

# Legislative Fiscal Bureau

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*State of Wisconsin*

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Senator Alberta Darling, Senate Chair  
Representative John Nygren, Assembly Chair  
Joint Committee on Finance  
State Capitol  
Madison, WI 53702

Dear Senator Darling and Representative Nygren:

In January of each year, this office conducts a review of the status of the state's general fund and presents its findings to the Legislature. In the even numbered years, this analysis includes an examination of economic forecasts and tax collection and expenditure data of the current fiscal year, and projections for each year of the current biennium. We have now completed that review.

Based upon our analysis, we project the closing, net general fund balance at the end of this biennium (June 30, 2019) to be \$385.2 million. This is \$137.5 million above the balance that was projected at the time of enactment of the 2017-19 biennial budget (2017 Act 59).

The \$137.5 million is the net result of: (1) an increase of \$76.3 million in estimated tax collections; (2) an increase of \$1.7 million in departmental revenues (non-tax receipts deposited into the general fund); (3) a decrease of \$97.7 million in net appropriations, and (4) a transfer of \$38.2 million to the budget stabilization fund.

The majority (\$77.8 million) of the \$97.7 million net appropriation reduction is due to reestimates of the amounts necessary to fund general fund debt service. General fund debt service savings are primarily attributable to three 2017 general obligation bond refinancing transactions and partly the result of a slower pace of bond issuance compared to earlier issuance assumptions. Recent changes to federal tax law have an effect on municipal bond refunding transactions. Effective in 2018, interest on a bond issued to advance refund another bond is no longer tax-exempt. This change prompted the state to advance refund bonds before the end of 2017, that were originally scheduled for advance refundings in 2018.

Under s. 16.518(3) the statutes, if actual tax collections exceed the amounts estimated in the state's biennial budget act, one-half of such excess is deposited into the budget stabilization

fund. Under the estimates of this analysis, tax collections are projected to exceed the Act 59 estimate by \$48.4 million in 2017-18 and \$27.9 million in 2018-19. Thus, one-half of that amount, \$24.2 million in 2017-18 and \$14.0 million in 2018-19 would transfer to the budget stabilization fund.

The following table reflects the 2017-19 general fund condition statement, which incorporates our revenue and expenditure projections.

**TABLE 1**  
**2017-19 General Fund Condition Statement**

	<u>2017-18</u>	<u>2018-19</u>
<b>Revenues</b>		
Opening Balance, July 1	\$579,015,000	\$652,082,900
Taxes	16,125,900,000	16,678,800,000
Departmental Revenues		
Tribal Gaming Revenues	26,157,000	26,085,900
Other	<u>485,877,700</u>	<u>452,009,000</u>
Total Available	\$17,216,949,700	\$17,808,977,800
<b>Appropriations and Reserves</b>		
Gross Appropriations		
2017 Act 59	\$16,876,502,200	\$17,690,079,800
Other 2017 Acts	19,922,500	10,281,300
Sum Sufficient Reestimates	-47,581,300	-5,288,800
Transfers to		
Transportation Fund	40,194,700	41,597,100
Budget Stabilization Fund	24,207,600	13,961,600
Compensation Reserves	3,080,500	52,081,600
Less Lapses	<u>-351,459,400</u>	<u>-453,889,700</u>
Net Appropriations	\$16,564,866,800	\$17,348,822,900
<b>Balances</b>		
Gross Balance	\$652,082,900	\$460,154,900
Less Required Statutory Balance	<u>-70,000,000</u>	<u>-75,000,000</u>
Net Balance, June 30	\$582,082,900	\$385,154,900

Table 1 incorporates the fiscal effects of all bills enacted to date in the current legislative session (through 2017 Act 135). It does not reflect the impact of any bills that are pending before the Legislature.

**General Fund Tax Revenues**

The following sections present information related to general fund tax revenues for the

2017-19 biennium, including a discussion of the national economic forecast and general fund tax revenue estimates for fiscal years 2017-18 and 2018-19.

**National Economic Review.** This office prepared revenue estimates for the 2017-19 biennium in January, 2017, based on the January, 2017, IHS Markit forecast for the U.S. economy. The forecast predicted real (inflation-adjusted) gross domestic product (GDP) growth of 2.3% in 2017, 2.6% in 2018, and 2.3% in 2019. The main drivers of growth were expected to be consumer spending, business fixed investment, and residential investment. On the other hand, IHS Markit expected the trade deficit to be a drag on economic growth, due to an appreciating U.S. dollar that was projected to increase domestic demand for imports.

The January, 2017, forecast was based on the following assumptions. First, Congress would lower the average personal income tax rate from 21.0% to 19.5% and lower the statutory corporate tax rate from 35% to 20% (partially offset by reducing tax deductions and credits). Second, federal infrastructure spending would increase by \$250 billion over the next ten years. Third, the Federal Reserve would increase the federal funds rate by 75 basis points in each of the next three years to 1.50% by the end of 2017, 2.25% by the end of 2018, and 3.00% by the end of 2019. Fourth, the Brent spot crude oil price would average \$54 per barrel in 2017 and \$57 per barrel in 2018. Fifth, the inflation-adjusted, trade-weighted value of the dollar for the broad index of U.S. trading partners would increase 3.3% between fourth quarter 2016 and fourth quarter 2017, where it would reach its peak value at 5.5% above the 2016 average, followed by a steady decline. Finally, the real GDP growth of major and other important U.S. trading partners would average 1.7% annually and 3.5% annually, respectively, over the next ten years.

In May, our office reviewed additional tax collection data and IHS Markit's May economic forecast and did not revise revenue estimates for 2016-17, 2017-18, or 2018-19. We noted that the May forecast was very similar to the January forecast and that tax sources were closely tracking the January revenue estimates and anticipated collection patterns. In September, 2017, it was reported that actual 2016-17 general fund tax collections deviated from the January, 2017, projections by only 0.1%.

The economy grew slowly in the first quarter of 2017, but strong momentum in the remainder of the year brought overall growth in line with the forecast. Real growth in GDP is now estimated at 2.2% in 2017, which is 0.1% less than estimated last January. As forecast, economic growth was bolstered by consumer spending and strong business investment.

Growth in employment, income, and household assets supported a 4.4% increase in personal consumption expenditures (PCE). Employers added more than 2.1 million jobs to lower the unemployment rate to 4.1% in the fourth quarter. Overall, there have been 86 consecutive months of jobs gains. Although personal income grew more slowly than forecast (3.1% compared to 4.6%), household net worth grew by more than forecast (7.5% compared to 4.5%). Household net worth increased by \$6.9 trillion in 2017, led by growth in financial assets (7.8%) such as stocks (15.4%). Wages also grew, albeit more slowly, at 2.6%. The personal saving rate fell to a 10-year low of 3.1% in the fourth quarter of 2017 as consumption growth (4.4%) outstripped gains in disposable income (3.0%).

Residential investment, on the other hand, grew by less than anticipated in 2017. IHS Markit reports that national housing starts rose 2.9% in 2017, well short of the 5.2% increase that had been forecast. Single family housing starts grew by 8.9% whereas multi-family units shrank by 9.0%. One possible explanation for the drop in multi-family starts is that the household formation rate amongst those aged 25 to 29 (who are more likely to utilize multi-family units) reached an all-time low in mid-2017. Other possible causes of the shortfall in housing starts include disruptions by damages and delays caused by the active hurricane season, tight credit for developers, and supply shortages of skilled labor.

The assumptions used in the IHS Markit January, 2017, forecast were mostly accurate. As predicted, the Federal Reserve increased the federal funds rate by 75 basis points to 1.5% in 2017. Further, Congress enacted the Tax Cuts and Jobs Act of 2017, which reduces the corporate tax rate from 35% to 21% and lowers the average effective personal income tax rate by about two percentage points (until the provisions expire in 2026). Similar to the forecast, actual oil prices increased to an average Brent spot price of \$54.8 per barrel in 2017, and \$61 by the end of the fourth quarter. The accuracy of other assumptions was mixed, however. For instance, Congress did not enact an infrastructure bill and it is unclear that it will do so in 2018. Further, the value of the dollar declined by 7.0%, in the broad-based dollar index rather than grow as forecasted by 5.3%. This was due in part to economic growth of trading partners and possibly due to a market correction after the surge in the dollar directly following the 2016 November election.

**National Economic Forecast.** Under the January, 2018, forecast, IHS Markit predicts real GDP growth of 2.7% in 2018 and 2.6% in 2019. Consumer spending and business investment are expected to contribute to growth throughout 2018 and into 2019. The trade deficit is again expected to be a drag on economic growth.

The new forecast is based on the following key assumptions. First, the recently enacted Tax Reform and Jobs Act of 2017 is projected to generate a modest boost to real GDP growth of approximately 0.1% percentage point in 2018 and 0.2% percentage point in 2019. Second, the Federal Reserve will increase the federal funds rate by 75 basis points to 2.25% by the end of 2018 and by 50 basis points to 2.75% by the end of 2019. Third, the Brent oil price is projected to decrease from \$61 per barrel in the fourth quarter of 2017 to \$55 per barrel by the fourth quarter of 2018. Fourth, the inflation-adjusted, trade-weighted value of the dollar for the broad index of U.S. trading partners will increase 1.5% throughout 2018 and reach a peak value in the first quarter of 2019 (which would be 1.3% below the 2016 average value). Finally, the real GDP growth of major-currency and other important U.S. trading partners will average 2.0% and 3.2%, respectively, in 2018.

The forecast is summarized in Table 2, which reflects IHS Markit's January, 2018, baseline outlook. Selected baseline projections are presented in more detail below, with alternative optimistic and pessimistic scenarios discussed thereafter.

**TABLE 2**

**Summary of National Economic Indicators  
IHS Markit Baseline Forecast January, 2018  
(\$ in Billions)**

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Nominal Gross Domestic Product	\$18,624.5	\$19,382.4	\$20,301.2	\$21,288.5
Percent Change	2.8%	4.1%	4.7%	4.9%
Real Gross Domestic Product	\$16,716.2	\$17,091.6	\$17,546.7	\$17,995.1
Percent Change	1.5%	2.2%	2.7%	2.6%
Consumer Prices (Percent Change)	1.3%	2.1%	1.7%	1.9%
Personal Income	\$15,928.7	\$16,415.9	\$17,132.9	\$18,031.3
Percent Change	2.4%	3.1%	4.4%	5.2%
Nominal Personal Consumption Expenditures	\$12,820.7	\$13,385.6	\$13,946.3	\$14,535.7
Percent Change	4.0%	4.4%	4.2%	4.2%
Economic Profits	\$2,073.5	\$2,169.2	\$2,300.8	\$2,383.7
Percent Change	-2.1%	4.6%	6.1%	3.6%
Unemployment Rate	4.9%	4.4%	3.9%	3.7%
Total Nonfarm Payrolls (Millions)	144.3	146.5	148.8	151.0
Percent Change	1.8%	1.5%	1.6%	1.5%
Light Vehicle Sales (Millions of Units)	17.47	17.15	16.93	16.85
Percent Change	0.4%	-1.8%	-1.3%	-0.5%
Sales of New and Existing Homes (Millions)	6.001	6.169	6.408	6.601
Percent Change	4.6%	2.8%	3.9%	3.0%
Housing Starts (Millions of Units)	1.177	1.211	1.289	1.402
Percent Change	6.3%	2.9%	6.4%	8.7%

*Employment.* Total nonfarm payrolls increased for the seventh consecutive year in 2017 by 1.5% to a total of 146.45 million. The unemployment rate averaged 4.4% in 2017, ending the year at 4.1% in the fourth quarter. The biggest employment increases were in natural resources and mining (4.6%), professional and business services (2.9%), and construction (2.8%). Manufacturing employment growth was modest (0.7%).

IHS Markit forecasts that the employment market will remain strong, with total nonfarm payrolls expanding by 1.6% in 2018 to 148.76 million and by 1.5% in 2019 to 151.01 million. The unemployment rate is expected to decrease to 3.9% in 2018 and 3.7% in 2019. Employment in manufacturing is expected to grow by 2.1% in 2018 and 1.6% in 2019, bolstered by

employment in manufacturing wood products (3.2% in 2018 and 6.0% in 2019) and machinery (5.0% in 2018 and 3.5% in 2019).

*Personal Income.* Personal income is forecast to grow robustly by 4.4% in 2018 and 5.2% in 2019, due to a strong employment market and increases in wages and salaries (4.4% in 2018 and 5.5% in 2019). As a result, IHS Markit estimates that real disposable income will grow by 3.8% in 2018 and 3.7% in 2019. On the other hand, IHS Markit expects growth in household financial assets to moderate in 2018 (3.5%) and 2019 (2.3%), with growth in household holdings of corporate equities decreasing from 15.4% in 2017 to 3.0% in 2018 and -0.4% in 2019. Partly as a result, growth in real household net worth is expected to decrease from 5.8% in 2017 to 2.8% in 2018 and 1.0% in 2019.

IHS Markit estimates that the Tax Reform and Jobs Act of 2017 will lower effective personal income tax rates by approximately 2%. As a result, the personal savings rate is expected to increase from 3.5% in 2017 to 4.3% in 2018 and 5.3% in 2019. In particular, growth in real disposable income (6.4%) is expected to exceed growth in real consumer spending (2.7%) in the first quarter of 2018.

*Personal Consumption.* IHS Markit estimates that nominal PCE will grow by 4.2% in both 2018 and 2019, supported by strong employment and income growth. IHS Markit estimates that the Tax Reform and Jobs Act of 2017 will increase real consumption growth by 0.2% in each of the next two years.

Sales of consumer items generally subject to the state sales tax (such as most durable goods, clothing, restaurant meals and accommodations, and certain services) grew by an estimated 3.6% in 2017 and are forecast to grow by 4.0% in both 2018 and 2019. Spending on gasoline and other energy goods is expected to decline 1.6% in 2018 and 0.1% in 2019 after growing by 10.7% in 2016. Purchases of light vehicles declined 1.8% in 2017, down from a record number of sales in 2016. Due in part to lower oil prices in 2016 and at the start of 2017, purchases of light trucks increased 4.3%; however, car purchases declined 11.1%. A somewhat similar pattern is predicted to hold in the next two years, with cars sales decreasing 4.9% in 2018 and 1.3% in 2019 and truck sales increasing 0.7% in 2018 and decreasing by only 0.1% in 2019.

*Corporate Profits.* After a 4.0% decline in 2015 and no growth in 2016, before-tax corporate profits grew 7.0% in 2017. IHS Markit forecasts continued growth of 4.1% in 2018 and 3.8% in 2019. Economic profits, which are adjusted for inventory valuation and capital consumption at current cost (and thus are not affected by federal tax laws), increased by 4.6% in 2017 and are forecast to increase by 6.1% in 2018 and by 3.6% in 2019.

The forecast reflects that the Tax Reform and Jobs Act of 2017 reduced the federal corporate tax rate from 35% to 21%, extended bonus depreciation by five years (followed by a three-year phase-out period), and provided additional tax deductions for certain pass-through business income. The 2018 forecast assumes that the effective tax rate for all industries will drop from 21.2% in 2017 to 9.2% in 2018, a 12.0-percentage-point difference that is expected to narrow in the future to 4.6% by 2027 as the depreciation provisions expire.

*Housing.* Low overall residential construction in 2017 led to tight supply, which supported growth in housing prices. According to the Wisconsin Realtors Association, the median value Wisconsin home price rose 5.6% year-over-year in November. For comparison, the volume of sales through November grew by only 1.7% over the same period last year.

In 2018, IHS Markit forecasts that the housing market will continue its recovery, supported by growth in incomes and employment. The household formation rate is expected to stabilize at its current levels and growth in overall housing starts is expected to accelerate in 2018 (6.4%). In particular, multi-family starts are expected to rebound, growing by 8.0% in 2018 and 14.0% in 2019. Housing prices for existing homes are expected to continue their rally into 2018, growing by 4.9%, in part due to growing demand and tight supply. However, growth in the sales of existing homes is not expected to be sufficient to increase sales to their 2005 pre-recessionary peak during the forecast period (through 2027).

It should be noted that the Tax Reform and Jobs Act of 2017 places a deductibility cap of \$10,000 on state and local taxes (which includes property taxes), caps the maximum mortgage amount for which interest payments may be deducted to \$750,000, and doubles the standard deduction (which erodes the value of itemizing deductions based on home ownership). Thus, the new law is expected to place downward pressure on housing prices, especially on the higher end, by an unknown amount going forward.

*Business Investment.* Nonresidential fixed investment grew 5.8% in 2017, led by investment in equipment (5.5%), intellectual property products (4.8%), and nonresidential structures (8.1%). Strong investment into mining and petroleum structures in the first half of the year (which grew 272% in the first quarter and 116% in the second quarter) supported investment into nonresidential structures.

IHS Markit anticipates that nonresidential fixed investment will continue to grow strongly by 6.7% in 2018 and 6.0% in 2019, supported by expanding global markets, low capital costs, and an improving regulatory climate. Investment in equipment is anticipated to expand by 8.4% in 2018 and 6.2% in 2019, supported by gains in industrial equipment (13.3% in 2018 and 7.3% in 2019) and aircraft (17.4% in 2018 and 18.6% in 2019). Investment in intellectual property products is forecast to remain strong, growing 4.8% in 2018 and 7.7% in 2019.

Investment in nonresidential structures and equipment in Wisconsin is expected to increase significantly in the short term due to the planned investment by Hon Hai Precision Industry, Co., Ltd (Foxconn) to construct a flat-screen manufacturing facility. It is anticipated that construction will begin in early 2018 and may require four or more years. Construction will also likely require significant additional improvements to local road and utility infrastructure, estimated at potentially more than \$1 billion. Foxconn has indicated that it plans to begin hiring employees to start assembly operations in 2018 and will expand operations over the next several years as the facilities are constructed.

*Consumer Prices.* The consumer price index (CPI) increased by 2.1% in 2017. Despite expected wage inflation from a tight labor market, IHS Markit forecasts that the CPI will continue to increase moderately by 1.7% in 2018 and by 1.9% in 2019. Core inflation, which

excludes energy and food prices, is expected to grow by 1.9% in 2018 and by 2.2% in 2019. Energy prices surged by 7.9% in 2017, but are expected to moderate to 0.4% growth in 2018 and 0.7% growth in 2019 as oil prices stabilize lower. Food prices, which grew only by 0.9% in 2017, are expected to grow modestly by 1.1% in 2018 and by 1.8% in 2019.

*Monetary Policy.* Although core inflation growth is below the Federal Reserve's 2.0% target, the Federal Reserve raised its target range for the federal funds rate three times in 2017, raising the target range to 1.25-1.50% in December. The rate hikes were due in part to the strong employment outlook. In its most recent meeting, the Federal Reserve continued to forecast 2.0% inflation over the medium term and for the unemployment rate to fall below 4.0% for a short time. IHS Markit assumes that the Federal Reserve will raise the federal funds rate by 25 basis points three times to 2.25% by the end of 2018 and two more times in 2019 to 2.75%.

IHS Markit projects that interest rates will increase throughout 2018. The average annual interest rate on a 30-year conventional fixed-mortgage is estimated to increase from 3.99% in 2017 to 4.54% in 2018 and 5.05% in 2019. The average annual yield on the 10-year U.S. treasury note is expected to increase from an estimated 2.33% in 2017 to 3.01% in 2018 and 3.54% in 2019.

*International Trade.* IHS Markit forecasts that net exports will continue to detract from GDP, as import growth outpaces export growth. Real exports grew by an estimated 3.4% in 2017, supported by a surge in exports of petroleum and petroleum products (10.1%). Overall, exports are anticipated to increase by 5.3% in 2018 and 4.3% in 2019, supported by strong growth in world real GDP. However, imports are expected to grow by even more than exports during this period (6.2% in 2018 and 4.8% in 2019), due in part to an appreciating U.S. dollar and increasing incomes in the U.S. boosting demand for foreign goods.

*Alternative Scenarios.* IHS Markit's 2018 forecast also includes an optimistic scenario and a pessimistic scenario. Under the optimistic scenario, IHS Markit assigns a 15% probability that the housing market recovery intensifies due to increased household formation amongst young adults. This drives increased housing starts, consumer spending, and business investment, increasing real GDP growth in 2018 to 3.7% and 4.0% in 2019. Low oil prices and inflation buoy consumer and business confidence while the stock market continues its rally through 2019. Exports jump in 2018 as economic conditions across the world improve. The Federal Reserve refrains from raising interest rates before 2020.

Under the pessimistic scenario, to which IHS Markit assigns a 20% probability, a drop in consumer confidence of 19% and a setback in the commercial real estate market shock the economy into recession in the second half of 2018. The drop in confidence drives up long-term interest rates and dampens the strength of the dollar after the first quarter of 2018. The higher interest rates and lower confidence end the housing recovery as housing starts never surpass 1.5 million. The stock market falls 17.6% between its fourth-quarter 2017 peak and its trough in the first quarter of 2019. Higher interest rates reduce growth in consumer spending and business fixed expenditures. As a result, the pessimistic scenario estimates that the US economy contracts at annual rates of 0.8% in the third quarter of 2018 and then 1.8% in the fourth quarter. The unemployment rate climbs through most of 2019, reaching an eventual peak of 5.2%.



## General Fund Taxes

Table 3 shows general fund tax revenue estimates for 2017-18 and 2018-19. In total, these amounts are \$76.3 million higher than the Act 59 estimates. The percentage difference is 0.2%. The excess revenue is almost entirely due to increased projections for the general sales and use tax. Sales tax collections are estimated to be higher than last January's estimates by \$81.2 million in 2017-18 and \$56.9 million in 2018-19. Estimated collections for the real estate transfer fee have also been increased slightly. Small downward adjustments have been made to most of the other taxes.

**TABLE 3**

### Projected General Fund Tax Revenues (Millions)

	2016-17 <u>Actual</u>	Previous Estimates		Revised Estimates January, 2018	
		<u>2017-18</u>	<u>2018-19</u>	<u>2017-18</u>	<u>2018-19</u>
Individual Income	\$8,039.5	\$8,379.8	\$8,720.0	\$8,380.0	\$8,720.0
General Sales and Use	5,223.9	5,383.8	5,593.1	5,465.0	5,650.0
Corporate Income and Franchise	921.0	950.8	962.4	950.0	960.0
Public Utility	360.5	373.5	378.2	359.0	363.0
Excise					
Cigarette	564.2	564.7	560.4	548.0	547.0
Tobacco Products	80.3	85.0	88.0	82.0	85.0
Liquor and Wine	52.1	52.0	53.0	52.0	53.0
Beer	9.1	8.9	8.8	8.9	8.8
Insurance Company	181.6	192.0	197.0	190.0	195.0
Miscellaneous Taxes	<u>85.5</u>	<u>87.0</u>	<u>90.0</u>	<u>91.0</u>	<u>97.0</u>
<b>Total</b>	<b>\$15,517.6</b>	<b>\$16,077.5</b>	<b>\$16,650.9</b>	<b>\$16,125.9</b>	<b>\$16,678.8</b>
Change from Prior Year		\$559.88	\$573.40	\$608.30	\$552.88
Percent Change		3.6%	3.6%	3.9%	3.4%

The new estimates are based on the most recent national economic forecast and tax collections data. They reflect all state tax law changes enacted to-date, and also four provisions of the federal Tax Cut and Jobs Act that will automatically be adopted for state income and franchise tax purposes. These include provisions expanding immediate expensing of business equipment purchases under section 179 of the Internal Revenue Code (IRC), increasing the exemption amounts for the alternative minimum tax (AMT), repealing statutes regarding technical termination of partnerships, and modifying the procedure for claiming the historic rehabilitation credit. It is estimated that the aggregate fiscal effect of these provisions will be a reduction in state tax revenues of \$16.6 million in 2017-18 and \$32.3 million in 2018-19.

In order to adopt other relevant provisions of the new law, legislation to update references to the federal IRC is necessary. This office is reviewing the federal law and preparing an analysis

of those provisions that are relevant for state tax purposes.

**Individual Income Tax.** State individual income tax revenues were \$8,039.5 million in 2016-17 and are estimated at \$8,380.0 million in 2017-18 and \$8,720.0 million in 2018-19. These amounts are unchanged from the amounts estimated in January, 2017, except for the effects of state law changes enacted since then. On a year-to-year basis, the current estimates represent increases of 4.2% for 2017-18 and 4.1% for 2018-19.

Based on preliminary collection information through December, 2017, individual income tax revenues for the current fiscal year are 5.3% higher than such revenues through the same period in 2016-17. These amounts include adjustments for pass-through withholding and for collections that occurred in January, but can be attributed to December because the month ended on a weekend. A lower rate of increase (3.3%) is anticipated over the next six months because refunds and final payments for tax year 2017 are expected to be affected by higher estimated payments at the end of 2017 by individuals anticipating the effects of the federal Tax Cuts and Jobs Act. It is believed that the \$10,000 limit on itemized deductions for state and local taxes under the Act, which will take effect in tax year 2018, has induced some taxpayers to accelerate federal deductions for state income taxes into tax year 2017.

Several provisions of the Act related to Section 179 expensing, AMT exemption levels, and the historic rehabilitation tax credit will automatically take effect for state tax purposes in tax year 2018 and reduce future state individual income tax collections, estimated at about -\$10.0 million in 2017-18 and -\$20.0 million in 2018-19. However, recent growth in collections has created a stronger base than previously estimated that should allow growth in collections that offset these reductions.

**General Sales and Use Tax.** State sales and use tax revenues totaled \$5,223.9 million in 2016-17 which was an increase of 3.1% over the prior year. Sales tax collections through December, 2017 are 5.2% higher than the same period in 2016. Accounting for law changes since the January, 2017, estimate, sales tax revenues are estimated to be \$5,465.0 million in 2017-18 and \$5,650.0 million in 2018-19, reflecting growth of 4.6% and 3.4% respectively.

**Corporate Income and Franchise Tax.** Corporate income/franchise taxes were \$921.0 million in 2016-17, which was \$21.0 million above the estimate. Corporate tax revenues are projected to be \$950.0 million in 2017-18 and \$960.0 million in 2018-19. These estimates reflect growth of 3.2% in 2017-18 and 1.1% in 2018-19.

The revised estimates are virtually unchanged from the Act 59 projections, reflecting several offsetting factors. While the January, 2018, forecast for growth in corporate economic profits for 2017 was reduced from the January, 2017, forecast, actual 2016-17 collections exceeded the prior estimate. Year-to-date corporate collections (including pass-through withholding) are 2.4% higher than the same period in 2016. However, there are two factors that we believe cause the year-to-date growth rate to be understated. First, 2017 Wisconsin Act 2 delayed the due date for the first estimated payment most corporations make by one month, shifting estimated payments for certain taxpayers that would have occurred in December, 2017, to January, 2018. Second, it is expected that some corporations incurred additional expenses

during the latter part of tax year 2017 in order to shift taxable income, and federal and state estimated payments associated with that taxable income, from tax year 2017 to 2018, in response to the lower federal corporate tax rates beginning in tax year 2018. Collections are expected to grow 3.7% over the remainder of 2017-18 to reach the revised estimate.

Federal law changes related to Section 179 expensing and the historic rehabilitation tax credit will automatically take effect for state tax purposes in tax year 2018 and reduce corporate income/franchise taxes by an estimated \$6.4 million in 2017-18 and \$12.1 million in 2018-19. These provisions offset the improved January, 2018, forecast for growth in economic profits in 2018 and 2019.

**Public Utility Taxes.** Public utility tax revenues were \$360.5 million in 2016-17, and are projected at \$359.0 million in 2017-18 and \$363.0 million in 2018-19. Compared to the previous estimates, these amounts are lower by \$14.5 million in 2017-18 and \$15.2 million in 2018-19. Utility tax collections are expected to decrease by 0.4% in 2017-18 and increase by 1.1% in 2018-19. Private light, heat, and power companies are the largest taxpayer group, comprising 64% of estimated public utility taxes for the 2017-19 biennium. Collections from these companies totaled \$229.6 million in 2016-17, and are estimated to decrease to \$227.7 million in 2017-18 (-0.8%) and increase to \$236.5 million (3.9%) in 2018-19. The decrease in 2017-18 reflects, in part, less electricity and natural gas consumed in 2017 than in 2016. These companies' 2017 sales form the basis for their 2018 license fee.

**Excise Taxes.** General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), other tobacco products, and beer. In 2016-17, excise tax collections totaled \$705.7 million, a decrease of 0.4% from the previous fiscal year. Of this amount, \$564.2 million (approximately 80%) was from the excise tax on cigarettes. Excise tax revenues are estimated at \$690.9 million in 2017-18, which represents reduced revenues of 2.1%. Excise tax revenues in 2018-19 are estimated at \$693.8 million in 2018-19, which represents an increase of 0.4%.

The estimated 2017-18 reduction in excise tax revenues is primarily from: (a) a decline through December, 2017, in year-to-year cigarette tax collections, which are currently 3.5% lower than collections over the same period in 2016-17; and (b) slower growth in tobacco products tax collections than previously estimated (0.7% through December, 2017, compared to the estimated 5.9% annual growth).

**Insurance Premiums Taxes.** Insurance premiums taxes totaled \$181.6 million in 2016-17, which was \$5.4 million less than had been estimated in January, 2017. Premiums tax collections are projected to be \$190.0 million in 2017-18 and \$195.0 million in 2018-19. The estimates are lower than prior estimates by \$2.0 million in each year. The reduced estimate in the first year is primarily caused by a lower base for tax collections following the actual collection total in 2016-17, offset partly by higher than expected year-to-date collections of 4.0% and an improved forecast for consumer spending on financial services and insurance. The estimate for 2018-19 reflects historic tax collection growth trends.

**Miscellaneous Taxes.** Miscellaneous taxes include the real estate transfer fee, municipal and circuit court-related fees, and a small amount from the occupational tax on coal.

Miscellaneous tax revenues were \$85.5 million in 2016-17, of which 83.0% was generated through the real estate transfer fee. Based on the economic forecast for the housing sector, as well as collections through December, 2017, miscellaneous taxes are projected to increase to \$91.0 million in 2017-18, which represents a 6.5% increase from 2016-17 collections. Miscellaneous taxes are estimated to increase 6.6% to \$97.0 million in 2018-19, primarily due to an anticipated continuation of the housing recovery.

This office will continue to monitor state revenues and expenditures and new economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,

A handwritten signature in black ink, appearing to read "R. Lang". The signature is stylized with a large, looped "R" and a cursive "Lang".

Robert Wm. Lang  
Director

RWL/lb

cc: Members, Wisconsin Legislature