February 15, 2002

MEMORANDUM

TO: The Honorable Mark R. Warner

FROM: John M. Bennett

SUBJECT: January Revenue Data

January revenue collections were disappointing. Total general fund tax collections (excluding Tobacco Master Settlement and Lottery) fell 9.1 percent below last January's collections, leaving year-to-date revenue 1.7 percent below last year.

Based on year-to-date revenue collections, analysis of available economic data, and examination of past revenue collection patterns, staff at the Department of Taxation recommended that the December revenue forecast be reduced by $231.1 million for FY 2002, $208.8 million for FY 2003, and $176.1 million for FY 2004 -- a total of $616.0 million. I supported the recommendation.

With your concurrence, that revised forecast was communicated to the General Assembly on February 11, 2002. The revised forecast will appear for the first time in the February report on revenue collections. This month's revenue report still reflects the December 19, 2001 revised revenue forecast, adjusted for amendments which you proposed on January 22, 2002.

Economic Indicators

Most national economic news indicates that the recession could be reaching a trough, although not all the signs were consistently positive.

- Fourth quarter real GDP grew 0.2 percent – much better than expected – buoyed largely by extraordinary auto sales;

- Employment totals continued to deteriorate, with 89,000 jobs trimmed from the nation's January payrolls;

- The unemployment rate fell by 0.2 percentage point to 5.6 percent, due to a decline in the total labor force;

- The index of leading economic indicators rose 1.2 percent in December, its largest increase since February 1996 and the third consecutive month of improvement in the index;

- Consumer confidence rose in January, but remains 16 percent below its level of a year ago; and

- The Federal Reserve Board did not change interest rates at its January meeting, indicating that "the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future."

January Revenue Collections

January's weak revenue collections can be attributed to sharp reductions in individual estimated payments, continuing declines in corporate income tax collections, and weak sales tax collections.

Individual Income Taxes

Withholding: Withholding collections in January were 5.0 percent above last year. Year-to-date growth of 3.4 percent is slightly behind the official estimate of 3.7 percent. The mid-session forecast reduced the withholding forecast by $29.8 million, revising the expected growth rate for FY 2002 to 3.2 percent.

January's withholding growth was somewhat stronger than expected. Nevertheless, the three-month moving average for withholding growth has declined for the eighth month in a row.

Nonwithholding: Nonwithholding receipts for the month fell by 22.6 percent. Average check size for individuals filing nonwithholding payments fell by about 30 percent. Because January is the last opportunity to adjust estimated payments before the final payment is due in May, weak January collections for this source point to weak final payments later this fiscal year.

Through January, nonwithhholding receipts are down 11.3 percent, well behind the December forecast. The mid-session forecast has reduced projections of nonwithholding collections by $129.4 million, revising the expected growth rate to –14.0 percent.

Refunds: Refunds in January totaled $33.5 million, compared with $18.0 million in January of last year. The Department of Taxation issued over 112,000 refunds, compared to last year's 61,000. The increase is somewhat distorted, since last January's processing was affected by problems with private vendors who use electronic filing.

Sales

January's sales tax collections fell by 8.7 percent. Holiday sales in Virginia were close to expectations. Sales were expected to be flat over the period and actual receipts increased by 0.8 percent. On a year-to-date basis, collections are down 0.4 percent -- slightly behind the annual estimate of 0.1 percent (after adjusting for the sales tax acceleration proposal).

Corporate Income Tax

January is not a significant month for corporate income tax payments. Corporate income tax receipts on a year-to-date basis are down 31.9 percent, significantly trailing the official annual rate of a 1.7 percent decrease. The mid-session forecast reduced projected corporate income tax collections by $63.4 million -- with a revised growth rate of -19.1 percent.

Public Service Corporations

Collections from consumption tax revenues were $6.0 million this month. Consumption tax revenues continue to track toward the original forecast.

Insurance Company Premiums

January is not a significant month for insurance premiums. On a year-to-date basis, collections are running 12.3 percent ahead of last year, which is also ahead of the annual estimate of 7.4 percent growth.

Interest

During January, the normal quarterly transfer of interest earnings into various nongeneral fund accounts took place. The year-to-date decline of 32.7 percent is slightly ahead of the annual official forecast of a 36.2 percent decline. Declining investable balances and lower interest rates led to the mid-session forecast for interest earnings to be reduced by $7.2 million.

ABC Taxes

ABC taxes (beer and beverage only) increased by 11.0 percent in January from last year. The year-to-date growth of 2.3 percent equals the original December forecast.

Lottery Revenues

Lottery net income decreased 0.8 percent from January last year. Sales decreased 1.2 percent, mainly due to lower advertised jackpots for The Big Game. On a year-to-date basis, Lottery net income is up 6.2 percent.

All Other Revenue

Revenue from all other sources fell in January, declining by 15.4 percent over last year. Most of the reduction this month is attributable to a $9 million decrease in other revenue and a $5.7 million decline in volatile inheritance, gift, and estate taxes. Collections of wills, suits, deeds and contract fees continued to surge, growing by 60.9 percent. The mid-session forecast increased by $29.9 million the estimate for wills, suits, and deeds – most of which is recordation tax revenue.

Summary

Revenue collections declined as expected in January. On a year-to-date basis, the 1.7 percent decline in revenues is the largest decline in over 20 years – easily eclipsing the 1.0 percent decline seen in fiscal year 1991.

January's disappointing performance was due to a substantial rate of decline in individual and corporate estimated payments. These payments reflect liabilities from taxable year 2001 and indicate that corporate and individual payments due in April and May will also decline.

The mid-session forecast reduction of $231.1 million for FY 2002 adjusts the original forecast to reflect revenue collections through January, collection patterns from prior years, and the most recent economic data available. Next month's revenue report will use this revised forecast as the basis of comparison.