



COMMONWEALTH of VIRGINIA

Office of the Governor

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Secretary of Finance

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April 12 , 2007

MEMORANDUM

TO: The Honorable Timothy M. Kaine
THROUGH: The Honorable William H. Leighty
FROM: Jody M. Wagner
SUBJECT: March 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. General fund revenues are projected to grow 6.5 percent in fiscal year 2007.

March is not typically a significant month for revenue collections. Collections consist mainly of withholding and sales tax revenues in addition to normal collections for most minor sources. No estimated payments are due from either individuals or corporations, although March collections do include the leading edge of corporate payments which are due April 15. Total general fund revenue collections grew 0.7 percent in March compared to March 2006. On a year-to-date basis, revenues grew 3.7 percent over the same period last year.

Two factors are distorting growth – the end of the Accelerated Sales Tax Program in fiscal year 2006 and the controlled production at TAX due to implementation of new systems, which slowed processing of individual and corporate refunds during the first half of last fiscal year. Adjusting for these factors, revenues grew 4.0 percent through the first nine months of fiscal year 2007, behind the adjusted forecast of 5.4 percent annual growth.

National Economic Indicators

Although the March employment report was positive news, most national indicators depict slower-than-expected first quarter growth in the economy. The national housing market and oil prices continue to be the significant factors affecting the short-term outlook.

- Employers added 180,000 jobs to payrolls in March. Gains for January and February were revised up by a total of 32,000 jobs. In a separate report, the unemployment rate fell slightly from 4.5 to 4.4 percent.
- Initial claims for unemployment rose by 11,000 to 321,000 during the last week of March. The four-week moving average fell slightly, from 317,000 to 316,000 and is consistent with a healthy labor market.
- An increase in energy prices pushed the Consumer Price Index up 0.4 percent in February, following a 0.2 percent increase in January. Core inflation, excluding food and energy, increased 0.2 percent in February contributing to

growth of 2.7 percent over the last year.

- The Institute of Supply Management index declined from 52.3 to 50.9 in March. A reading over fifty indicates the manufacturing sector is expanding.
- The Conference Board's index of leading indicators fell 0.5 percent to 137.3 in February, following a 0.3 percent decline in January. The index is at its lowest level since August 2006.
- The Conference Board's index of consumer confidence fell from 111.2 to 107.2 in March, a three-month low, reflecting a decline in the expectations component of the index. The current assessment component was unchanged.
- The Federal Reserve held the federal funds rate steady at 5.25 percent at its March meeting, the same level it has been since August of 2006.

Virginia Economy

Virginia, payroll employment grew 1.2 percent in February. Northern Virginia posted job growth of 1.7 percent in February. Jobs grew by 1.3 percent in Hampton Roads, 2.7 percent in Richmond-Petersburg, and 2.2 percent in the western MSAs. The unemployment rate was flat at 3.2 percent in February.

The Virginia leading index rose 0.9 percent in February, its third consecutive monthly increase. Rising auto registrations and declining initial unemployment claims drove the increase. Building permits again posted a slight decline. The regional indices increased in five of the state's eleven metropolitan areas in January: Richmond, Charlottesville, Blacksburg, Lynchburg, and Harrisonburg. The leading index was unchanged in Hampton Roads and fell in the remaining MSAs.

March Revenue Collections

March is not typically a significant month for revenue collections. Total general fund revenue collections grew 0.7 percent in March compared to March 2006. On a year-to-date basis, revenues grew 3.7 percent over the same period last year.

Individual Income Tax Withholding (54% of general fund revenues): Collections of payroll withholding taxes grew 1.8 percent in March compared to March 2006. The weakness is partially due to one less deposit day in March 2007 than March 2006. Year-to-date withholding growth is 5.8 percent, close to the projected annual growth rate of 5.7 percent.

Individual Income Tax Nonwithholding (18% of general fund revenues): March is not typically a significant month for nonwithholding collections. A total of \$62.9 million was collected in March, compared with \$59.5 million in March of last year.

To date, about 42 percent of the nonwithholding forecast has been collected, and collections during this period are 8.7 percent above the same period last year, which is below the projected annual growth of 10.2 percent. April and May are significant months for nonwithholding collections, as both final payments for tax year 2006 and estimated payments for the current tax year are due May 1. In addition, another estimated payment is due June 15.

Individual Income Tax Refunds: In the latter half of calendar year 2005, the transition to a new computer system required TAX to process a limited number of tax returns in the fall, resulting in few refunds for that period. With the new system in place, TAX returned to a normal schedule for processing this year. Through March, \$960.4 million have been refunded compared with \$751.4 million in the same period last year. For the filing season beginning January 1, about 1.5 million refunds have been issued, compared with 1.45 million issued in the same period last year.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting February sales, fell 5.1 percent in March. Year-to-date growth in sales and use taxes of 10.5 percent is inflated due to the repeal of the Accelerated Sales Tax program. Adjusting for the repeal of this program, growth in this source was 2.8 percent through March, compared with the forecast of 4.1 percent adjusted growth needed to meet the annual estimate.

Corporate Income Tax (6% of general fund revenues): Collections of corporate income tax were \$103.8 million in March 2007, compared with \$67.7 million in March of last year. March receipts are typically from companies paying ahead of the April 15 filing date for final payments on tax year 2006 liability and estimated payments for the first quarter of the current fiscal year. April receipts will provide a clearer picture of growth in this source. Year-to-date collections are down 3.0 percent compared to the same period last year, trailing the annual projected growth rate of 3.4 percent.

Wills, Suits, Deeds, Contracts (4% of general fund revenues): Wills, suits, deeds, and contracts – mainly recordation tax collections – fell 13.4 percent in March as the housing market continued to slow. Year-to-date collections in this source declined 18.0 percent from last year, close to the estimate of a 20.2 percent decline.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (3% GF revenues)	-2.7%	2.9%
ABC Taxes (1.0% GF revenues)	4.1%	3.6%
Interest Income (0.6% GF revenues)*	64.7%	101.0%

All Other Revenue: Receipts in All Other Revenue fell 21.3 percent in March – \$42.2 million compared with \$53.6 million in March of last year. Most of the decline was in inheritance, gift, and estate taxes. For the fiscal year-to-date, collections of All Other Revenue are 5.7 percent below the same period in fiscal year 2006, lagging the annual estimate of 3.4 percent growth.

Lottery Revenues: Net income of \$46.0 million in March was 8.0 percent above March of last year mainly due to the Mega Millions jackpot growing to a record \$390 million in March. March also set a new monthly record with total product sales of \$138.6 million. Additional Sunday drawings, new product offerings, and the record \$390 million Mega Millions jackpot have all resulted in a positive influence on product sales. Year-to-date, net income is down 7.4 percent, better than the forecast of a 10.7 percent decline.

Summary

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Two factors are distorting growth – the end of the Accelerated Sales Tax Program in fiscal year 2006 and the controlled production at TAX due to implementation of new systems, which slowed processing of individual and corporate refunds during the first half of last fiscal year. Adjusting for these factors, revenues grew 4.0 percent through the first nine months of fiscal year 2007, which is below the adjusted forecast of 5.4 percent growth.

Total general fund collections currently are trailing the annual estimate. The last three months of the fiscal year are significant collections months, particularly April and May. Estimated and final payments from both corporations and individuals are due in April and May, and estimated payments are again due in June.