



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: September Revenue Collections

September is a significant collections month. Estimated payments from individuals, corporations, and insurance premiums are all due in September, along with regular monthly collections in withholding, sales, and other sources. September also completes the first quarter of the fiscal year.

Monthly collections in September increased by 11.2 percent. About 88 percent of September's growth can be attributed to the three most volatile revenue sources – nonwithholding, corporate income taxes, and recordation taxes – continuing a pattern of strength which began in fiscal year 2005. Through the first quarter, year-to-date growth has been 14.5 percent.

The Department of Taxation continued its conversion process to the new Integrated Revenue Management System (IRMS) in September. As was the case in August, few individual refunds were processed in September. This has the effect of boosting apparent growth rates. In addition, many of the individual and corporate estimated payment vouchers remain to be entered into the system. This does not affect deposits, but it does hamper the ability to fully analyze revenue flows. IRMS is expected to be more fully functional in October and should provide much of the data necessary to provide a comprehensive revenue analysis.

This month's revenue report displays in the first column the revenue estimates for fiscal year 2006 on which the Appropriation Act (Chapter 951) was based. The last column reflects the percent annual growth required by the estimate when compared to actual fiscal year 2005 collections. These growth rates represent growth needed to meet the amounts budgeted, and do not represent a revised forecast. Some of FY 2005's strong revenue performance will ripple forward into FY 2006, but revised estimates for FY 2006 will not be finalized until the fall forecasting process is complete.

National Economic Indicators

National economic indicators suggest the effects of Hurricane Katrina may not be as severe as initially anticipated.

- Payroll employment fell by 35,000 jobs in September – the first monthly report to reflect the effects of Hurricane

Katrina. Hurricane Rita struck after the survey week, and did not affect the employment report. The relatively small job loss for the month suggests that employment growth was solid in other areas of the country. So far, about 360,000 claimants have filed for unemployment insurance due to job losses from the hurricane, but some jobs also were created in the region due to rescue and clean-up efforts. According to the federal Bureau of Labor Statistics, the economy would have added about 200,000 jobs in September had Katrina not hit. In a separate report, the unemployment rate rose slightly to 5.1 percent.

- Initial claims for unemployment rose to 390,000 during the last week of September, and claims for the previous week were revised up from 356,000 to 369,000. The four-week moving average rose to 405,000.
- The impact of the hurricanes was also evident in weakened consumer confidence. The Conference Board's index of consumer confidence fell almost 19 points in September to 86.6 -- the largest monthly decline in nearly fifteen years.
- The Institute of Supply Management index rose 5.8 points to 59.4 in September – indicating that manufacturing activity picked up for the month.
- The Conference Board's index of leading indicators fell 0.2 percent in August, and July's small increase was also revised to report a decline of 0.1 percent. Declining consumer confidence was the main contributor to the decrease.
- The consumer price index rose 0.5 percent in August, with rising energy costs accounting for the increase. Core inflation rose 0.1 percent for the fourth consecutive month.
- The Federal Reserve raised the federal funds rate another quarter point to 3.75 percent at its September meeting – the eleventh consecutive increase.

Virginia Economy

In Virginia, payroll employment grew by 1.4 percent in August compared with the same month last year – the fourth consecutive month it has been reported at that level. In the Northern Virginia and Richmond-Petersburg MSAs, payrolls grew by 3.1 percent, followed by the western MSAs with 2.3 percent, and Hampton Roads with 1.1 percent growth. The unemployment rate rose to 3.7 percent in August.

The Virginia Leading Index increased 1.1 percent in August after falling 0.1 percent in July. Strong auto sales due to employee discount pricing, and a decline in initial unemployment claims, contributed to the monthly increase.

September Revenue Collections

September is a significant month for general fund revenue collections. In addition to normal monthly collections in withholding, sales, and other sources, estimated payments are due for individual income, corporate income, and insurance premiums.

Total general fund revenue collections grew 11.2 percent in September – all but a fraction of which was due to continuing strength in individual nonwithholding, corporate income, and recordation taxes.

Individual Income Tax Withholding (60% of general fund revenues): As expected, collections of payroll withholding taxes grew only 2.4 percent in September. September's calendar included four Wednesdays, compared to five Wednesdays last September – balancing the “five v. four Wednesday” pattern which had artificially boosted August's withholding collections. Year-to-date withholding growth is 7.3 percent.

Individual Income Tax Nonwithholding (13% of general fund revenues): The first estimated payment of fiscal year 2006 was due in September. Collections of nonwithholding were up 24.1 percent for the month. The average check size appears to have increased by about 21 percent – close to the 18 percent increase seen in the June, 2005 payment. Through the first quarter, year-to-date nonwithholding collections are up 21.8 percent.

Individual Income Tax Refunds: In August and September, TAX continued its implementation of a new accounting system. The transition to a new computer system requires TAX to process a limited number of tax returns at a time. About \$9.3 million in refunds were issued in September, compared to \$21.0 million last year.

Fiscal year-to-date, \$50.5 million in refunds have been issued, compared to \$87.8 million in the same period last year. The slower processing of refunds thus far has boosted apparent revenue growth in fiscal year 2006 by about 1.2 percentage points.

Sales Tax (21% of general fund revenues): September sales tax receipts reflect August retail sales. Sales tax collections grew 7.7 percent in September. Year-to-date growth stands at 10.5 percent. A large part of the revenue impact of the rate increase on sales has now been offset by the reduction in the sales tax rate on food.

Although sales tax collections continued to grow at above-trend rates in September, increased energy costs are expected to slow collections in this source over the coming months.

Corporate Income Tax (4% of general fund revenues): The first estimated payment of fiscal year 2006 was due in September. Monthly collections surged 53.5 percent.

Through the first quarter, corporate income tax collections have grown 76.1 percent – the strongest first quarter on record. Similar increases have been seen at the federal level and in other states. Continued strong corporate profitability is believed to be fueling the increases in tax payments.

Although most of the increase is due to growth in corporate payments, slower processing of refunds has also had an effect. Thus far in fiscal year 2006, \$4.3 million in refunds have been issued – compared to \$18.9 million in the first quarter of last year.

Other Revenue Sources

The table below provides data on September collections for other revenue sources:

	Year-to-Date	Required to Meet Estimate
Insurance Premiums Taxes (3% GF revenues)	-4.4%	10.7%
ABC Taxes (1.1% GF revenues)	7.4%	-0.5%
Public Service Corporations (0.7% GF revenues)	5.2%	0.3%
Interest Income (0.7% GF revenues)	* 64.3%	-0.2%

*Approximately sixty percent of interest income for the quarter is due to nongeneral funds and will be transferred in October.

All Other Revenue: All Other Revenue fell by 7.8 percent in September – with \$89.8 million in collections, compared with \$97.4 million in September of last year. A \$20.9 million decline in collections in the inheritance, gift, and estate taxes was partly offset by significant growth in wills, suits, deeds, and contract fees, which includes recordation taxes. Wills, suits, deeds, and contract fees grew by 45.5 percent in September. The rate increase in the recordation tax enacted in HB 5018 took effect in September 2004; therefore, comparisons to the same month last year can now be drawn on an “apples to apples” basis.

For the fiscal year, collections of All Other Revenue are 17.8 percent above fiscal year 2005 totals for the same period.

Lottery Revenues: Lottery revenues increased 9.6 percent for the month and year-to-date growth stands at 5.6 percent. Gross sales increased 12.8 percent for the year – mainly due to strong growth in Mega Millions. Sales for Mega Millions were buoyed by a growing jackpot which peaked at \$258 million on September 16th. Both sales and net income were the highest ever for the first quarter. During the fall forecasting process, the Lottery forecast will be updated, and will include an estimate of the impact of North Carolina’s decision to start its own lottery.

Summary

September typically represents the first significant data point for the fiscal year. Estimated payments from individuals, corporations, and insurance premiums are all due in September, along with regular monthly collections in withholding, sales, and other sources. September also completes the first quarter of the fiscal year.

Monthly collections in September increased by 11.2 percent. About 88 percent of September's growth can be attributed to the three most volatile revenue sources – individual nonwithholding, corporate income taxes, and recordation taxes – continuing a pattern of strength which began in fiscal year 2005.

Through the first quarter, year-to-date growth has been 14.5 percent. Tax policy changes and slower processing of income tax refunds as TAX implements its new accounting system account for 3.9 percentage points of the growth in the first quarter.

The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists will meet later in October to assess the outlook for the Virginia economy over the current and next biennium. The economic outlook which is recommended will drive the preliminary revenue forecast, which will be developed by the Tax Department's forecasting staff. The Governor's Advisory Council of Revenue Estimates, composed of business leaders and legislative leaders, will meet in November to consider this preliminary revenue forecast. This forecast, which will be finalized in December, will underpin the proposed Executive Budget.