GENERAL FUND REVENUE UPDATE
FISCAL 2011

A Report Prepared for the

Revenue and Transportation Interim Committee

By

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Legislative Fiscal Division

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PURPOSE OF REPORT

The purpose of this report is to update the Revenue and Transportation Interim Committee (RTIC) on year to date general fund revenue collections. This report is designed to brief the committee on recent revenue trends and the corresponding outlook for FY 2011 general fund revenue collections. Since the fiscal year end close-out process will not occur until late July, staff has not attempted to address these current trends with the outlook for the 2013 biennium. This analysis is based on collection data received through the end of May 2011. A more detailed analysis of potential revenue changes for the 2013 biennium will be completed when tax return data are received in November, 2012.

THE BOTTOM LINE

This analysis shows that general fund revenue collections have improved as compared to the revised HJ2 revenue estimates approved in March 2011 by the House taxation committee. It should be noted that the following estimates are in context to the HJ2 estimates adopted by the House tax committee in March 2011 and are adjusted for legislation that impacted FY 2011 estimates. Current revenue trends, based on collection activity through the end of May, show that general fund revenue collections could exceed the adjusted HJ2 revenue estimate by $67.7 to $77.7 million. Strong growth in wage and salary income, higher individual "current year payments", and improved corporate profitability explain this change. Other general fund revenue sources were reviewed with no major change in trends anticipated.

Figure 1 shows the total anticipated general fund differences to the HJ2 revenue estimate for FY 2011.

The revenue improvement for FY 2011 will increase the beginning general fund balance for the 2013 biennium. Without accurate details to explain the revenue improvement, it is unknown whether these changes are one-time or on-going. The causes for the potential increases will be analyzed later this fall when the tax return data are available for individual income taxpayers for calendar 2010. The next section of the report summarizes the results of our analysis.

Figure 1

Anticipated Additional Revenue - FY 2011		
Tax Source	Range in Millions	
Individual Income Tax	$49.601	$51.598
Corporation Income Tax	18.078	26.065
Totals	$67.679	$77.663

YEAR TO DATE COLLECTIONS

The primary components of total general fund revenues are individual and corporate income taxes, property taxes, motor vehicle fees/taxes, and natural resource taxes. If all of these components are added together, over 78% of total general fund revenues are produced from these sources. The analysis discussed in this report focuses on individual income tax and corporation income tax. As mentioned previously, other general fund revenues were reviewed but no significant change was noted.

This report is prepared in a format that compares collection data through May 2011 with collections through May 2010. This type of comparison can provide insight to the strengths or weaknesses of year to date collections and can help identify trends that may be indicative of collections for the remainder of FY 2011. This information can then be used to research the economic conditions that have changed to impact the collection patterns.

Figure 2 shows general fund revenue collections by individual revenue source. This table is produced monthly based on the revenue transactions recorded on the statewide accounting, budgeting, and human resource system (SABHRS). The information shown in Figure 2 represents revenue collections for eleven months of FY 2011 compared to eleven months of FY 2010. As shown at the bottom of Figure 2, total general fund collections are $134.2 million (10.0%) above last year. The HJ2 total general fund revenue estimate as adopted by the House taxation committee in March, including adjustments for enacted legislation, expected revenues to be $79.5 million (4.9%) above FY 2010 collections. These data indicate that total general fund revenue collections are on pace to exceed the HJ2 estimate. As shown in Figure 2, individual and corporation income taxes account for a majority of this increase.

Figure 2

Legislative Fiscal Division

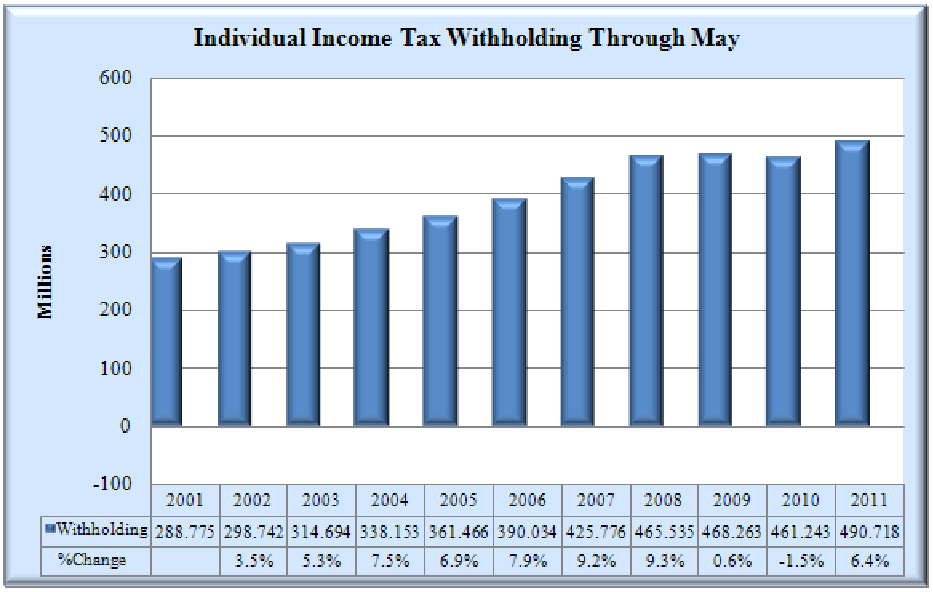
General Fund Revenue Monitoring Report

Revenue Source	Actual Fiscal 2010	HJ2 Estimate Fiscal 2011	Through 5/31/10	Through 5/31/11	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	4,156,003	3,567,000	3,681,152.66	3,346,704.37	(334,448.29)	-9.09%	-14.17%
GF0200 Insurance Tax	54,892,354	55,445,000	41,509,525.48	42,009,529.71	500,004.23	1.20%	1.01%
GF0300 Investment Licenses	6,224,662	6,375,000	5,904,603.04	6,620,481.54	715,878.50	12.12%	2.42%
GF0400 Vehicle License Fee	89,484,621	92,192,000	69,767,280.39	70,696,713.10	929,432.71	**1.33%**	3.03%
GF0500 Vehicle Registration Fee	14,376,928	14,812,000	10,636,858.36	11,730,515.82	1,093,657.46	10.28%	3.03%
GF0600 Nursing Facilities Fee	5,300,229	4,984,000	3,968,307.29	3,907,380.07	(60,927.22)	-1.54%	-5.97%
GF0700 Beer Tax	3,031,854	3,157,000	2,504,586.77	2,420,829.19	(83,757.58)	**-3.34%**	4.13%
GF0800 Cigarette Tax	32,217,914	31,554,000	27,973,367.41	27,187,156.11	(786,211.30)	**-2.81%**	-2.06%
GF0900 Coal Severance Tax	10,321,853	12,494,000	8,103,170.07	9,571,745.72	1,468,575.65	**18.12%**	21.04%
GF1000 Corporation Tax	87,900,911	97,360,000	68,360,720.07	97,206,510.04	28,845,789.97	42.20%	10.76%
GF1100 Electrical Energy Tax	4,713,429	4,452,000	3,320,502.94	4,480,456.94	1,159,954.00	34.93%	-5.55%
GF1150 Wholesale Energy Trans Tax	3,556,056	3,657,000	2,786,712.08	2,970,648.55	183,936.47	6.60%	2.84%
GF1200 Railroad Car Tax	2,579,263	2,031,000	2,579,262.89	2,130,191.68	(449,071.21)	-17.41%	-21.26%
GF1300 Individual Income Tax	717,834,371	762,396,000	714,947,990.88	804,426,832.35	89,478,841.47	12.52%	6.21%
GF1400 Inheritance Tax	90,544	5,000	87,104.18	43,164.57	(43,939.61)	-50.44%	-94.48%
GF1500 Metal Mines Tax	6,541,391	8,931,000	3,455,753.62	3,943,003.05	487,249.43	**14.10%**	36.53%
GF1700 Oil Severance Tax	95,490,812	104,514,000	45,506,077.61	47,267,467.94	1,761,390.33	**3.87%**	9.45%
GF1800 Public Contractor's Tax	6,969,395	7,262,000	5,412,304.10	5,993,407.78	581,103.68	10.74%	4.20%
GF1850 Rental Car Sales Tax	2,807,415	3,118,000	2,205,428.45	2,446,860.38	241,431.93	**10.95%**	11.06%
GFxxxx Property Tax	222,509,767	229,084,000	136,036,056.43	139,800,757.81	3,764,701.38	**2.77%**	2.95%
GF2150 Lodging Facilities Sales Tax	12,330,846	13,209,000	9,060,726.43	10,465,298.37	1,404,571.94	15.50%	7.12%
GF2200 Telephone Tax	-	-	-	-	-		
GF2250 Retail Telecom Excise Tax	23,523,474	21,772,000	14,412,234.86	16,097,531.60	1,685,296.74	11.69%	-7.45%
GF2300 Tobacco Tax	5,334,499	5,680,000	4,462,180.28	4,502,876.80	40,696.52	**0.91%**	6.48%
GF2400 Video Gaming Tax	52,395,999	49,333,000	39,819,234.46	36,754,357.60	(3,064,876.86)	**-7.70%**	-5.85%
GF2500 Wine Tax	1,932,669	2,058,000	1,612,082.19	1,648,447.31	36,365.12	**2.26%**	6.48%
GF2600 Institution Reimbursements	22,000,354	17,555,000	16,983,847.32	14,170,211.57	(2,813,635.75)	-16.57%	-20.21%
GF2650 Highway Patrol Fines	4,646,462	4,672,000	3,915,341.73	3,580,807.21	(334,534.52)	**-8.54%**	0.55%
GF2700 TCA Interest Earnings	2,692,285	2,215,000	2,249,853.69	2,133,041.74	(116,811.95)	-5.19%	-17.73%
GF2900 Liquor Excise Tax	15,626,091	16,151,000	9,852,710.26	13,114,774.36	3,262,064.10	33.11%	3.36%
GF3000 Liquor Profits	9,000,000	9,499,000	-	-	-		5.54%
GF3100 Coal Trust Interest Earnings	26,914,102	26,514,000	20,421,272.05	20,246,047.28	(175,224.77)	-0.86%	-1.49%
GF3300 Lottery Profits	10,631,304	10,086,000	5,558,657.00	5,332,464.00	(226,193.00)	-4.07%	-5.13%
GF3450 Tobacco Settlement	3,468,623	3,565,000	3,468,623.20	3,258,739.00	(209,884.20)	**-6.05%**	2.78%
GF3500 U.S. Mineral Leasing	30,287,794	31,136,000	20,591,338.08	23,791,984.81	3,200,646.73	15.54%	2.80%
GF3600 All Other Revenue	35,360,264	45,821,000	28,365,269.42	30,376,440.18	2,011,170.76	**7.09%**	29.58%
Grand Total	1,627,144,538	1,706,656,000	1,339,520,135.69	1,473,673,378.55	134,153,242.86	10.02%	4.89%

Individual Income Tax

Figure 3 shows individual income tax withholding collections for eleven months of FY 2011 compared to the same period of FY 2010. Other fiscal years are shown for reference. As shown in the figure, total individual income withholding tax collections are 6.4% ($29.5 million) above last year.

Figure 3

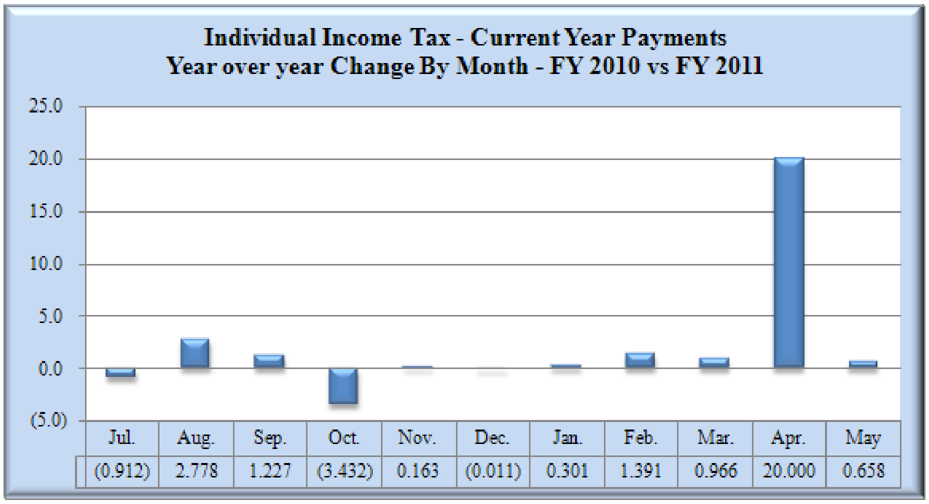


The increase in FY 2011 is a good indicator that wage and salary incomes are improving and that Montana's economic conditions are recovering from the "Great Recession". Because of this improvement, the withholding tax growth rate was compared to the wage and salary income growth rate as forecast by Global Insight (IHS). IHS is a national economic forecasting company that Montana has a contract with for state and national economic forecasts. Wage and salary incomes are a good proxy for withholding tax collection patterns. This comparison (on a fiscal year basis) showed that the forecast rate as prepared by IHS was 1.6% versus the 6.4% shown in Figure 3. Using the individual income tax simulation model, an assumed wage and salary income growth rate of 6.4% instead of 1.6% would produce an additional $20.5 million in revenue during FY 2011. Since staff used the wage and salary income forecast by IHS as an input to the simulation model, the validity of their wage and salary forecast is questionable. This one assumption change could have increased staff revenue estimate recommendations by over $60 million for the three year period 2011 through 2013. Withholding taxes are approximately 65% of total individual income taxes before refunds or almost 40% of total general fund revenue collections. The assumption for wage and salary income growth is critical to the state budgeting process and should be discussed extensively during the next budget cycle.

Figure 4 shows individual income tax "current year payments" for eleven months of FY 2011 compared to the same period of FY 2010. Other fiscal years are shown for reference. Current year payments are a tabulation of all payments that are made by taxpayers when their returns are submitted. This category of tax is generally the difference between the taxpayers liability less withholding and estimated payments. If taxes have been overpaid, then a refund is usually issued. As shown in the figure, current year payments spiked in April and were $20.0 million more than during April of last year. Since these payments are the result of under withholding or insufficient estimated payments, it is difficult to quantify whether these payments were due to higher wage and salary income or non-wage income. Examples of non-wage income would interest and dividend income, rents, royalties, and partnership income, or net capital gains realizations. The tax return data to be received in November should help staff better understand the reasons for the increase.

The range specified in Figure 1 is based on no impact of H.R. 4853 versus individual income tax payers taking full advantage of the federal legislation.

Figure 4



Based on the above information, collection data strongly suggest that wage and salary income increased at a higher rate than forecast by IHS. It also shows that the unanticipated spike in current year payments in April played a significant role in the overall improvement in individual income tax collections. Together, the sum of these two factors accounts for approximately $44 million of the estimated $50 million increase.

Corporation Income Tax

Figure 5 shows more detailed corporation income tax collection data (less refunds) for eleven months of FY 2011 compared to the same period of FY 2010. Other years are shown for reference. As shown in the figure, total corporation income tax collections less refunds are 17.6% ($17.4 million) above last year. The current growth rate may subside when corporate taxpayers take advantage of H.R. 4853. Federal legislation (H.R. 4853) allows corporate taxpayers to expense depreciable assets placed in service between September 9, 2010 and the end of 2011 and also allows a 50% bonus depreciation for depreciable assets placed in service in 2012. Because corporate taxpayers are expected to take full advantage of this legislation, the anticipated revenue reduction is not expected to occur until the final estimated payment due June 15th. The corporation tax estimate adopted in March was adjusted for the impacts of this federal legislation. The estimated impact on state revenues is $16.4 million for the three year period, 2011 through 2013.

Figure 5

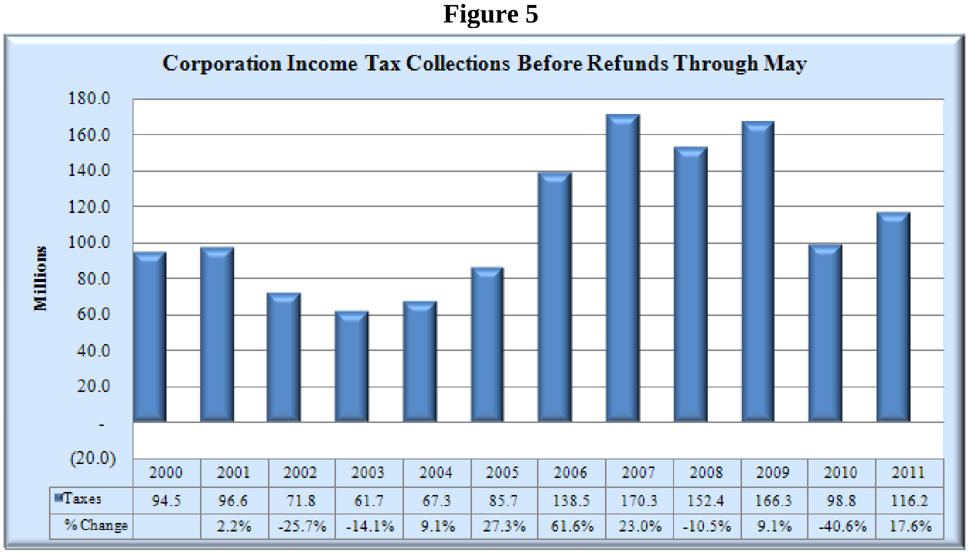
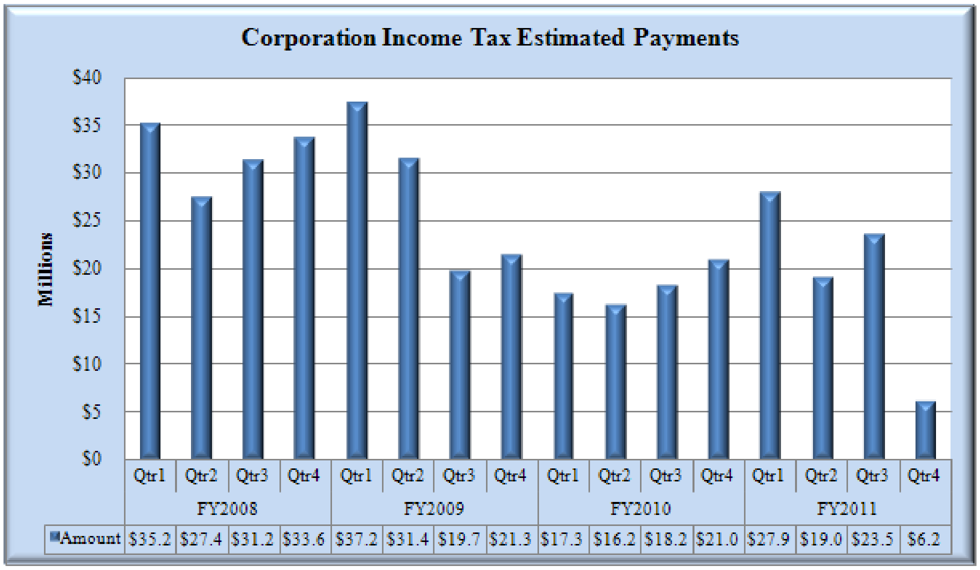


Figure 6 shows corporation income tax estimated payments by fiscal quarter. As shown in the figure, estimated payments declined significantly in the third quart of FY 2009. Since that time, estimated payments have not varied significantly until the first quarter of FY 2011. Staff was reluctant to recommend major adjustments to the corporation tax estimates during the 62nd Legislature. This caution was based on the rather abrupt drop in estimated payments for the second quarter of FY 2011 (end of December). By the end of the third quarter of FY 2011 (end of April), however, estimated payments improved which alleviated some of staff concerns. The average payment for the first and second quarter is almost identical to the third quarter payment. The amounts shown for the fourth quarter is as of June 14th and is expected to increase when processing of all payments are completed by the Department of Revenue. This processing should be complete by the end of June.

Figure 6



Based on the above information, collection data suggest that corporation tax collections will exceed the HJ2 revenue estimate. To what extent corporate taxpayers take advantage of H.R. 4853 will determine the magnitude of the unanticipated increase. The range specified in Figure 1 is based on no impact of H.R. 4853 versus corporate tax payers taking full advantage of the federal legislation. Although corporation income tax collections for FY 2011 are expected to be better than anticipated by the revenue estimates contained in HJ 2, corporation income taxes are significantly below the peak level of $177.5 million observed in FY 2007.

SUMMARY

This analysis shows that general fund revenue collections have improved as compared to the revised HJ2 revenue estimates approved in March 2011 by the House taxation committee. It should be noted that the changes are in context to the HJ2 estimates adopted by the House tax committee in March 2011 as adjusted for legislation that impacted FY 2011. Current revenue trends, based on collection activity through the end of May, show that general fund revenue collections could exceed the adjusted HJ2 revenue estimate by $67.7 to $77.7 million. Strong growth in wage and salary income, higher individual “current year payments”, and improved corporate profitability explains this change. Other general fund revenue sources were reviewed with no major change in trends anticipated.

Figure 7 shows the total anticipated general fund differences to the HJ2 revenue estimate for FY 2011.

The revenue improvement for FY 2011 will increase the beginning general fund balance for the 2013 biennium. Without accurate details to explain the revenue improvement, it is unknown whether these changes are one-time or on-going. The causes for the potential increases will be analyzed later this fall when the tax return data are available for individual income taxpayers for calendar 2010.

Figure 7

Anticipated Additional Revenue - FY 2011		
Tax Source	Range in Millions	
Individual Income Tax	$49.601	$51.598
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Totals	$67.679	$77.663

Financial Consideration

Senate bill 426, by Senator Bayleat, was enacted by the 62nd Legislature. This legislation created the "Treasure State Taxpayer Dividend Program" with the provision the act be submitted to the qualified electors on the November 2012 ballot. This legislation is designed to refund surplus state government fund balance through an income tax credit mechanism. If approved by the electors, the legislation would be applicable to fiscal years 2013 and beyond.

The Department of Administration is required to certify to the budget director, by August 1 of each year, the amount of the unaudited general fund balance for the previous fiscal year. If this balance exceeds the budgeted balance by 125%, then tax credits for individual and property taxes paid are allowed to be claimed on subsequent tax return filings. It should be noted, however, that the excess balance must be at least $5 million otherwise no tax credits are allowed. The legislation also specifies that one-half of the excess balance must be distributed "in the form of individual income tax credits related to property taxes paid on the taxpayer's principal residence and related to the taxpayer's individual income tax paid." The remaining one-half of the excess balance remains in the general fund ending fund balance.

The legislation defines the procedures to be used by the Department of Revenue to determine how much of the excess fund balance is to be used for residential property tax and individual income tax relief. This calculation is based on the ratio of the total amount to be refunded divided by the sum of total residential property and total individual income taxes. For example, if residential property tax collections were $600 million and individual income tax collections were $800 million and the excess amount was $67.7 million, then residential property and individual income taxpayers would be allowed to claim an income tax credit in the subsequent year equivalent to 2.4% ($67.7 million times 50% divided by ($600 plus $800 million) of their residential property and individual income taxes paid in the previous year. This tax credit is a refundable tax credit that applies to only the subsequent tax return filed. Any potential future tax credits are determined annually based on whether there is excess fund balance above the projected amount.

This is an important financial consideration for the 63rd Legislature. If the 2013 biennium general fund budget adopted by the 62nd Legislature develops as intended, then 50% of the FY 2011 additional estimated revenue (50% of $67.7 million =$33.8 million) discussed in this report would be used for residential property and individual income tax relief (assuming the referendum is approved by the voters in November 2012). Because taxpayers would claim the tax credit when filing their tax year 2013 return, the impact of tax relief would not be realized until FY 2014.