



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: May Revenue Data

May is a significant month for revenue collections. In addition to normal collections in withholding and sales taxes, estimated and final payments for individuals are due May 1. In addition, corporations with a fiscal year ending other than December 31 – primarily retailers – have final payments due in May.

Total general fund revenue collections grew 13.9 percent in May 2007 compared to May 2006. Strong growth in individual withholding and nonwithholding payments was offset by a decline in sales tax collections. On a year-to-date basis, revenues grew 4.7 percent over the same period last year, significantly behind the annual forecast of 6.5 percent. Sales tax collections are disappointing, and individual income tax refunds are exceeding expectations, dampening growth.

Adjusting for the end of the Accelerated Sales Tax Program, revenues grew 3.5 percent through May of fiscal year 2007, behind the adjusted forecast of 5.4 percent annual growth.

National Economic Indicators

Most national indicators depict an economy growing at a moderate pace, with the housing market and oil prices having a significant dampening effect.

- First quarter GDP growth was revised down from 1.3 percent in the advance estimate to 0.6 percent, down sharply from the 2.5 percent growth of the fourth quarter.
- Employers added 157,000 jobs to payrolls in May, ahead of expectations. Gains in education and healthcare, business and professional services, and leisure and hospitality offset losses in construction, financial services, and retail trade. In a separate report, the unemployment rate was flat at 4.5 percent.
- Initial claims for unemployment fell by 1,000 to 309,000 during the last week of May. The four-week moving average rose slightly, from 305,000 to 307,000 and is at the lowest level since April 2006.
- Inflation remains contained. An increase in energy prices pushed the Consumer Price Index up 0.4 percent in April, following a 0.6 percent increase in March. Core inflation, excluding food and energy, increased 0.2 percent in April, resulting in growth of 2.4 percent over the last year.

- Conditions in the manufacturing sector are improving. The Institute of Supply Management index increased from 54.7 to 55.0 in May, the highest level since April 2006.
- The Conference Board's index of leading indicators fell 0.5 percent to 137.3 in April, following a 0.6 percent increase in March. A drop in residential building permits drove the decline.
- The Conference Board's index of consumer confidence rose from 106.3 to 108.0 in May. Both the expectations and current situation components increased, with most of the strength in the assessment of current conditions.
- The Federal Reserve held the federal funds rate steady at 5.25 percent at its meeting in May, noting that "the economy seems likely to expand at a moderate pace over coming quarters."

Virginia Economy

Virginia payroll employment grew 1.6 percent in April. Northern Virginia posted job growth of 2.2 percent in April. Jobs grew by 1.2 percent in Hampton Roads, 2.2 percent in Richmond-Petersburg, and 1.6 percent in the western MSAs. The unemployment rate fell from 3.1 percent to 2.9 percent in April.

The Virginia leading index grew 0.3 percent in April, its fourth increase in five months. An increase in auto registrations and a decline in initial claims for unemployment offset the negative impact of a drop in building permits. The regional indices increased in eight of the state's eleven metropolitan areas in April. The indices in Blacksburg, Lynchburg, and Harrisonburg fell for the month.

May Revenue Collections

May is a significant month for revenue collections. Estimated and final payments for individuals are due May 1, and corporations with a fiscal year ending other than December 31 – primarily retailers – have final payments due in May.

Total general fund revenue collections grew 13.9 percent in May compared to May 2006. Strong growth in individual withholding and nonwithholding payments was offset by a decline in sales tax collections. On a year-to-date basis, revenues grew 4.7 percent over the same period last year, significantly behind the annual forecast of 6.5 percent.

Individual Income Tax Withholding (54% of general fund revenues): Collections of payroll withholding taxes grew 11.7 percent in May. Year-to-date withholding growth is 6.3 percent, slightly ahead of the projected annual growth rate of 5.7 percent. June collections can be flat compared to June 2006 and attain the annual forecast, however, this source must be considered in the context of net individual income tax collections, which include individual nonwithholding and refunds as discussed below.

Individual Income Tax Nonwithholding (18% of general fund revenues): May is a significant month for this source, since final payments for tax year 2006 and the first estimated payment for tax year 2007 are both due May 1. Nonwithholding receipts, which have been trailing the annual estimate, rebounded in May.

May collections were \$693.6 million compared with \$542.1 million in May of last year, a 27.9 percent increase. To date, about 90 percent of the nonwithholding forecast has been collected, and collections during this period are 12.1 percent above the same period last year -- above projected annual growth of 10.2 percent. The last estimated payment for this fiscal year is due June 15. As with withholding, June collections can be flat compared to June 2006 and attain the annual forecast, however, this source must be considered in the context of net individual income tax collections, which include individual withholding and refunds.

Individual Income Tax Refunds: Through May, \$1.5 billion have been refunded compared with \$1.2 billion in the same period last year. For the filing season beginning January 1, about 2.39 million refunds have been issued, compared with 2.34 million issued in the same period last year. The average check size is up a sharp 13 percent compared with the forecast of 5 percent. With one month left in the fiscal year, refunds have already surpassed the forecast of \$1.3 billion. The gap will continue to grow with refunds issued in June. Over the last three years, individual refunds issued in June have averaged about \$50 million.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting April sales, fell 13.2 percent

in May. An early Easter this calendar year and one less Saturday distorted monthly collection patterns. Year-to-date growth in sales and use taxes of 8.8 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 2.6 percent through May, trailing the forecast of 4.2 percent growth needed to meet the annual estimate.

Corporate Income Tax (6% of general fund revenues): May is typically not a significant month in corporate income tax collections, with final or extension payments due mainly from retailers, who typically have a January 31 close date for the fiscal year. Such payments vary significantly from year to year. Collections this month totaled \$20.2 million, compared to \$11.4 million received last year. Through May, corporate income tax collections are up 1.6 percent for the year, trailing the forecast of 3.4 percent growth. The last corporate estimated payment of the fiscal year is due June 15.

Wills, Suits, Deeds, Contracts (4% of general fund revenues): Wills, suits, deeds, and contracts – mainly recordation tax collections – fell 15.0 percent in May as the housing market continued to slow. Year-to-date collections in this source declined 16.5 percent from last year, compared with the estimate of a 20.2 percent decline.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (3% GF revenues)	0.2%	2.9%
ABC Taxes (1.0% GF revenues)	4.7%	3.6%
Interest Income (0.6% GF revenues)*	60.8%	104.0%

All Other Revenue: Receipts in All Other Revenue fell 23.0 percent in May – \$32.5 million compared with \$42.2 million in May of last year. Most of the decline was in payments from public service corporations. For the fiscal year-to-date, collections of All Other Revenue are 4.5 percent below the same period in fiscal year 2006, lagging the annual estimate of 3.6 percent growth.

Lottery Revenues: Net income of \$34.8 million in May was 3.3 percent ahead of May of last year mainly due to continued strong sales in the daily games (Pick 3, Pick 4, and Cash 5). Year-to-date, net income is down 6.1 percent, better than the forecast of a 10.7 percent decline.

Summary

May is a significant month for revenue collections. In addition to normal collections in withholding and sales taxes, estimated and final payments for individuals are due May 1. Also, final payments are due from corporations with a fiscal year ending other than December.

Total general fund revenue collections grew 13.9 percent in May 2007 compared to May 2006. Strong growth in individual withholding and nonwithholding payments was offset by a decline in sales tax collections. On a year-to-date basis, revenues grew 4.7 percent over the same period last year, significantly behind the annual forecast of 6.5 percent. Sales tax collections are lagging the forecast, and individual income tax refunds are exceeding expectations, dampening growth. Adjusting for the end of the Accelerated Sales Tax Program, revenues grew 3.5 percent through May of fiscal year 2007, behind the adjusted forecast of 5.4 percent annual growth.

June is another significant month for revenue collections, and typically accounts for about 11 to 12 percent of total general fund revenue for the year. June collections include receipts of individual and corporate estimated payments, estimated payments for insurance premiums and corporate franchise fees, along with regular monthly collections in other sources.

June collections must total about \$1.9 billion to meet the forecast for the fiscal year. Receipts last June totaled \$1.6 billion. Fiscal year 2007 revenues appear highly likely to fall short of the forecast. Section 2.2-1503.3 of the Code of Virginia requires a re-estimate of general fund revenues if the sum of individual income, corporate income, and sales

taxes falls more than 1.0 percent below the official budget estimate for the sum of the three sources.

As the first step in the reestimation process, a special meeting of the Governor's Advisory Board of Economists (GABE) was held on June 13. The Board recommended an interim economic forecast that reflects weaker growth than the official forecast.

On July 16, a meeting will be convened with individuals involved in home building, real estate, and mortgage banking to gauge the future impact of the housing slowdown on Virginia's revenue collections.

On July 25, the Governor's Advisory Council on Revenue Estimates (GACRE) will meet to discuss the interim economic and revenue forecasts. These forecasts will include input from the GABE and the housing sector experts. The GACRE will recommend what it believes to be the most likely path of the Virginia economy along with the revenue forecast associated with its chosen economic outlook. The interim revenue forecast for fiscal years 2008 through 2010 will be released by the Governor at the August 20 joint meeting of the General Assembly money committees.
