



# COMMONWEALTH of VIRGINIA

## Office of the Governor

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Secretary of Finance

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January 12, 2006

### 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 on which the introduced budget is based. It reflects the deliberations of the Governor's Advisory Board of Economists and the Advisory Council on Revenue Estimates, as well as policy actions which are proposed. With the revisions, projected growth in general fund revenue for fiscal year 2006 is now 6.1 percent. Net of tax policy changes, economics-based revenue growth in fiscal year 2006 is projected to be 8.4 percent.

December is a significant month for revenue collections. In addition to normal monthly collections in withholding and sales taxes, quarterly estimated payments are due from most corporations, and the first wave of quarterly nonwithholding payments from individuals begins to come in.

Total general fund revenue collections grew 10.4 percent in December. Most of the December revenue growth was due to a surge in corporate income tax collections, and continued strength in individual nonwithholding payments. Through the first half of the fiscal year, revenues have grown 11.3 percent over the same period last year.

The Department of Taxation (TAX) continues its conversion process to the new Integrated Revenue Management System (IRMS). The conversion has resulted in a controlled production of individual and corporate extension returns processed during the conversion period. As a result, fewer than the typical number of individual and corporate refunds have been processed, compared to the same period last year. As a result, revenue growth in these sources is overstated. As the IRMS system moves toward full production, the backlog of refunds will be reduced, and revenue growth will more closely reflect underlying economic activity.

### National Economic Indicators

Current indicators depict a healthy national economy, and suggest economic growth will remain solid moving into 2006.

- Employers added 108,000 jobs to their payrolls in December. However, November's gain was revised up from 215,000 to 305,000, making the fourth quarter the strongest of the year in terms of job growth.
- Initial claims for unemployment fell to 291,000 during the last week of December. The four-week moving

average fell slightly to 317,000 – consistent with a solid labor market expansion.

- The Consumer Price Index fell 0.6 percent in November, largely due to an 8.0 percent decline in energy prices. Core inflation rose 0.2 percent for the month, bringing the annual rate of core inflation to 2.4 percent.
- The Conference Board's index of consumer confidence increased to 103.6 in December, following a significant 13-point gain in November. Both components of the index increased, but the largest gain was in the current conditions index. The index suggests that consumer confidence has essentially returned to its pre-hurricane levels.
- The Institute of Supply Management index fell 3.9 points to 54.2 in December, indicating growth in the manufacturing sector continues, but at a slower pace.
- As expected, the Federal Reserve raised the federal funds rate another 25 basis points in December, to 4.25 percent.

## Virginia Economy

In Virginia, payroll employment grew by 1.4 percent in November compared with the same month last year – about where it has been since last May.

In Northern Virginia payrolls grew by 3.2 percent. In Richmond-Petersburg jobs grew by 2.6 percent, followed by the western MSAs with 2.2 percent, and Hampton Roads with 1.2 percent growth. The unemployment rate rose slightly to 3.3 percent in November.

The Virginia Leading Index fell by 1.6 percent in November after rising 0.2 percent in October. The largest contributor to the decline was a sharp drop in auto registrations. Building permits also declined slightly. The U.S. Leading Index and initial claims for unemployment made positive contributions to the index.

## December Revenue Collections

Total general fund revenue collections grew 10.4 percent in December. Most of the December revenue growth was due to a surge in corporate income tax collections and continued strength in individual nonwithholding payments. Limited processing of corporate and individual income tax refunds also played a part. Through the first half of the fiscal year, revenues have grown 11.3 percent over the same period last year, ahead of the annual estimate of 6.1 percent.

Individual Income Tax Withholding (55% of general fund revenues): Collections of payroll withholding taxes grew 4.6 percent in December. Monthly growth is slightly understated since this December had one less deposit day than last year. Year-to-date withholding growth is 6.1 percent -- slightly below the projection of 6.9 percent growth for the fiscal year.

Individual Income Tax Nonwithholding (16% of general fund revenues): Nonwithholding payments were up 23.0 percent for the month. Year-to-date collections in this source are up 17.7 percent -- ahead of the estimate of 13.2 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 2005, and January collections in this source are typically much higher than December collections.

In addition, monthly growth patterns in prior years have shown large swings between December and January. Strong growth in December is 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 quarterly payments have been received.

Individual Income Tax Refunds: This month, TAX issued \$17.2 million in refunds, compared with \$13.0 million in December of last year. Fiscal year-to-date, \$113.0 million in refunds have been issued compared to \$168.9 million in the same period last year. TAX continues to be in a controlled production mode for extension returns processed during its conversion to IRMS, resulting in fewer than normal individual refunds being processed year-to-date. This has the effect of temporarily boosting apparent growth in individual income tax collections.

**Sales Tax (19% of general fund revenues):** Collections of sales and use taxes, representing November sales, declined 5.0 percent in December. Adjusting for the effects of the reduced tax rate on food, growth was flat for the month. Year-to-date growth stands at 4.5 percent through December, ahead of the estimate of a 4.6 percent decline.

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

**Corporate Income Tax (5% of general fund revenues):** Collections in corporate income taxes surged in December, with \$184.7 million in receipts compared with \$111.1 million in December of last year. The largest payments came from companies in defense, technology, housing, and mortgage banking. Collections in this source have grown 91.0 percent through the first half of the fiscal year – far ahead of the annual estimate of 17.1 percent growth. Although underlying growth in this source is very strong, it is probably also overstated to some degree.

As with individual income tax collections, controlled production in processing extension returns has meant that fewer than normal extension returns are being fully processed. Last year at this time, \$84.2 million in corporate refunds had been issued. This year-to-date, \$8.9 million in corporate refunds have been issued. As the backlog of extension returns is worked off, the apparent growth rate will come closer to reflecting underlying economic activity.

### Other Revenue Sources

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

	Year-to-Date	Required to Meet Estimate
Insurance Premiums Taxes (3% GF revenues)	-0.5%	5.1%
ABC Taxes (1.0% GF revenues)	5.4%	-0.5%
Public Service Corporations (0.6% GF revenues)	14.5%	2.6%
Interest Income (0.7% GF revenues)*	34.0%	17.3%

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

**All Other Revenue:** All Other Revenue grew by 2.3 percent in December – \$86.9 million compared with \$84.9 million in December of last year. Substantial growth in the largest component of all other revenue – wills, suits, deeds, and contract fees – helped to offset declines in many of the minor sources. Wills, suits, deeds, and contract fees (mostly recordation tax receipts) grew by 13.2 percent in December. Year-to-date growth stands at 41.1 percent. For the fiscal year, collections of All Other Revenue are 8.1 percent above fiscal year 2006, trailing the annual estimate of 10.4 percent growth.

**Lottery Revenues:** Lottery net profits increased 28.7 percent for the month. An increase of 8.1 percent in gross sales was driven by growth in all product categories with scratch products generating the most sales. Overall expenses were nearly flat compared to last year – mainly due to lower than expected prize payouts for Pick 3 and Pick 4 games.

Year-to-date net income growth of 11.5 percent is well ahead of the projected 2.4 percent annual rate. The Lottery Department reports that comparisons to prior periods are greatly influenced by the size of advertised jackpots and prize expense rates that fluctuate with the “luck of the draw.” Also, the kick-off of the North Carolina lottery later this fiscal year is expected to slow the overall sales growth. Both factors have been incorporated into the Lottery’s revised revenue projections.

### Summary

This month’s revenue letter incorporates the revised general fund revenue forecast on which the introduced budget is based. It reflects the deliberations of the Governor’s Advisory Board of Economists and the Advisory Council on Revenue Estimates, as well as policy actions recommended in the Governor’s introduced budget. With the revisions,

projected growth in general fund revenue for fiscal year 2006 is now 6.1 percent. Net of tax policy changes, economics-based revenue growth in fiscal year 2006 is projected to be 8.4 percent.

Total general fund revenue collections grew 10.4 percent in December. Most of the December revenue growth was due to a surge in corporate income tax collections, and continued strength in individual nonwithholding payments. Through the first half of the fiscal year, revenues have grown 11.3 percent over the same period last year.

The timing of payments in December and January can significantly distort apparent growth rates. 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, corporate payments from retailers will be received in January. December and January receipts must therefore be considered together to get a clearer picture of revenue growth.

This year, TAX's conversion to its new Integrated Revenue Management System (IRMS) has contributed to distortions in the collections data. Controlled production for individuals and corporations that filed extension returns has slowed the processing of refunds. As a result, revenue growth in these sources is over-stated. TAX continues to work these returns to insure taxpayers are not adversely affected by the conversion.