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State general fund revenues take a hit from shutdown

Summary: We have written several *Policy Briefs* recently on the effects of the coronavirus lockdown on local governments, the Port Authority and even the Turnpike Commission. This *Brief* will focus on the state's general fund revenues, particularly the larger categories of personal income, corporate net income and sales and use taxes.

There is no doubt that the state's general fund revenues have fallen dramatically during the lockdown. The latest news release from the Department of Revenue shows that the May 2020 total general fund revenue came in at $2.1 billion—about 20 percent less than was collected in May 2019 ($2.6 billion). However, May is not typically a strong revenue month. April and March are typically the strongest revenue months for the commonwealth.

In March 2020, when the shutdown only affected the last week and a half or so (officially March 23), total general fund revenues were only down 2.6 percent from last March. In April 2020, that amount was $2.2 billion or 50.6 percent below that of the same month a year ago. Over the three-month stretch of March through May, general fund revenues are down about $2.87 billion over 2019's level for the same period. January and February's 2020 collections were actually better than 2019's by about $312 million, so the overall loss for the first five months of 2020 is roughly $2.55 billion.

The largest component of general fund revenue is the personal income tax (PIT). Normally, much of the tax collected in the first half of 2020 is on income earned in 2019 as taxes are paid before the April 15 filing deadline. Keep in mind that the state's deadline to file personal income taxes was extended from April 15, along with the federal deadline, to July 15, 2020, so a significant share of the shortfall in April will most likely be collected in July as the unpaid non-withholding PIT taxes from 2019 comes due.

As noted above the personal income tax is broken into two categories—withholding and non-withholding. The former is collected throughout the year as workers have the tax deducted from their paychecks; the latter is remitted typically at the end of the tax year (March-April). Non-withholding payments make up about 25 percent, on average, of the monthly PIT collections.

PIT revenue, combined withholding and non-withholding, for April 2020 was down 56 percent from the April 2019 level ($1.11 billion vs. $2.52 billion). Compared to the year earlier collections, PIT revenue was only 7 percent lower in March and just 2 percent below May. In total, the collections for these three months were down by $1.51 billion from the same months in 2019. Again, January and February's collections in 2020 ran $136 million above last year and so the overall drop for the first five months is about $1.37 billion.

Loss of personal income due to the dramatic decline in employment and business closings in the lockdown period will result in lower tax obligations that are unlikely to be made up in the next few months, if ever.

For the months of January and February 2020 the amount of non-withholding PIT came in $44.3 million above 2019's collection. However, collections slowed dramatically in March and April (May is not yet available) as the shutdown hit and the filing deadline was pushed back. For March non-withholding PIT collections were 52.2 percent lower than the year before while in April that figure was 87.7 percent less ($205 million vs. $1.67 billion).

As mentioned above, much of this shortfall might be made up as the July deadline approaches and the non-withholding payments for 2019 are made. The real concern with PIT collections will be for the upcoming fiscal year as 2020 incomes, for which much of the owed taxes will be collected in 2021, are likely to come in well below what will be collected this year. That income undoubtedly took a hit from the shutdown, the closing of non-essential businesses and the furloughing of a large portion of workers statewide.

Corporate net income tax collections were down for every month thus far in 2020 versus the year ago amounts. This tax is typically paid quarterly with collections heaviest in the quarter-ending months of March, June, September and December.

January and February's collections were down compared to a year earlier (4 and 6 percent respectively) with March's also 4 percent lower than last year. For the first quarter of 2020 the corporate net income tax collections were $27.1 million below the first quarter of 2019. April and May were hit much harder. April 2020's $135.96 million is $184.6 million (57.6 percent) lower than last April while May is $166.7 million lower than the previous May. In total, the revenue from the corporate net income tax over the first five months of 2020 is behind 2019's total by $378.4 million (30 percent).

But, as with the PIT, the state will most likely recover its losses as the July deadline approaches. The worry would then be for the next fiscal year as many non-essential businesses were closed for the better part of three months and corporate incomes were almost certainly adversely affected.

The sales and use tax revenue, the state's second-largest category of revenue for the general fund, may not be as easily recovered as it is based on current sales, which obviously suffered during the shutdown and continue to languish in the partial re-opening under the "green" phase.

The first three months of 2020 showed a higher level of sales and use tax revenue collected (up $147.1 million) than for the same time in 2019. However, in April and May the decline was steep, although not as steep as it could have been, as some retailers such as grocery stores, pharmacies, general stores and restaurants (takeout) were still operating and collecting sales tax. Although in Pennsylvania basics such as food (except prepared foods), clothing and medicines are exempted from the sales tax. April's revenue was 34.7 percent lower while May's was 26 percent below last year's level. Actual revenues for these two months were $583.9 million lower than a year-ago. Federal stimulus payments and generous federally supplemented unemployment benefits (which are exempt from Pa. state taxes) kept spending power much stronger than it otherwise would have been.

While March's sales and use tax revenue was up 2.2 percent, had that month followed the pattern for January and February, up 7.7 and 6.8 percent respectively, and had increased by 7 percent instead, the state's revenues would have been higher by $39.1 million ($878.3 vs. 839.2 million). Thus, assuming the strong sales recorded in January and February would have continued in March if the virus caused shutdown had not happened, the loss to sales and use tax revenue from the shutdown amounts to approximately $623 million compared to the first three months of 2019.

A large share of this lost revenue will be unrecoverable this year as it is unlikely consumers will increase spending enough beyond normal levels to make up the loss. Although the federal government has flooded the economy with enough stimulus money to do so and savings have piled up for many who were able to retain their paychecks. Many consumers may still be reluctant to venture out amid the ongoing uncertainty. Even though nationally May's retail sales did increase a record 18 percent, is that sustainable enough to erase the drop during the shutdown? The national drop in March was 8 percent and in April 15 percent and overall, for the year, it is still down 6 percent. Also, did Pa. sales surge as rapidly as the national gain?

The sales and use tax is divided into two components—non-motor vehicle and motor vehicle. With car dealers being shut down for more than two months, it is no surprise that the sales tax on motor vehicles declined sharply.

In January and February 2020, motor vehicle sales taxes amounted to $225.9 million—9 percent higher than in 2019. March 2020, with the sales period being shortened by a couple of weeks due to the shutdown, was still better than 2019 by $2 million. Had it followed the pattern of the previous two months and increased by 8 percent, instead of 2, it would have brought in an additional $7 million ($128.6 vs. $121 million).

In April the closure of auto dealers is very noticeable. In April 2020 the amount of motor vehicle sales tax collected was just $15.6 million. In April 2019 it was $146.1 million—a difference of $130.5 million (89 percent). However, April 2019 may be a bit of an anomaly as it was the highest level in the last five years. April 2018 came in second at $127.1 million and April 2015 was $123.5 million.

May's data on motor vehicle sales taxes has not yet been released. In May 2019 it was $133.3 million and had been over $130 million each year from 2017-19. So, if auto sales were just 50 percent of that total, the state would have lost another $65 million.

It is likely that some of the sales tax money from auto sales may be recovered but not all. It is possible that some Pennsylvanians opted to keep their current vehicles or had them repaired instead of purchasing a new one.

Some other minor taxes that had been affected are the liquor tax, gaming tax (from table games), and the realty transfer tax. They all took a hit during the shutdown. In January and February all were running ahead of the collections from a year earlier by a combined total of $32.6 billion. That changed in March as all were down slightly, liquor tax (-1.4 percent), gaming tax (-1.1 percent) and realty transfer tax (-2.8 percent), from last March for a total loss of $1.7 billion.

However, the drop in April was more severe. Note that the May breakout is not yet available. The realty transfer tax collections fell the most by $23.3 billion in April from a year earlier, followed by the liquor tax collections (-$17.5 billion) and the gaming tax (-$9.4 billion). All totaled the losses are $50.2 billion, enough to wipe out the gains from the beginning of the year. While some of the realty transfer tax may be recovered as the real estate market heats up again, it is unlikely the gaming and liquor tax revenues will replace the lockdown losses.

The pandemic of 2020 will leave lasting economic scars as the shutdown forced many businesses to close resulting in the furloughing of more than a million Pennsylvania workers. The damage to general fund revenues may not be as severe this year as it may be for next as income tax collections based on this year's incomes will be much lower in the next fiscal year. Personal income and corporate net income taxes for 2020 should see a significant pickup as the July 15 deadline approaches. But it's unlikely the sales and use tax revenues will return to last year's level and much of the loss will take years to make up. The same holds true for some of the so-called minor tax collections.

Hard decisions will have to be made with the upcoming budget, after the interim budget expires later this year. How much federal funding for state and local governments will be forthcoming is not known. Now is the time for the state to look at changing the way it operates—to cut unnecessary spending and reduce personnel counts, to lower tax rates and reduce regulations to help businesses get back on their feet and encourage them to add employees to their payrolls. Getting the state's economy back up to speed should be a top priority.

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