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FISCAL REPORT

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

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2022 Tax Receipts Down \$26 Billion

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posted December 1, 2023

According to the Legislative Analyst's Office update on state tax collections, 2022 tax receipts came in \$26 billion lower than 2023 Budget Act estimates. Recall that the state expected personal income and corporation tax filers to pay \$46.5 billion by November 16, 2023-the tax filing deadline extended by the Internal Revenue Service and the State Franchise Tax Board. Netting out anticipated tax refunds, the budget assumed that the state would collect over \$42 billion. Since the shortfall stems from 2022 tax collections, it affects 2022-23 fiscal year estimates.

This steep drop in state revenues equates to a significant downward adjustment to the 2022-23 Proposition 98 minimum guarantee of approximately \$10.4 billion, presenting a difficult conundrum for Governor Gavin Newsom and the Legislature as they begin negotiations on the 2024-25 State Budget in just over a month. The big question, of course, is whether lawmakers will decide to leave the prior year minimum guarantee at the June 2023 level of \$107.4 billion (essentially over-appropriating the minimum guarantee), or take action to align the state's spending obligation to K-12 schools and community colleges to the lower state revenues (or to approximately \$97 billion).

How the state handles the shortfall will directly impact local educational agencies and their ability to maintain educational programs and services for students. This is particularly true given that Proposition 98 is already carrying a deficit attributable to costs associated with fully funding the 8.22% cost-of-living adjustment (COLA), for which the state used nearly \$2 billion in one-time dollars to fund. The significantly lower COLA for 2024-25 will help reduce the amount the state will need to eliminate the deficit, but the savings it gains from the lower COLA and lower Local Control Funding Formula costs due to declining enrollment is not enough to offset the \$10.4 billion revenue shortfall for Proposition 98.

That said, Governor Newsom and lawmakers will have at least one new tool in the budget toolbox that it has not had when the state has faced similar pressures in the past: the Proposition 98 reserve. At the 2023-24 Budget Act, the balance of the education rainy day fund was \$10.8 billion. The authority of the Legislature to make automatic withdrawals from the fund is formulaic and requires the Proposition 98 minimum guarantee to be lower in one fiscal year than it was in the prior fiscal year. When this occurs, the Legislature can only withdraw funds from the Proposition 98 reserve account in an amount sufficient to bring funding up to the prior year level. Alternatively, if the Governor declares a State Budget emergency, the Legislature has the discretion to make withdrawals from the rainy day fund and in any amount.

There is no doubt the budget advisors to the Newsom Administration and the Legislature are considering all options to address the sizable budget shortfall from lower-than-expected 2022 tax receipts and what we can expect will be downward adjustments to estimated revenues for 2024-25. We anticipate that Governor Newsom's January 10 release of the 2024-25 Governor's Budget proposal will illuminate how he intends to confront it.