



# COMMONWEALTH of VIRGINIA

## Office of the Governor

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### MEMORANDUM

**TO:** The Honorable Timothy M. Kaine  
**THROUGH:** The Honorable William H. Leighty  
**FROM:** Jody M. Wagner  
**SUBJECT:** **August Revenue Data**

In August 2005, the Department of Taxation (TAX) began conversion to a new Integrated Revenue Management System (IRMS) responsible for handling all transaction and revenue processing. During that month, as each module was implemented in a controlled production environment, TAX issued a mere \$447,000 in refunds.

August 2005 had one additional deposit day compared to August 2006, and the additional day was a Wednesday -- the due date for all employers to submit withholding payments to the Federal government and to states, including Virginia, that follow the federal schedule. In addition, companies that have Friday payroll dates also normally settle EFT payments on Wednesday. Both these factors led to a significant increase in withholding collections in August 2005.

On a year-to-date basis, total revenue grew 8.6 percent, compared to the annual forecast of 4.2 percent. A significant portion of the growth is attributable to the July 2006 repeal of the Accelerated Sales Tax program. Adjusting for the effects of the July 2006 repeal of the Accelerated Sales Tax program and reduced August 2005 refunds, revenues grew 2.6 percent through the first two months of the current fiscal year, compared to an annual forecast of 3.1 percent.

### National Economic Indicators

Current economic indicators continue to depict the national economy cooling from the strong growth of the first quarter.

- Second quarter real GDP growth was 2.9 percent, well below the 5.6 percent pace in the first quarter.
- The labor market remains healthy overall; however, there are signs of weakness in some sectors. Payroll employment grew by 128,000 jobs in August. Most of the gains were in the service industry, particularly education, healthcare, and business and professional services. The unemployment rate fell slightly to 4.7 percent.
- Initial claims for unemployment dropped from 313,000 to 308,000 during the first week of September. The four-week moving average fell to 314,000, which is consistent with a healthy labor market.

Inflation remains contained. Rising energy prices drove the Consumer Price Index up 0.4 percent in July, following a 0.2 percent increase in June. Core inflation (excluding food and energy) rose 0.2 percent for the month, which was down from the 0.3 percent increases in each of the last four months.

- Institute of Supply Management index fell slightly in August, from 54.7 to 54.5, but remains in the range indicating industry expansion.
- The Conference Board's index of consumer confidence dropped 7.4 points to 99.6 in August, the lowest since November 2005. However, the index remains in the relatively high range seen prior to Hurricane Katrina.
- Following seventeen consecutive rate hikes over the last two years, the Federal Reserve left the federal funds rate unchanged at 5.25 percent at its August meeting. They cited slowing growth due to a "gradual cooling in the housing market and the lagged effects of increases in interest rates and energy prices."

## Virginia Economy

In Virginia, payroll employment grew 1.4 percent in July. Growth in Northern Virginia remained well above the rest of the state, with a 2.7 percent gain. Jobs in the western MSAs grew by 1.9 percent, followed by Hampton Roads with 1.7 percent, and Richmond-Petersburg with 1.5 percent growth. The unemployment rate remained at 3.3 percent in July.

The Virginia Leading Index fell 0.4 percent, from 121.8 in June to 121.2 in July, its third consecutive monthly decline. All three of the components (building permits, automobile registrations, and initial unemployment claims) contributed to the decline.

## August Revenue Collections

Total monthly general fund revenue fell 4.3 percent compared to August 2005. Declines in collections in sales and use taxes, recordation taxes, and to a lesser extent, corporate income taxes, were partially offset by a small increase in payroll withholding collections. In addition, because of several anomalies in payment patterns, August 2005 was a very strong collections month by comparison. On a year-to-date basis, total revenue grew 8.6 percent, compared to the annual forecast of 4.2 percent.

**Individual Income Tax Withholding (53% of general fund revenues):** Collections of payroll withholding taxes grew 2.5 percent in August. Monthly growth in this source is somewhat understated due to the timing of payments that boosted growth in August 2005. August 2005 had one additional deposit day compared to the prior year, and the additional day was a Wednesday -- the due date for all employers to submit withholding payments to the Federal government and to states, including Virginia, that follow the federal schedule. In addition, companies that have Friday payroll dates also normally settle EFT payments on Wednesday. Both these factors led to a significant increase in withholding collections in August 2005. Year-to-date withholding growth is 3.9 percent, lagging the projected annual growth rate of 5.3 percent.

**Individual Income Tax Nonwithholding (16% of general fund revenues):** August is not a significant month for nonwithholding receipts since the first estimated payment of fiscal year 2007 is due in September. Nonwithholding collections in August 2006 were \$39.5 million compared with \$43.7 million in August 2005.

**Individual Income Tax Refunds:** Last year, the transition to a new computer system required TAX to process a limited number of tax returns, resulting in refunds of only \$447,000 in the month of August. In August 2006, with the new system fully in place, TAX returned to a more normal level of activity, and issued \$40.2 million in refunds.

**Sales Tax (20% of general fund revenues):** Collections of sales and use taxes, reflecting July sales, fell 2.1 percent in August. The slowdown in the housing market, rising interest rates, and higher energy prices appear to be affecting retail sales.

Year-to-date growth in sales and use taxes of 49.9 percent is overstated due to the repeal of the Accelerated Sales Tax program. Adjusting for its repeal, sales and use taxes grew 3.2 percent in the first two months of this fiscal year.

**Corporate Income Tax (5% of general fund revenues):** Corporate collections are not significant in August as the first estimated payment for fiscal year 2007 is due in September. Substantially all of the \$15.1 million in corporate payments in August were from companies whose fiscal years run on a schedule other than calendar year. Year-to-date collections of corporate income tax total \$51.2 million compared with \$56.6 million in August of last year.

**Wills, Suits, Deeds, Contracts (4% of general fund revenues):** Wills, Suits, Deeds, Contracts -- mainly recordation tax collections -- declined 29.3 percent in August 2006 compared to August 2005, as housing sales continued to slow. This slowdown is likely to continue, as there was a 42 percent decline in pending home sales in Northern Virginia in July 2006 as compared to July 2005. Year-to-date collections in this source are down 25.0 percent compared to the same period last year.

## Other Revenue Sources

The following list provides data on August collections for other revenue sources:

	Year-to-Date	Required to Meet Estimate
Insurance Premiums Taxes (3% GF revenues)	-17.0%	11.4%
ABC Taxes (1.0% GF revenues)	5.7%	1.3%
Interest Income (0.7% GF revenues)*	86.2%	87.8%

*\*Approximately 60% of the interest for the current quarter is due to nongeneral funds and will be transferred in October.*

**All Other Revenue:** Receipts in All Other Revenue fell 7.6 percent in August -- \$40.2 million compared with \$43.5 million in August of last year. Year-to-date collections of All Other Revenue are 2.4 percent above the same period in fiscal year 2006, which is ahead of the annual estimate of 0.7 percent growth.

**Lottery Revenues:** Lottery net profits decreased 3.3 percent for the month compared to the same month in 2005. All games experienced a decline in sales, with the largest decline in the jackpot category as a result of lower advertised Mega Millions jackpots. Year-to-date net income declined 3.3 percent and is slightly ahead of the projected 6.3 percent decline in the annual forecast.

The Lottery will continue to evaluate the impact of the North Carolina Education Lottery on sales and revenue forecasts for the current biennium, and will update the official forecast in conjunction with the overall state re-forecasting process in the fall of 2006.

## Summary

August general fund revenue fell 4.3 percent compared to August 2005. The decline reflects anomalies in payment and refund activity in August 2005, as well as an apparent slowing in recordation tax and sales and use tax collections in August 2006. Declines in collections in sales and use taxes, recordation taxes, and to a lesser extent, corporate income taxes, were partially offset by a small increase in payroll withholding collections.

On a year-to-date basis, total revenue grew 8.6 percent, compared to the annual forecast of 4.2 percent. A significant portion of the growth is attributable to the July 2006 repeal of the Accelerated Sales Tax program. Adjusting for the effects of the July 2006 repeal of the Accelerated Sales Tax program and reduced August 2005 refunds, revenues grew 2.6 percent through the first two months of the current fiscal year, compared to an annual forecast of 3.1 percent.

September collections will complete the first quarter of fiscal year 2007 and provide a better assessment of revenue growth. The first estimated payments from individuals and corporations and the quarterly payments for insurance premiums are due in September 2006.

