

The State Personal Income Tax Recovers A Snapshot of Recent Trends

Nicholas W. Jenny

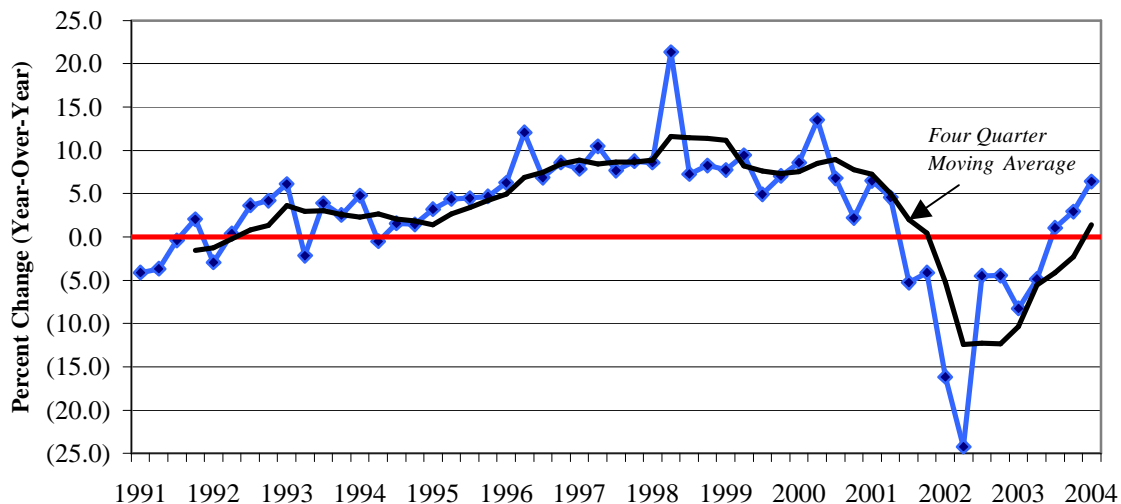
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For over two years, the personal income tax was dragging state tax revenue down. Now, preliminary data indicates that personal income tax revenue, adjusted for legislated tax changes and inflation, grew by 6.4 percent in the January-March 2004 quarter, faster than the 5.4 percent growth in total real adjusted state tax revenue.¹ The personal income tax is collected in 41 states, and accounts for about one-third of all state tax revenue.

Figure 1 shows the performance of state personal income revenue tax over the last 13 years, adjusted for the effects of legislated tax changes and inflation. There was increasingly strong growth through the mid to late 1990s, featuring “April Surprises” as payments with final returns surged into state treasuries – observable as the spikes in the quarterly data.² It would seem that this April has been a good one, though it is not likely as large as the growth of a few years ago.

Taking a four-quarter moving average to smooth out the spikes, the dramatic decline in personal income tax revenue is evident. While personal income tax revenue grew at around ten percent in the late 1990s, it declined by over 10 percent in the recent recession and its aftermath. It is only recently that this moving average of real, adjusted personal income tax growth moved back into the positive range.

Figure 1.
State Personal Income Tax Change,
Adjusted for Legislation and Inflation

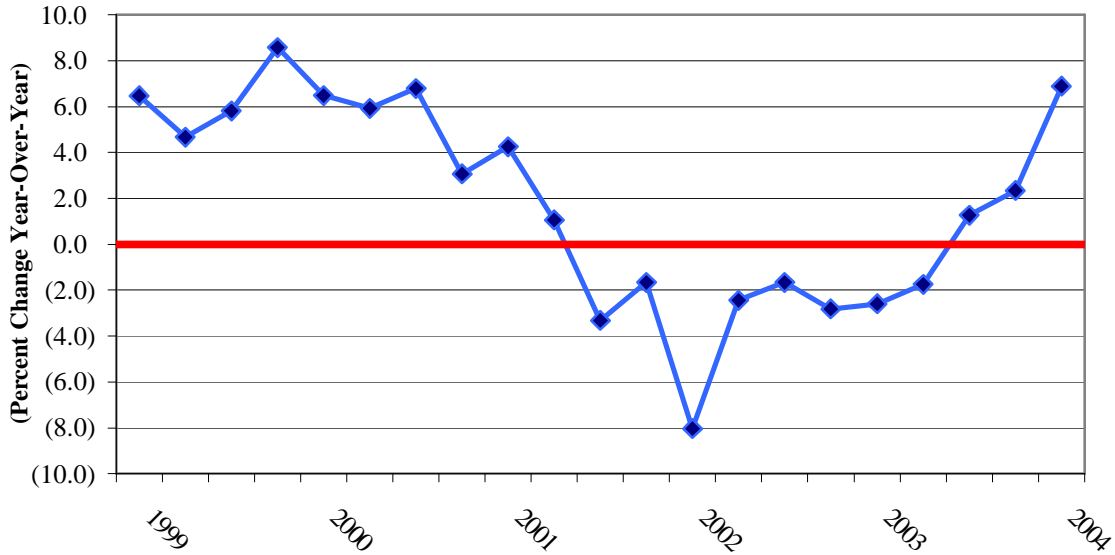


¹ See *State Fiscal News* Vol. 4 No. 3 “State Tax Revenue Growth Gains Momentum.”

² All data is from the Rockefeller Institute of Government Revenue Report Database, data for the January-March 2004 quarter is preliminary.

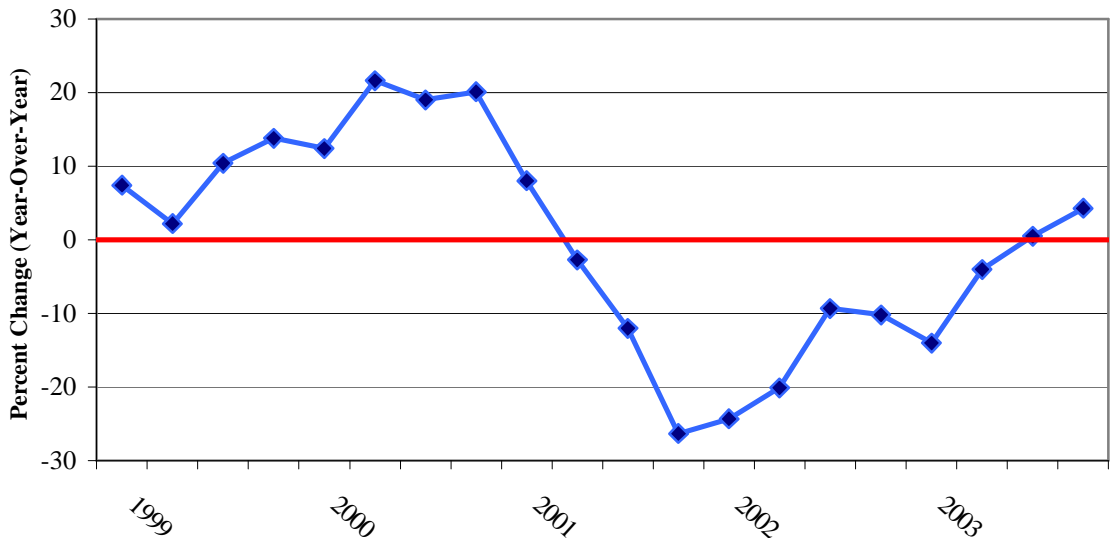
We can discover more about what is driving the performance of personal income tax revenue by looking at its components. Most personal income tax collections come from withholding. Figure 2 shows the performance of state withholding collections for the last five years, adjusted for legislated changes and inflation. The pattern is the same as with total personal income tax revenue, but less extreme in both good years and bad.

Figure 2.
Change in Withholding, Adjusted for Inflation and Legislation



Estimated tax payments are made on a quarterly basis by taxpayers who have income that is not subject to withholding; this includes income from capital gains and other investment-related income. Estimated taxpayers are heavily skewed towards the highest incomes. Figure 3 shows what has happened to estimated tax payments over the last five years.

Figure 3.
Change in Quarterly Estimated Payments



Estimated tax payments only amount to about a fifth as much as withholding, but they obviously have had a big impact on the overall swings in personal income tax collections. In 2000, they were increasing at a 20 percent year-over-year rate, and in 2002 they were declining by over 20 percent. The fact that they have now begun to grow again is encouraging for the future of state revenues. This data is not adjusted for legislation or inflation because of the difficulty in apportioning the impact of these factors on any given payment.

The final major components of the personal income tax are payments with final returns and refunds. Big surges in final payments were what generated the April Surprises, as they jumped in the late 1990s, and then plunged in 2002. In April 2003, final payments under performed the expectations of most states, though they did not decline nearly as sharply as they had in 2002. Although, we do not have full data for April 2004 yet, a survey that includes most of the largest personal income tax states indicates that final payments have finally turned around. While states are reporting that this growth is exceeding their expectations this year, it does not seem to be in the range of the previous “April Surprises.” This is also evidence that refunds are running below those in the previous two years, another good sign for state revenue.

This brief is drawn from data will appear in revised form in the *State Revenue Report, No. 56*. This report is due out in June 2004.

The Nelson A. Rockefeller Institute of Government is the public policy research arm of the State University of New York. Nick Jenny is a Senior Policy Analyst in the Fiscal Studies Program at the Institute.

Contact Information:

Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government
411 State Street
Albany, NY 12203-1003

(518) 443-5285

(518) 443-5274(fax)

fiscal@rockinst.org

<http://StateAndLocalGateway.rockinst.org>