



# 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: October Revenue Data

October is not a major collections month for general fund revenue. Normal monthly collections are due in withholding, sales taxes, public service corporations, and most other sources. Estimated corporate income tax payments for corporations with a February through January fiscal year -- mainly retailers -- are filed in October.

October is the first month that revenues include the sales and use tax increase enacted in House Bill 5018, as well as repeal of the sales tax exemption for public service corporations and common carriers. Of the one half percent sales tax increase, one-quarter percent is deposited to the general fund. The Appropriation Act treats the other one-quarter percent as a transfer from the SOQ/Property Tax Relief Fund to the general fund, and not as general fund revenue.

Total general fund revenue collections grew 10.5 percent in October, boosted by collections in individual nonwithholding, corporate income, and sales taxes. Recordation and estate taxes were also strong. About 1.7 percent of October's 10.5 percent growth was due to the sales tax increase enacted in HB 5018. Another 2.2 percent of October's growth was due to the increase in recordation taxes.

Through the first four months of the fiscal year, revenues have grown 11.5 percent above the same period last year, well ahead of the annual estimate of 4.5 percent growth.

### **National Economic Indicators**

Current economic indicators are mixed, suggesting that the moderate pace of national economic growth will continue.

- Payroll employment in October increased by 337,000 jobs nationally -- the strongest gain in seven months. Payroll gains for August and September were also revised upwards by a combined 113,000 jobs. Jobs were gained primarily in services industries. Temporary employment increased, and activity in the wake of the hurricanes spurred construction employment.

Payroll gains over the past five months have averaged about 171,000 jobs -- slightly above the 150,000 level generally regarded as necessary to keep unemployment rates stable.

- Initial claims for unemployment fell to 332,000 during the last week of October. The four-week moving average fell to 342,000, the lowest level in six weeks -- indicating that a moderate labor market expansion will continue.

- Real GDP grew 3.7 percent during the third quarter of fiscal year 2004, driven by solid growth in consumer spending and business investment. Although healthy, the real GDP rate was slightly below what had been expected for the quarter.

- The Institute of Supply Management index, which tracks manufacturing output, fell to 56.8 in October -- the third consecutive monthly decline -- indicating again that the pace of the manufacturing expansion is slowing.

- The Conference Board's index of leading indicators fell for the fourth consecutive month in September, pushing the index 0.2 percent lower than it was six months ago. The slowing growth rate in the index suggests economic growth will continue, but remain below trend.

- The Conference Board's index of consumer confidence fell 3.9 points to 92.8 in October, marking its third consecutive monthly decline. The expectations component -- particularly the outlook for the job market -- accounted for most of the decline.

### **Virginia Economy**

In Virginia, payroll employment grew 2.2 percent in September compared to the same month last year. Northern Virginia payrolls grew 3.2 percent, while Richmond-Petersburg employment increased 1.7 percent. The slowest job growth was in the Western Region, with a 0.9 percent gain. All regions in the Commonwealth have posted consecutive gains for the last seven months.

The Virginia Leading Economic Index increased 0.3 percent in September -- its third consecutive monthly gain. Regional indices rose in Northern Virginia, Hampton Roads, Richmond-Petersburg, Roanoke, and Charlottesville. The indices for Lynchburg, Bristol, and Danville declined in September.

### **October Revenue Collections**

Total general fund revenues grew 10.5 percent in October, driven by strong growth in individual nonwithholding taxes, corporate, and sales taxes. Unusually strong collections in estate taxes and increases in recordation taxes further boosted growth. About 3.9 percent of the 10.5 percent growth for the month was due to tax policy changes which became effective on September 1.

Year-to-date growth through October is 11.5 percent, well ahead of the estimate of 4.5 percent.

***Individual Income Tax Withholding (59% of general fund revenues):*** Collections of payroll withholding taxes fell 3.4 percent in October. The timing of withholding collections makes October appear weaker than it really was.

Electronic filing has made Wednesday the most significant collections day of the week for payroll withholding. This year, October contained four Wednesdays, but is being compared to collections last October, when October included five Wednesdays.

October's weak withholding revenue balances out the overstated withholding strength reported last month, when a five-Wednesday September was compared to last year's four-Wednesday September.

Year-to-date withholding growth is 6.4 percent, ahead of the 4.6 percent growth required to meet the annual forecast, but more in line with what available indicators of employment and income growth would suggest.

***Individual Income Tax Nonwithholding (13% of general fund revenues):*** October is typically a slow month for nonwithholding collections. However, revenue in October included an unusually large level of payments from compliance programs, which seems to account for much of the strength in this source. Payments in October totaled

\$52.6 million, compared with \$31.9 million in October of last year. Year-to-date collections in this source are up 24.5 percent, well ahead of the estimate of 6.9 percent growth.

**Individual Income Tax Refunds:** October is typically a slow month for issuing refunds. Fiscal year-to-date, \$123.2 million in refunds have been issued, compared with \$111.0 million in the same period last year. Growth of 11.0 percent exceeds the annual estimate of 3.8 percent.

**Sales Tax (23% of general fund revenues):** Collections of sales and use taxes grew 19.9 percent in October. Because October collections represent September sales, October was the first month that collections reflected the increase in the sales tax rate, which was effective September 1. Year-to-date growth of 11.0 percent is roughly tracking the forecast of 11.3 percent.

Underlying growth in sales tax collections was also strong. Adjusting for the one-quarter percent increase which is budgeted as general fund revenue, collections were up 12.3 percent for the month and 8.8 percent year-to-date.

**Corporate Income Tax (3% of general fund revenues):** October collections in corporate income tax represent estimated payments by corporations that have a fiscal year beginning in February, which mainly includes retailers. These corporations have estimated payments due in October rather than September.

October estimated payments totaled \$42.4 million, compared with \$22.6 million in October of last year. This balances out some of September's weakness in corporate collections. Taken together with September, the first estimated payment of the fiscal year is up 25.5 percent. Through the first four months of the fiscal year, corporate income tax collections grew 27.4 percent compared with the same period last year.

**Insurance Premiums Tax (3% of general fund revenues):** October is not a significant month for collections of the tax on insurance premiums, although the timing of refunds can produce large monthly swings in growth rates.

Year-to-date collections in this source are 29.9 percent above the same period last year -- ahead of the annual estimate of 8.5 percent growth. This unusually high growth rate is largely due to the fact that refunds of estimated payments went out last October, but will be sent out in November this year. About \$12 million in refunds will be issued.

## Other Revenue Sources

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

	Year-to-Date	Required to Meet Estimate
ABC Taxes (1.1% GF revenues)	-1.6%	-8.7%
Public Service Corporations (0.7% GF revenues)	6.6%	-0.7%
Interest Income (0.7% GF revenues)	8.9%	30.9%

**All Other Revenue:** All Other Revenue grew 32.4 percent in October. Two factors affected growth in this source. Collections in the largest component of all other revenue -- wills, suits, deeds and contract fees - jumped 54.8 percent with the increased recordation tax rate. Of the \$48.6 million collected in this source, \$43.3 million was recordation tax receipts. Adjusting for the rate increase, receipts actually declined by 5.2 percent.

Several large estates were also settled in October, boosting growth in All Other Revenue. In October, \$21.3 million was collected in this source, compared with \$9.5 million in October of last year.

Year-to-date, collections of All Other Revenue are 31.6 percent above the same period last year -- ahead of the estimate of a 13.1 percent decline.

**Lottery Revenues:** In October, Lottery net income increased 1.0 percent over last year due to higher sales in scratch and Mega Millions products. On a year-to-date basis, growth of 5.7 percent is well above the annual revenue estimate of a 3.2 percent decline.

## **Summary**

October is the first month that revenues include the sales and use tax increase enacted in House Bill 5018, as well as repeal of the sales tax exemption for public service corporations and common carriers. Of the one-half percent sales tax increase, one-quarter percent is deposited to the general fund. The Appropriation Act treats the other one-quarter percent as a transfer from the SOQ/Property Tax Relief Fund to the general fund, and not as general fund revenue.

Total general fund revenue collections grew 10.5 percent in October. Strong collections in individual nonwithholding, corporate income, and sales taxes drove the increase, along with healthy increases in recordation and estate taxes. Some of the collections strength is explained by recordation and sales tax changes included in HB 5018. Without these changes, monthly revenue growth would have been about 6.6 percent

Through October, revenues have grown 11.5 percent above the same period last year, well ahead of the annual estimate of 4.5 percent growth.

The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists met in October to review the economic forecast for the Virginia economy over the next two biennia. The Governor's Advisory Committee on Revenue Estimates will meet in November to review the economic forecast and preliminary general fund revenue estimates. This forecast will serve as the basis for the revised revenue forecast to be presented by the Governor in December.