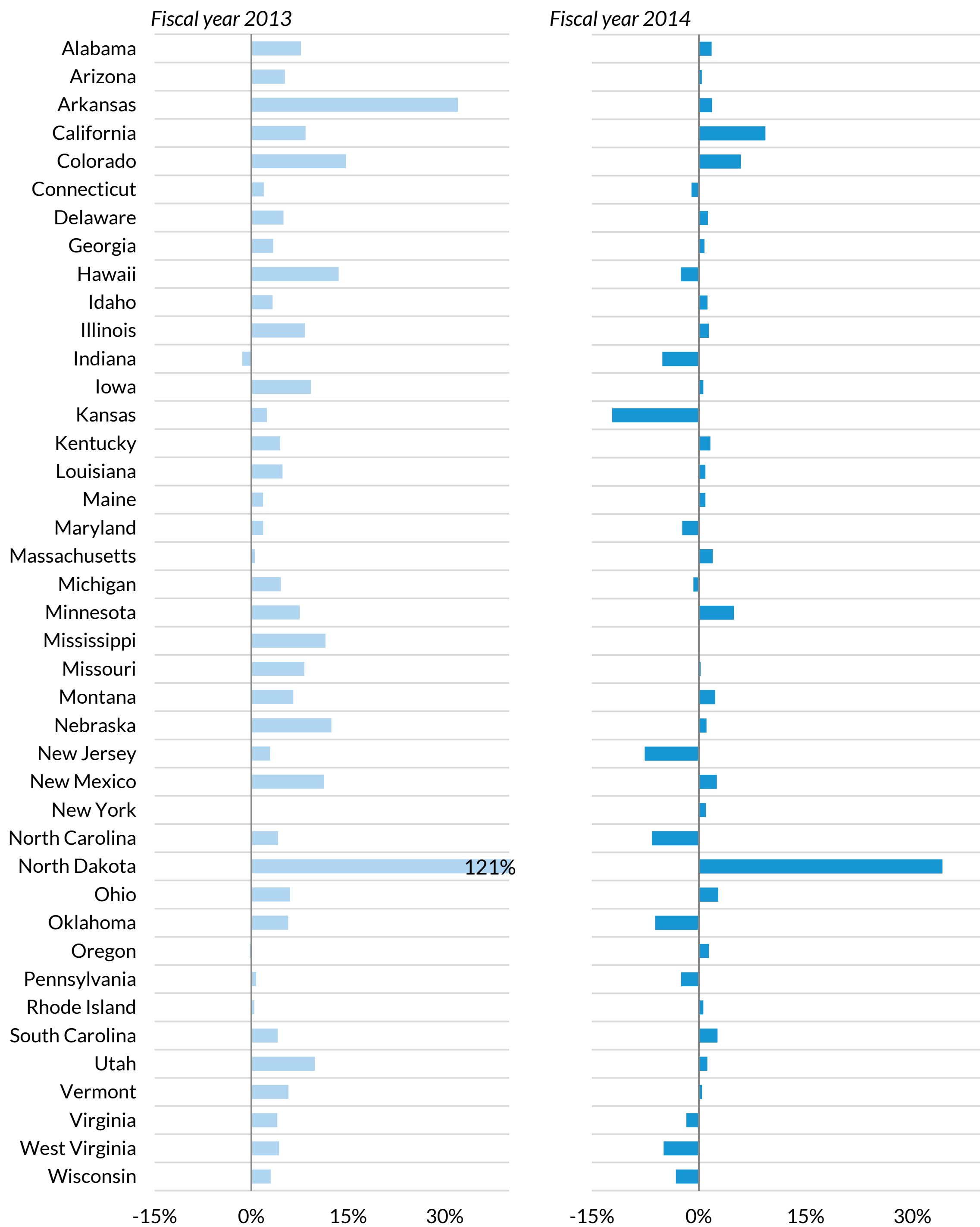
California

California derives almost half of its tax revenue from personal income tax and the information provided by California budget agencies is among the best and most transparent in the nation. In the fall of 2012, the state had a perfect storm combining the fiscal cliff with two significant tax events. In November, California voters passed Proposition 30, which retroactively increased tax rates on high-income taxpayers. The tax rates were temporarily increased from 10.3 percent to 12.3 percent, expiring in 2018. Then Facebook's initial public offering created hundreds of millionaires (and a few billionaires). The California Legislative Analyst's Office estimated that the fiscal cliff would shift 20 percent of normal capital gains realizations from 2013 to 2012 and that the Facebook public offering would generate $1.25 billion in additional capital gains spread over 2012 and 2013. Because the Proposition 30 increase was retroactive, the Analyst's Office warned of increased volatility (Taylor 2012).

FIGURE 10

Forecast Error

Difference in Estimated from Actual Personal Income Tax Collections by State



Source: NASBO, 2013b and 2014b.

Notes: States without broad-based income taxes excluded. Estimate was used to prepare budget.

Conclusions

The April surprise story of 2014 had many moving parts. First, the scheduled ACA surtaxes would hit high-income taxpayers beginning January 1, 2013. The surtaxes were big enough by themselves to induce some taxpayers to shift capital gains realizations into 2012, but probably not so big as to significantly shift bonuses or dividends.

Second, uncertainty about a possible tax hike led to significant additional shifting of income from 2013 into 2012. Had Congress passed ATRA earlier in the year, taxpayers would have known that the tax hike would be smaller than expected with the fiscal cliff and the level of special dividends and capital gains realizations would have been much lower in 2012. While Congress dithered, forecasters expected at least a one-year extension of the tax cuts enacted after 2001 and thus missed the shift of income into 2012.

Third, the federal policymaking did not align well with the state budget timelines. At various crucial points, states had already made decisions before they knew what the federal government would do. Fourth, the strong stock market performance in 2013 sent false signals about capital gains realizations, leading some states to revise the FY 2014 estimates upward.

In one high profile case, New Jersey revenue estimators took the blame for the state's 2014 revenue shortfall because too much of the revenue in 2013 was attributed to economic strength rather than the fiscal cliff.[28] But most states just got lucky: their extra FY 2013 revenues (relative to their underestimates) went into surpluses and their original FY 2014 budgets did not assume the 2013 surprise.

Could the estimates have been better? For budgeting, the lead time was too short to make accurate estimates. To get FY 2013 revenues right, estimators would have had to know in late 2011 or early 2012 what federal policy would be. By the time Congress enacted ATRA, the FY 2013 was half over. To get FY 2014 revenues right, estimators would have had to know what would happen to final payments for 2013. Unlike the 1986 tax reform, ATRA was passed too late for investors who took steps to limit the risk of a significant tax increase by realizing capital gains and issuing special dividends. Meanwhile, estimators made decisions based on a near-consensus expectation that Congress would extend the tax cuts.

But by summer of 2013, when FY 2014 had started, estimators should have taken a closer look at their forecasts to see if the new information supported their FY 2014 budget estimates. In particular, they should have analyzed the shift in capital gains into 2012 and asked whether a widespread portfolio rebalancing had dampened investor appetite for selling stocks in 2013 because more of gains would be short term (and taxed at regular income rates). For the states that really got it wrong, there was a head-in-the-sand outlook. In Kansas, Governor Sam Brownback attributed the surplus in FY 2013 to his own policies rather than the fiscal cliff.[29] In New Jersey, the estimate dropped from atmospheric to lofty but should have been flat.[30]

As 2013 ended, however, the market performed even better than expected, suggesting the new strength would offset more of the 2012 shift. When the data come out, part of the story likely will be a pullback in dividends (which many states do not explicitly factor into their models) as well as lower-than-expected capital gains realizations.

The most important lesson for states is to have workable rainy day funds to manage swings in revenue.[31] States that retained their surpluses that had built up since the recession and were augmented by the April 2013 surprise did not suffer fiscal crises in 2014. But states that capped their rainy day funds too low or did not divert enough of the 2013 surplus faced shortfalls in 2014. For example, Connecticut has a cap of 10 percent of general fund appropriations but, despite a balance of less than 5 percent, the state only deposited $178 million of the $398 million FY 2013 surplus in the state's rainy day fund (Office of Fiscal Analysis 2013).

One thing is certain. The fiscal cliff highlighted a new source of uncertainty: federal policy. It induced changes in taxpayer behavior that the data do not reflect. It also forced state revenue estimators to predict what the federal government would do and how their states' residents would respond. Though more dramatic than in other years, the fiscal cliff revealed the ongoing role that delayed federal actions can have on state budgets and estimators' abilities to forecast revenue streams. If Washington continues its habit of finalizing the national budget at the last minute and thereby leaving both spending policies and tax rules up in the air, states will have to build in buffers into their policies to avoid the impacts of April surprises.

Notes

1. States with different filing deadlines are Delaware (April 30), Hawaii (April 20), Iowa (April 30), Louisiana (May 15), and Virginia (May 1).
2. P.L. 113-295 (H.R. 5771) was enacted on December 16, 2014 and extended various provisions of the tax code that had expired on 12/31/2013 to 12/31/2014. Examples include the state and local sales tax deduction and the deduction for mortgage insurance premiums.
3. *California State Controller's Office State Tax Tracker* (blog), http://scotaxtracker.blogspot.com/.
4. Examples of expiring provisions are the state and local sales tax deduction and bonus depreciation.
5. DC was worried enough to reduce the revenue estimate based on projected cuts. See Natwar M. Gandhi to Vincent C. Gray and Kwame R. Brown, http://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/ocfo_fy_2011_revenue_estimates.pdf.
6. See the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Job and Growth Tax Relief Reconciliation Act of 2003. The tax provisions in these acts were set to expire in 2010 and were extended to 2012 by the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010.
7. CBO's baseline, which assumed the tax increases and the spending cuts, projected a contraction in 2013 in real gross domestic product. CBO's alternative scenario, which assumed 2012 tax law would be extended and the automatic BCA spending cuts would not occur, projected 1.7 percent growth in gross domestic product (CBO 2012a).
8. See the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010.
9. Middle Class Tax Cut Act S. 3412, 112th Cong. (2012), https://www.congress.gov/bill/112th-congress/senate-bill/3412.
10. See H.R. 8, 112th Cong. (2012): https://www.congress.gov/112/bills/hr8/BILLS-112hr8eh.pdf. See Tax Policy Center analysis for complete analysis of the competing proposals, "T12-0167 – Comparison of Tax Cut Extension Bills: S.3412, S.3413, and H.R.8, Impact on Tax Revenue," http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3463.
11. A payroll credit and other features of the American Recovery and Relief Act of 2009 were also expiring but are not discussed here.
12. The New York State controller reported that withheld income in December 2012 was 15 percent higher and estimated that $2.5 billion was shifted from 2013 to 2012. This response was probably strongest in New York where the financial industry is centered and bonus income is a larger share of compensation than the US average. Office of the New York State Comptroller, "Wall Street Bonuses Rose in 2012: Industry Profits Rebound from Prior Year," news release, February 26, 2013, http://www.osc.state.ny.us/press/releases/feb13/022613.htm.
13. The rate on interest and dividends in 2003 was 38.1 percent, reflecting the partial phase-in of lower top rates but would revert back to the 2000 level of 39.6 percent.
14. IRS Statistics of Income, Table A, July 2014.
15. The only comparable increase in dividend income was in 2004 when Microsoft paid a special dividend of $32 billion. Bureau of Economic Analysis, "Personal Income and Outlays, January 2013," news release, March 1, 2013, http://bea.gov/newsreleases/national/pi/2013/pi0113.htm.
16. In the 2012 White House budget, the "baseline" revenue estimate assumes continuation of these policies (US Department of Treasury, 2012). Minnesota explicitly adjusted capital gains for the ACA tax but assumed an extension of the 15 percent capital gains and dividend tax rate (Minnesota Management & Budget 2012).
17. Four states and the District of Columbia have different fiscal years: New York (April–March); Texas (September–August); and Alabama, District of Columbia, and Michigan (October–September).

18. In addition, a one-time tax rebate for tax year 2012 obscured the strength of Indiana's personal income tax revenue in 2013.

19. Retirement distributions, certain lottery winnings, and some mutual fund distributions are also subject to withholding.

20. For federal tax purposes, tax payers with income greater than $150,000 can avoid a penalty if they have made estimated payments or withheld income equivalent to 110 percent of prior year tax liability or 90 percent of current tax liability.

21. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not tax personal income; New Hampshire and Tennessee have narrow income taxes on dividends and interest. Budget estimates for FY 2013 were made in late 2011 or early 2012.

22. North Dakota's forecast for FY 2013 was made in April 2011, before oil prices shot up to over $100 per barrel.

23. A review of methodology reveals few states use dividends in forecasts of final or nonwithheld payments.

24. Excluding the four states and DC with different fiscal years (see note 16).

25. See Rick Lyman, "Battles Loom in Many States Over What to Do With Budget Surpluses." *New York Times*, February 2, 2014, http://www.nytimes.com/2014/02/03/us/battles-loom-in-many-states-over-what-to-do-with-budget-surpluses.html.

26. See Maryland Board of Revenue Estimates, http://finances.marylandtaxes.com/Where_the_Money_Comes_From/Board_of_Revenue_Estimates/default.shtml.

27. See Minnesota Department of Revenue, "2013 Individual Income Tax and Corporate Franchise Tax Legislative Bulletin," (Saint Paul: May 31, 2013), http://www.revenue.state.mn.us/law_policy/Documents/2013%20Individual%20Income%20Tax%20and%20Corporate%20Franchise%20Tax.pdf; the previous top rate was 7.85 percent on income above $140,961.

28. See Salvador Rizzo, "Chris Christie's Chief Economist to Resign," *NJ.com*, July 18, 2014, http://www.nj.com/politics/index.ssf/2014/07/christies_chief_economist_to_resign.html.

29. See Tim Carpenter, "Brownback Touts Kansas Model in Radio Address: Democrats Question Detail, Intent of Governor's Address," *CJOnline.com*, April 6, http://cjonline.com/news/state/2013-04-06/brownback-touts-kansas-model-radio-address.

30. The original forecast for FY 14 was for 7.7 percent growth. This was revised down to 5.9 percent in February 2014, just before the April 2014 surprise. Actual growth was just 1.7 percent. Details can be found at the Office of Legislative Services website, http://www.njleg.state.nj.us/legislativepub/snapshot.asp.

31. A rainy day fund is akin to a savings account for states to provide a cushion against volatility and a critical element to maintain balanced budgets.

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