# Legislative Fiscal Bureau

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June 10, 2020

TO: Members
Wisconsin Legislature

FROM: Bob Lang, Director

SUBJECT: May, 2020, General Fund Tax Collections

This memorandum provides information regarding: (a) general fund tax collections for the month of May, 2020; (b) unemployment insurance claims through the week ending June 6, 2020; and (c) factors affecting the 2019-20 general fund balance.

On January 23, 2020, this office distributed projections of general fund revenues for the 2019-21 biennium. That report, when adjusted for tax law changes enacted under the federal CARES Act and 2019 Wisconsin Acts 181 and 185, estimated that tax collections for 2019-20 would increase by 1.75% ($303 million) over 2018-19 collections and that 2020-21 taxes would increase by 2.0% ($354 million) over the 2019-20 estimate.

Actual tax collections for the first nine months of the current fiscal year (through March, 2020) increased by 5.1% over the same period for 2018-19. Although this growth was higher than the projected 1.75%, collections were on target with the estimates as the impact of the individual income tax rate reductions of 2019 Acts 9 and 10 would be realized in the remaining months of the 2019-20 fiscal year.

The contraction following the coronavirus pandemic resulted in the largest month-over-month increase in seasonally adjusted unemployment since the data series began in 1976. The seasonally adjusted unemployment rate in Wisconsin for April, 2020, was 14.1%, which was 11 percentage points higher than the March rate of 3.1%. The increase in the number of unemployed individuals was expected to result in diminished taxable salaries and wages, lower state sales and use tax collections reflecting limited ability for consumers to purchase taxable goods and services, and lower corporate income/franchise taxes due to reduced corporate profits.

**Preliminary General Fund Tax Collections, May, 2020**

Preliminary information on taxes collected by DOR for the month of May, 2020, is now available. As anticipated, due to the coronavirus pandemic and its impact on employment and the economy, the May report indicates a continued reduction in collections. May, 2020, preliminary tax collections were $1,261 million, which is $66 million below collections of May, 2019. And, for the 11 months of the current fiscal year, collections are $380 million below those over the same 11 months of 2018-19.

Although collections for May reflect a continued decline, the decline is significantly less than that shown in the April collection report. April, 2020, collections were $870 million below April, 2019, collections. In contrast, the May, 2020, collections are $66 million below those for the same month in 2019.

The decline in May collections is primarily attributable to lower state sales and use taxes, which reflects that the coronavirus pandemic has severely impacted economic activity in the state and tax collections. Reduced collections for the 11 months of the current fiscal year have been affected by the extension of income and franchise tax filing deadlines from April to July 15 in 2020. It is important to note, however, that income and franchise tax returns and estimated payments filed by July 15 will accrue to state fiscal year 2019-20 under the state's budgetary cash and modified accrual method of accounting.

***Individual Income Tax.*** Preliminary individual income tax collections for May, 2020, are $4 million (0.7%) lower than those collected in May, 2019. Year-to-date, individual income tax collections for 2019-20 are lower by $690 million, or 9.0% lower than the comparable 11-month period in 2018-19. Most of the decline in tax collections year-to-date is likely caused by the delayed filing dates for estimated payments and final payments. It is assumed that many individuals have taken advantage of the filing date extension and will wait to make payments closer to the July filing date.

Estimated payments and final payments that were otherwise owed in April are now due in July. Year-to-date estimated payments are $713 million, which are $448 million lower than the comparable period in 2018-19. Individual final payments year-to-date are $348 million, or $320 million lower than the same period a year ago. This partly reflects lower tax payments related to the income tax rate reductions for tax year 2019 enacted under 2019 Acts 9 and 10, but is also skewed by the delayed filing date for individuals. Final payments and refunds for tax year 2019, and April and June estimated payments for tax year 2020, will not be known until after the July filing date.

Preliminary withholding tax collections for May were 2.1% higher than the same month in the previous year. Adjusting for the $36.5 million withholding deposit that occurred last May relating to the individual who won the lottery, withholding collections would be higher by 8.4% for the current month. Year-to-date, withholding collections are higher by 3.5% compared to the same 11-month period in 2018-19. According to media reports, certain large retailers have increased hiring and have raised hourly pay for current employees, which could be mitigating, to some extent, the decline in withholding collections that would otherwise be expected from the current high levels of unemployment. As discussed later in this memorandum, continuing claims for unemployment benefits have declined weekly since April 18, which suggests that some individuals are returning to work.

As noted above, historically high levels of unemployment following the coronavirus outbreak were expected to reduce taxable wages and salaries. Though this trend has yet to materialize in the form of lower withholding tax collections, such lower collections are expected to occur in subsequent months.

***Corporate Income/Franchise Tax.*** Preliminary corporate income/franchise tax collections for May, 2020, are $35 million, which is $14 million more than collected in May of last year, or an increase of 68%. Corporate tax collections are generally paid to the state as estimated payments, which are due for most filers in April, June, September, and December. As a result, the collection report for May is a relatively less significant month for comparing changes to corporate tax collections.

The extent to which the economic decline from the coronavirus pandemic has reduced corporate estimated payments will not be known until after the July filing date. Similar to individual estimated payments, most corporations have likely taken advantage of the filing date extension and will wait to make payments until the July date. Nevertheless, year-to-date collections through May, 2020, are $1,294 million, which is $209 million (19%) higher than in the comparable 11-month period last year. Corporate collections year-to-date remain above the 12.3% growth rate previously estimated.

Unanticipated tax payments may offset the anticipated decline in estimated payments in 2019-20. A significant amount of unanticipated corporate collections accrued to the state in the form of one-time audit payments and increased collections under the 2017 Act 368 entity-level tax. According to DOR, several large audit payments were made to the state in the four months following the January estimates such that audit payments in 2019-20 are now $196 million higher compared to 2018-19. In addition, partnerships remitting estimated payments under the entity-level tax, rather than the individual tax, were $30 million higher in March than previously forecast.

***Sales and Use Taxes.*** Preliminary state sales and use tax collections in May generally reflect taxes paid for retail sales occurring in April. The coronavirus pandemic resulted in the Safer-at-Home order, which took effect on March 26, 2020, and remained in effect until May 13, 2020. Sales tax collections for May, 2020, reflected a full month of reduced economic activity during the Safer-at-Home order. Such collections were lower than May collections in the previous year by 10.1%, or $46 million. Sales tax collections through May, 2020, are $100 million above collections in the comparable 11-month period in 2018-19, representing 2.2% growth year-to-date.

Based on preliminary sales tax data provided by DOR, the economic impact of the coronavirus pandemic and the Safer-at-Home order has impacted retail industries differently. Taxable retail sales were lower in April of 2020, compared to April in the prior year, by 74% for clothing and clothing accessories stores, 53% for food services and drinking establishments, and 28% for motor vehicle and parts dealers. Conversely, April taxable sales in 2020 were higher at nonstore retailers (including remote sellers and marketplace providers) by 83%, building material and garden equipment and supplies stores by 23%, and food and beverage stores by 18%. Growth in total taxable retail sales at these three retail sectors were $403 million, or 38% higher, in April, 2020, than in April of the previous year.

In this office's May 6 memorandum on April's collections, we had expected that growth in May, 2020, sales tax collections compared to May of the previous year would be significantly lower than that observed in the April report. However, the decrease in sales tax collections for May, 2020, over the prior May was nearly identical to the decrease in April, 2020, compared to the prior April. It is possible that the economic contraction in certain industries had begun earlier in March than when the statewide Safer-at-Home order took effect. In addition to the aforementioned growth in taxable sales in certain retailer sectors, growth in other industries with large amounts of taxable sales, such as telecommunications and general merchandise stores, were relatively flat, while industries such as broadcasting and professional, scientific, and technical services showed relatively strong growth in April, 2020, over the previous April. Economic activity shifting to these industries may also have helped arrest the more significant decline in sales tax revenues that had been anticipated.

For several retail categories, the decline in taxable sales in April, 2020, over April, 2019, was less drastic in Wisconsin than the decline observed in similar data for the U.S. as a whole. DOR data for motor vehicle related taxable sales, which account for a significant portion of overall sales tax collections, as well as taxable sales at gasoline stations, furniture stores, and electronics and appliance stores, all declined less precipitously than data for similar national indicators would suggest.

Under 2019 Act 10, individual income tax rates will be reduced to offset the increased sales and use tax collections attributable to remote sellers and marketplace providers. For tax year 2020 and taxable years thereafter, the tax rate reduction is based on the sales and use tax collected from remote sellers and marketplace providers during the 12-month period from October 1, 2019, to September 30, 2020. To the extent that the coronavirus pandemic results in increased taxable sales made by remote sellers and marketplace providers that would have otherwise been in-person taxable sales at physical stores located in Wisconsin, the sales tax revenue used to offset individual income tax rate reductions for tax year 2020 will have a larger fiscal effect than the $119 million income tax reduction estimated under Act 10.

**Unemployment Claims**

The U.S. Bureau of Labor Statistics (BLS) reported on June 5 that total U.S. nonfarm payroll employment rose by 2.5 million in May and that "improvements in the labor market reflected a limited resumption of economic activity that had been curtailed in March and April due to the coronavirus pandemic and efforts to contain it." The May payroll report showed that employment rose sharply in leisure and hospitality, construction, education and health services, and retail trade, while employment in state and local government fell sharply.

Comparable nonfarm payroll data for the month of May are not yet available for Wisconsin. However, recent state unemployment data are available and can be helpful in understanding current labor market conditions. It should be noted that there is not a direct translation between unemployment claim levels and monthly payroll figures because the two numbers derive from different sources and methodologies. State labor departments receive applications for unemployment benefits and report the numbers to the U.S. Labor Department each week, while the BLS nonfarm payroll figure is based on a survey of businesses.

From March 15 through June 6, there have been 636,998 initial claims for regular unemployment insurance (UI) benefits filed in Wisconsin. This level of initial claims represents a 1,099% increase in initial claims filed over the same period in 2019, when 53,131 initial claims were filed. Since the coronavirus outbreak in early 2020, initial claims reached a peak of 116,129 for the week ending March 28, but have since declined each week to a current level of 22,497 for the week ending June 6. Despite the sustained decline in the number of initial claims since March, the current level of initial claims still exceeds the average weekly initial claim level experienced during 2009, which was the highest year of unemployment during the Great Recession.

Initial claims measure emerging unemployment (the flow of people into the UI system) and continuing claims measure the number of persons claiming unemployment benefits (the pool of people in the UI system). Economists tend to view continuing claims as a better gauge of labor market health than initial claims, which can overstate unemployment. Continuing claims account for the number of people that leave the UI system each week because they return to work, exhaust their benefits, or become otherwise ineligible. Additionally, some initial claims get denied, while others are held in a pending status due to processing delays, both of which could lead to discrepancies between the two sets of claims data.

Continuing claims for regular UI in Wisconsin were 321,063 during the week ending April 18, which represents the highest weekly level following the coronavirus outbreak. Since that time, the level of continuing claims has declined every week to 269,055 claims filed for the week ending May 23 (reported on June 4), representing a 19% decline since the April peak. The decline in continuing claims, in part, indicates that claimants were beginning their return to work in late April and continued to return in May.

**2019-20 General Fund Balance**

The January 23, 2020, report, adjusted for tax law changes enacted under the federal CARES Act and 2019 Wisconsin Acts 181 and 185, estimated that the gross balance in the state's general fund on June 30, 2020, would be $1,093 million. That balance will undoubtedly decrease because of reduced tax collections as shown in the May report and the upcoming reports. The extent of the effect of that collection information will not be known until after the July 15 filing deadline for income and franchise taxes. There are, however, some items that might mitigate the decline in the 2019-20 balance.

1. It is unlikely that the $189 million transfer to the budget stabilization fund identified in the January 23 report will occur. That $189 million will remain in the general fund and enhance the 2019-20 balance.

2. The Department of Administration announced that it is requiring certain state agencies to lapse or transfer $70 million from 2019-20 appropriations to the general fund by the end of the current fiscal year.

3. The administration recently re-amortized variable rate debt that otherwise would have been paid off in fiscal year 2019-20, and instead scheduled it for repayment over a five-year period starting in the 2021-22 fiscal year. This variable rate debt re-amortization will reduce GPR debt service payments by an estimated $66 million in 2019-20.

4. It is estimated that the budget stabilization fund will have a balance of $656 million at the end of the 2019-20 fiscal year. Legislation is required in order to access any amounts in the stabilization fund.

This office will continue to monitor tax collection reports, economic forecasts, and federal legislation and inform you of findings that might impact the state's budget.

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