



# COMMONWEALTH of VIRGINIA

Office of the Governor

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## MEMORANDUM

TO: The Honorable Mark R. Warner

THROUGH: The Honorable William H. Leighty

FROM: John M. Bennett

SUBJECT: December Revenue Data

This month's revenue letter incorporates the revised general fund revenue forecast considered by the Governor's Advisory Board of Economists and the Advisory Council on Revenue Estimates during their fall deliberations, as well as policy actions recommended in the Governor's introduced budget. With the revisions, projected growth in general fund revenue for fiscal year 2005 is now 8.2 percent.

Total general fund revenue collections grew 18.7 percent in December. Unusually strong corporate payments drove much of the growth. Strong collections in individual nonwithholding, and recordation taxes also contributed to the increase. Adjusting for the tax policy changes enacted last year in HB 5018, underlying revenue growth in December was 15.5 percent.

Through the first half of the fiscal year, revenues have grown 13.0 percent, well ahead of the revised annual estimate of 8.2 percent growth. Adjusted for tax policy changes enacted last year, year-to-date revenue growth is 10.9 percent.

Year-to-date revenue growth must continue to outpace the annual estimate in order to compensate for the effect of unusually strong revenue growth in the fourth quarter of fiscal year 2004. Revenue growth in the final quarter of fiscal year 2004 was 14.1 percent, the second highest rate of quarterly growth in the last 20 years.

### **National Economic Indicators**

Current economic indicators suggest that the national economy will continue to expand, although employment growth continues to be uneven.

- Labor market gains in December were generally below expectations. Payroll employment grew by 157,000 jobs -- still well below the 200,000 a month rate which is generally consistent with an expanding economy.

- Initial unemployment claims during the last week in December rose by 43,000 to 364,000. At about 333,000, the four-week moving average is consistent with an expanding job market.

- The manufacturing sector continues to expand. The Institute of Supply Management index increased 0.8 to 58.6 in December. A sharp increase in new orders drove the growth, suggesting production should increase in the coming months.
- After five monthly declines, the Conference Board's index of leading indicators rose 0.2 percent in November. Six of the ten components comprising the index rose, with stock market performance accounting for much of the growth.
- The Conference Board's index of consumer confidence jumped to 102.3 in December, reversing declines in the four previous months. Both the expectations and the present situation components improved.
- The consumer price index rose 0.2 percent in November. Core inflation also rose 0.2 percent for the month, with an annualized rate of 2.2 percent.
- As expected, the Federal Reserve raised the federal funds rate by another 25 basis points to 2.25 percent at its December meeting.

## Virginia Economy

In Virginia, payroll employment grew by 2.0 percent in November compared with the same month a year ago. Northern Virginia payrolls grew by 2.7 percent, followed by Richmond-Petersburg with 1.6 percent, and Hampton Roads with 1.0 percent growth. The slowest job growth was in the Western Region, with a 0.8 percent gain. The unemployment rate in November fell to 3.1 percent.

The Virginia Leading Economic Index fell 0.2 percent in November. The U.S. Leading Index made the only positive contribution, while the state components drove the index down. Virginia auto registrations and building permits fell, and initial claims for unemployment increased. On a regional basis, the indexes for Hampton Roads, Lynchburg, and Danville grew in November. The Northern Virginia index remained flat, and indexes fell in the other four major metropolitan areas of the Commonwealth.

## December Revenue Collections

Total general fund revenues grew 18.7 percent in December, driven by strong growth in corporate income taxes, individual nonwithholding, and recordation taxes. Healthy growth in sales taxes also contributed. Year-to-date growth through December is 13.0 percent, well ahead of the revised annual estimate of 8.2 percent.

**Individual Income Tax Withholding (62% of general fund revenues):** Collections of payroll withholding taxes grew 6.5 percent in December. Year-to-date withholding growth is 7.8 percent -- ahead of the 6.4 percent growth required to meet the revised annual forecast.

**Individual Income Tax Nonwithholding (12% of general fund revenues):** Collections of nonwithholding jumped 21.2 percent from December of last year. Year-to-date collections in this source are up 23.8 percent from the same period last year -- well ahead of the revised estimate of 7.1 percent growth.

December growth in nonwithholding can be distorted by the timing of payments. Taxpayers have until January 15 to submit their fourth estimated payment for tax year 2004. Payment patterns in prior years have shown large swings between December and January. Strong receipts in December are often followed by marked weakness in January and vice versa. A clearer assessment of collections will be possible at the end of January, when all payments have been received.

**Individual Income Tax Refunds:** Refunds this month totaled \$13.0 million, compared with \$23.3 million in December of last year. Through the first half of the fiscal year, refunds are \$10.0 million above the same period last year. Refund growth of 6.3 percent is tracking very close to the annual estimate of 6.5 percent. The income tax filing season begins during the last part of January, so more meaningful analysis of refund activity will be conducted in the next few months.

**Sales Tax (22% of general fund revenues):** Collections of sales and use taxes grew 17.3 percent in December. Year-to-date growth of 12.9 percent is lagging the revised forecast of 14.7 percent. The increase in the sales tax rate, which was effective September 1, is boosting apparent growth. Adjusting for the rate increase, collections were up 9.4 percent for the month and 8.6 percent year-to-date.

As with individual nonwithholding, January receipts are necessary to accurately assess growth in this source, since a large part of holiday sales tax collections will be received in January.

**Corporate Income Tax (3% of general fund revenues):** Corporate income tax payments surged in December, with \$111.1 million in collections compared with \$38.2 million in December of last year. Estimated payments were substantially higher than last year and refunds were significantly lower.

Monthly growth can be distorted this time of year, since November and December are both significant months for processing extension returns for corporations. Taking November and December together, estimated payments totaled \$177.6 million in November and December of this year, compared with \$102.5 million last year. Total refunds were \$56.7 million this year, compared with \$75.8 million over the same two months last year.

Over the first half of the fiscal year, corporate income tax collections have grown 63.6 percent compared with the same period last year - substantially ahead of the revised forecast of 12.5 percent growth.

January is also an important month for corporate income tax collections, with payments due from retailers.

### **Other Revenue Sources**

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

	<b>Year-to-Date</b>	<b>Required to Meet Estimate</b>
Insurance Premiums Tax (3.0% GF revenues)	9.9%	8.5%
ABC Taxes (1.1% GF revenues)	3.5%	0.1%
Public Service Corporations (0.7% GF revenues)	-3.9%	0.6%
Interest Income (0.7% GF revenues)	20.3%	12.4%

**All Other Revenue:** All Other Revenue grew 31.4 percent in December -- \$84.9 million compared with \$64.6 million in December of last year. Collections in the largest component of All Other Revenue -- wills, suits, deeds and contract fees -- grew 94.9 percent. Of the \$53.2 million collected in this source, \$47.6 million was recordation tax receipts. Adjusting for the rate increase effective last September 1, recordation tax collections grew by 21.2 percent. Year-to-date, collections of all other revenue are 28.3 percent above the same period last year -- ahead of the revised estimate of 9.0 percent growth.

**Lottery Revenues:** In December, Lottery net income decreased 8.6 percent over last year due to unusually high Pick 3 and Pick 4 payouts during the month, and slightly lower sales. Although year-to-date growth of 5.8 percent is above the annual revenue estimate of 3.8 percent, sales and profits lag nearly two percent below the growth projected for the first half of the fiscal year. To meet the fiscal year 2005 annual forecast, sales will need to be stronger than the forecast for the last half of the year, which already requires five percent growth over last year's record-breaking results.

### **Summary**

Total general fund revenue collections grew 18.7 percent in December. Strong collections in corporate income and individual nonwithholding, as well as recordation taxes, drove the increase. Adjusting for rate increases in sales and

recording taxes enacted in HB 5018, underlying revenue growth in December was 15.5 percent.

The timing of payments in December and January can significantly distort growth rates. December and January receipts must therefore be considered together to get a clearer picture of revenue collections. Individual estimated payments are due January 15, and the bulk of sales taxes from the holiday shopping season will be received in January. In addition, retailers' corporate payments will be received in January.

Through December, revenues have grown 13.0 percent above the same period last year, well ahead of the revised annual estimate of 8.2 percent growth. Adjusted for tax policy changes enacted last year, year-to-date growth is 10.9 percent.

Year-to-date revenue growth must continue to outpace the annual estimate in order to compensate for the effect of unusually strong revenue growth in the fourth quarter of fiscal year 2004. Revenue growth in the final quarter of fiscal year 2004 was 14.1 percent, the second highest rate of quarterly growth in the last 20 years.