

GENERAL FUND REVENUE UPDATE 2013 BIENNIUM

A Report Prepared for the
Legislative Finance Committee
Revenue and Transportation Interim Committee

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INTRODUCTION

The purpose of this report is to provide the committees with general fund revenue collection data through November FY 2011 compared to November FY 2012. This and future updates are intended to provide the most recent information on general fund revenue collections as we proceed through the 2013 biennium. These reports, most of the time, will only highlight the significant revenue sources with a brief explanation of what trends may be developing. It should be noted that these reports are designed to be similar in content and structure from issue to issue so new readers will have the benefit of the historical information provided.

During the regular legislative session, the general fund revenue estimates (including interest and income estimates for public schools) were increased by \$72.8 million for fiscal 2011, 2012, and 2013 as compared to the original recommendations of the Revenue and Transportation Committee (RTIC) in November, 2010. The increased revenue was anticipated primarily from individual income taxes with reductions in the corporation license tax because of the estimated impacts of H.R. 4853, the federal legislation to accelerate depreciation and to expense certain items. The revenue estimates used by the legislature for the 2013 biennium have been incorporated into this report.

THE BOTTOM LINE

Total general fund revenue collections through November are exceeding HJ2 revenue estimates used by the 62nd Legislature for FY 2012. As shown in Figure 1, total general fund revenues for FY 2012 are forecast to be \$61.9 million more than anticipated in HJ2 (revenue estimating resolution) and \$76.0 million more in FY 2013. Individual income, corporation license, oil and gas production, and insurance taxes are anticipated to be higher. Vehicle fees/taxes and some smaller sources are expected to be less than anticipated in HJ2. Property taxes appear to be on track with HJ2 estimates at this time.

Figure 1

2013 Biennium General Fund Revenue Estimates					
Anticipated Revenue Adjustments - In Millions					
Tax Source	FY 2012 HJ2 Estimate	% of Total	Adjustment FY 2012	Adjustment FY 2013	Adjustment 2013 Biennium
1 Individual Income Tax	\$809.322	45.3%	\$56.861	\$60.411	\$117.272
2 Property Tax	237.188	13.3%	No Chg.	No Chg.	No Chg.
3 Corporation License Tax	115.086	6.5%	15.079	16.777	31.856
4 Vehicle Fee/Tax	106.716	6.0%	(7.775)	(7.807)	(15.582)
5 Oil & Gas Production Tax	102.996	5.8%	5.329	19.917	25.245
6 Insurance Tax	57.372	3.2%	1.878	1.982	3.860
Remaining	<u>356.942</u>	20.0%	<u>(9.495)</u>	<u>(15.327)</u>	<u>(24.822)</u>
Totals	\$1,785.622		\$61.877	\$75.953	\$137.829

As shown in Figure 1, the potential 2013 biennium revenue adjustment is \$137.8 million. This represents a 3.8% upward adjustment to the revenue estimates contained in HJ2. The 62nd Legislature budgeted for an ending fund balance of \$150.4 million by the end of the 2013 biennium. Figure 2 shows the revised general fund balance sheet that incorporates the preliminary FY 2011 amounts and the anticipated revenue improvements as shown in Figure 1. The revised projected balance of \$426.7 million includes the anticipated supplemental appropriations of \$29.6 million for public schools. The supplemental appropriation amount has been decreased from the post-session forecast because of the potential additional revenue collections from interest and income bonus payments.

Figure 2

Legislative Budget - General Fund Outlook						
Figures in Millions						
	Actual FY 2010	Preliminary FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium
Beginning Fund Balance	\$396.334	\$314.880	\$343.762	\$382.887	\$396.334	\$343.762
Revenue						
HJ2 Revenue Estimate	1,627.145	1,782.559	1,785.623	1,853.138	3,409.703	3,638.761
Anticipated Adjustments			61.877	75.953	-	137.829
Total Funds Available	\$2,023.478	\$2,097.439	\$2,191.262	\$2,311.978	\$3,806.037	\$4,120.353
Disbursements						
General Appropriations - HB2	1,575.921	1,697.805	1,601.307	1,648.383	3,273.726	3,249.690
Statutory Appropriations	169.872	170.849	184.532	195.170	340.721	379.702
Transfers	88.877	46.639	17.122	12.898	135.516	30.020
Other Appropriations	-	-	2.384	1.822	-	4.206
Supplementals	-	-	5.944	23.670	-	29.614
Feed Bill	-	-	2.469	10.009	-	12.478
Reversions	(117.960)	(167.976)	(5.383)	(6.686)	(285.936)	(12.069)
Total Disbursements	\$1,716.710	\$1,747.317	\$1,808.375	\$1,885.266	\$3,464.027	\$3,693.641
Fund Balance Adjustments	8.112	(6.360)	-	-	1.752	-
Ending Fund Balance	\$314.880	\$343.762	\$382.887	\$426.712	\$343.762	\$426.712

The projected balance of \$426.7 million is a total improvement of \$276.3 million as compared to the 62nd Legislature budgeted balance. This projected balance is 11.6% of biennium disbursements.

It should be noted that as revenues exceed expectations, the structural imbalance (difference between on-going revenues and on-going expenditures) has been eliminated thereby creating a more favorable 2015 biennium budget outlook for the 2013 Legislature. As shown in Figure 2, the 2013 biennium revenues (including the revenue adjustments) exceed the 2013 biennium disbursements (before reversions) by \$70.9 million.

GENERAL FUND REVENUE UPDATE

FISCAL 2012 REVENUE COLLECTIONS

Based on information recorded on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts through November for FY 2012 were \$643.7 million as shown in Figure 3. This compares to \$585.8 million collected through November for FY 2011. This is an increase in collections from FY 2011 of \$57.9 million or a 9.9% increase. This is a significant change from the amounts as of the end of October when FY 2012 collections were well below FY 2011 collections. This change in trends was due to some of the accrual adjustments that are normally made in October not being processed until November. Individual income, corporation license, and lodging sales taxes were not adjusted in October but have subsequently been adjusted in November. These adjustments totaled over \$131 million. Instead of a decline of \$77.0 million as shown at the end of October, the more comparable amount now is an increase of \$57.9 million (9.9%) at the end of November. This is a good example of how timing, accounting processes, and other anomalies can significantly change a conclusion if a detailed analysis is not prepared. For example, using the unadjusted collection amount as of the end of October would have produced an annualized amount for FY 2012 of \$1.503 billion. Using the November amount produces an annualized amount for FY 2012 of \$1.959 billion. This is a difference of about \$456 million.

Total general fund collections as estimated by the legislature for FY 2012 were expected to be \$3.1 million (0.17%) above the FY 2011 actual collections. These estimates were used by the 62nd Legislature and are contained in the adjusted HJ2 (revenue estimate resolution plus impacts of enacted legislation) estimates. The reason for such a small increase was because the collections received in FY 2011 were \$75.9 million more than anticipated in HJ2. This

means the HJ2 estimate for FY 2012 is now compared to the actual collections received in FY 2011 versus the FY 2011 estimate used during the legislative session. Most major sources of revenue contained in HJ2 were expected to increase from FY 2011 to FY 2012. The two exceptions were vehicle fees/taxes and oil and gas production taxes. Oil and gas production collections were expected to decline because of reduced production levels while vehicle fees/taxes were expected to decline because the distribution of vehicles was expected to be weighted more heavily towards older vehicles.

Figure 3 shows revenue collection and estimate data by major revenue category. The last three columns in the figure compare collections from each revenue source to the estimate contained in HJ2. For example, corporation license tax (10th line) shows \$15.8 million in the “Difference” column. This means collections through November of this year are \$15.8 million more than the amount received through November of FY 2011 for a 44.2% difference shown in the “% Change” column. The legislature assumed collections would be down by 3.3% shown in the last column. This means collections are exceeding the legislative estimate and will surpass the HJ2 estimate if these trends continue.

Figure 3

Revenue Source	Actual Fiscal 2011	HJ2 Estimate * Fiscal 2012	Through 11/30/10	Through 11/30/11	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	3,710,998	4,173,000	1,776,791.68	1,532,806.46	(243,985.22)	-13.73%	12.45%
GF0200 Insurance Tax	57,963,581	57,372,000	12,256,871.61	12,528,816.34	271,944.73	2.22%	-1.02%
GF0300 Investment Licenses	6,922,143	6,838,000	1,022,039.81	962,856.64	(59,183.17)	-5.79%	-1.22%
GF0400 Vehicle License Fee	85,762,322	91,945,000	31,020,607.57	30,136,584.51	(884,023.06)	-2.85%	7.21%
GF0500 Vehicle Registration Fee	14,814,333	14,771,000	5,395,666.23	5,687,371.15	291,704.92	5.41%	-0.29%
GF0600 Nursing Facilities Fee	5,197,229	4,876,000	1,296,067.75	1,251,487.55	(44,580.20)	-3.44%	-6.18%
GF0700 Beer Tax	2,981,809	3,239,000	1,117,335.80	1,127,500.63	10,164.83	0.91%	8.63%
GF0800 Cigarette Tax	30,991,570	30,763,000	12,623,671.43	12,927,189.67	303,518.24	2.40%	-0.74%
GF0900 Coal Severance Tax	12,882,504	12,257,000	3,540,048.77	3,794,264.26	254,215.49	7.18%	-4.86%
GF1000 Corporation Tax	119,043,890	115,086,000	35,714,018.28	51,498,937.65	15,784,919.37	44.20%	-3.32%
GF1100 Electrical Energy Tax	4,332,363	4,480,000	1,279,294.12	1,277,049.59	(2,244.53)	-0.18%	3.41%
GF1150 Wholesale Energy Trans Tax	3,945,547	3,738,000	1,028,070.47	953,520.42	(74,550.05)	-7.25%	-5.26%
GF1200 Railroad Car Tax	2,130,192	2,095,000	1,646,750.41	1,773,720.63	126,970.22	7.71%	-1.65%
GF1300 Individual Income Tax	816,089,973	809,322,000	399,706,154.29	432,594,601.80	32,888,447.51	8.23%	-0.83%
GF1400 Inheritance Tax	43,165	-	31,617.67	22,452.66	(9,165.01)	-28.99%	-100.00%
GF1500 Metal Mines Tax	8,096,531	10,037,000	991.48	2,413.38	1,421.90	143.41%	23.97%
GF1700 Oil Severance Tax	99,763,712	102,996,000	-	-	-	-	3.24%
GF1800 Public Contractor's Tax	6,803,285	5,716,000	4,324,925.53	(2,057,307.33)	(6,382,232.86)	-147.57%	-15.98%
GF1850 Rental Car Sales Tax	3,149,201	3,326,000	1,299,504.67	1,536,612.41	237,107.74	18.25%	5.61%
GFxxxx Property Tax	229,351,961	237,188,000	9,662,126.54	8,937,688.17	(724,438.37)	-7.50%	3.42%
GF2150 Lodging Facilities Sales Tax	14,240,586	13,952,000	5,849,139.99	6,311,278.68	462,138.69	7.90%	-2.03%
GF2200 Telephone Tax	-	-	-	-	-	-	-
GF2250 Retail Telecom Excise Tax	22,049,967	21,759,000	5,501,227.90	4,644,946.26	(856,281.64)	-15.57%	-1.32%
GF2300 Tobacco Tax	5,477,308	6,016,000	1,949,828.25	2,013,270.36	63,442.11	3.25%	9.83%
GF2400 Video Gaming Tax	49,824,310	52,776,000	12,413,517.98	12,472,728.98	59,211.00	0.48%	5.92%
GF2500 Wine Tax	1,993,659	2,131,000	664,234.17	728,933.19	64,699.02	9.74%	6.89%
GF2600 Institution Reimbursements	20,158,177	17,125,000	-	2,595,061.92	2,595,061.92	-	-15.05%
GF2650 Highway Patrol Fines	4,359,203	4,725,000	1,155,037.07	1,442,964.47	287,927.40	24.93%	8.39%
GF2700 TCA Interest Earnings	2,518,853	6,717,000	987,743.69	804,580.81	(183,162.88)	-18.54%	166.67%
GF2900 Liquor Excise Tax	15,989,480	16,822,000	5,565,710.42	5,759,269.20	193,558.78	3.48%	5.21%
GF3000 Liquor Profits	9,000,000	9,733,000	-	-	-	-	8.14%
GF3100 Coal Trust Interest Earnings	26,783,197	27,084,000	6,547,711.29	6,757,520.57	209,809.28	3.20%	1.12%
GF3300 Lottery Profits	10,611,184	10,950,000	-	-	-	-	3.19%
GF3450 Tobacco Settlement	3,258,739	3,564,000	-	-	-	-	9.37%
GF3500 U.S. Mineral Leasing	31,923,308	29,400,000	7,520,059.35	6,800,985.98	(719,073.37)	-9.56%	-7.90%
GF3600 All Other Revenue	50,393,275	42,650,000	12,919,111.86	26,858,498.31	13,939,386.45	107.90%	-15.37%
Grand Total	1,782,557,555	1,785,622,000	585,815,876.08	643,678,605.32	57,862,729.24	9.88%	0.17%

* Plus impacts of enacted legislation

DISCUSSION OF SELECTED SOURCES FOR FISCAL 2012 AND FISCAL 2013

The following section of the report addresses the six largest general fund revenue sources that are shown in Figure 1. These sources are individual income tax, property tax, corporation license tax, vehicle fee/tax, oil and gas production tax, and insurance tax. These sources are estimated to contribute 80.0% of total general fund revenue in FY 2012. This section of the report also includes a brief discussion on sources that are showing very unusual collection patterns. These sources are highlighted in the “Remaining Sources” category of the report. As discussed previously, individual

income, corporation license, and lodging sales taxes were incorrect as of the end of October because of untimely accrual adjustments. This issue has been resolved and the revenues are now more comparable.

Individual Income Tax

Based on November accounting data, net individual income tax collections for FY 2012 (gross collections less refunds) were 8.2% above net collections for FY 2011 or an increase of \$32.9 million. The 62nd Legislature assumed that revenues would increase by 5.9% from the estimated FY 2011 amount or an increase of \$44.7 million. This increase was anticipated because the impacts of the economic recession were anticipated to be over and Montana was expected to begin a slow, modest recovery. It should be noted that actual FY 2011 collections were higher than estimated in HJ2 which means collections would have to decline from the FY 2011 amount to achieve the HJ2 estimate for FY 2012.

Figure 4 shows the accounting details through November of individual income tax collections for FY 2012 compared to the same period for FY 2011. As shown in Figure 4, individual income tax collections were \$32.9 million above the same period for FY 2011.

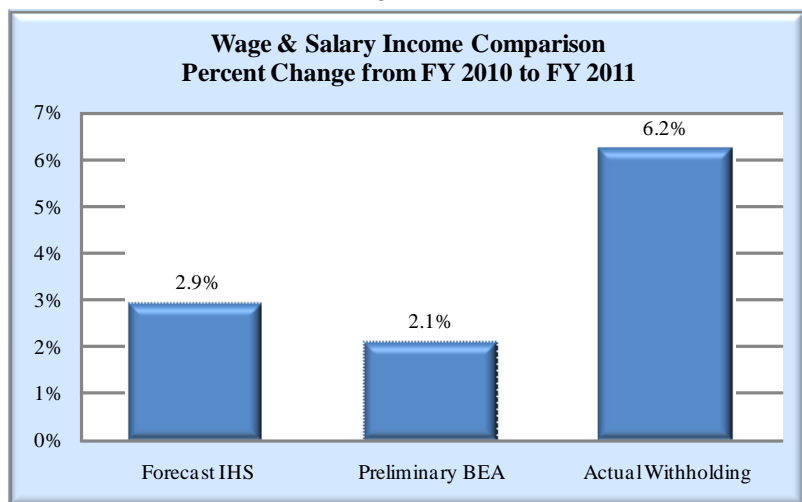
Since withholding tax collections are generally accepted as a proxy for total wage growth, the 2.9% growth from last year would indicate total wages have increased from the level observed a year ago. Withholding taxes are approximately 65% of total individual income taxes before refunds or almost 40% of total general fund revenue collections.

Figure 4

Individual Income Tax Comparison				
Revenue Code & Description	11/30/2010 Fiscal 2011	11/30/2011 Fiscal 2012	Difference	Percent Change
510101 Withholding Tax	253,682,951.26	260,979,851.72	7,296,900.46	2.88%
510482 Mineral Royalty WH Tax	3,538,368.25	4,998,254.14	1,459,885.89	41.26%
510111 Fiduciary Estimated Income Tax	1,526,648.10	1,460,598.67	(66,049.43)	-4.33%
510102 Estimated Tax	60,663,907.98	68,997,528.87	8,333,620.89	13.74%
510103 Current Year I/T	6,398,905.60	13,329,339.62	6,930,434.02	108.31%
510105 Income Tax - Audit Collections	8,893,660.00	8,299,241.00	(594,419.00)	-6.68%
510106 Income Tax Refunds	65,001,713.10	74,529,787.78	9,528,074.68	14.66%
Income Tax Refunds Adjustment	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	0.00%
Totals	\$399,706,154.29	\$432,594,601.80	\$32,888,447.51	8.23%
Percent of Actual/Estimated	48.98%	53.45%		

Since the increase in withholding taxes should be a good indicator that wage and salary incomes are improving and that Montana's economic conditions are recovering from the "Great Recession", the withholding tax growth rate was compared to the wage and salary income growth rate as forecast by Global Insight (IHS) and the preliminary Bureau of Economic Analysis (BEA) data. IHS is a national economic forecasting company that Montana has a contract with for state and national economic forecasts.

Figure 4a



As shown in Figure 4a, this comparison (on a fiscal year basis) shows that the forecast rate as prepared by IHS was 2.9% for wage growth versus the preliminary 2.1% for BEA versus the

6.2% withholding growth observed in FY 2011. Using the individual income tax simulation model, an assumed wage and salary income growth rate of 6.2% instead of 2.9% would have increased the HJ2 estimate by approximately \$17 million and \$34 million for FY 2012, and FY 2013, respectively. Since the wage and salary income forecast by IHS was an input to the individual income tax simulation model, the variation between the IHS forecast, BEA data, and the withholding collections rate required further analysis.

The BEA, IHS, and DOR were contacted in an effort to understand and to develop a forecast methodology change provided a change was necessary. A more accurate individual income tax forecast is critical to the budgeting process since individual income taxes account for about 45% of total general fund revenues. For a summary of the results of the research, see the “Individual Income Tax Research Results”.

Individual Income Tax Research Results

The BEA has indicated that the information they use to construct their wage and salary income estimates are based on Bureau of Labor Statistics employment and hourly earnings by sector. They also suggested that the weighting methods used may not totally account for the impact of the natural resource sector in Montana.

- ✓ IHS has indicated that the wage and salary income data they use for historical periods and modeling formulation are based on BEA data specifically for Montana.
- ✓ The DOR maintains an annual tabulation of withholding tax returns filed with the department. This data is only the returns filed – it does not necessarily represent payments made to the department. This means the accounting data (SABHRS) would be the more accurate source of payment information but SABHRS does not include the name of the employer nor the wage base the payment was based on.
- ✓ The withholding tax return information received from the DOR was analyzed to determine if there were any unusual changes from calendar 2009 to calendar 2010. Calendar 2011 data are not available. Because the information shown in this dataset was not totally complete, it was difficult to draw any conclusions from this information. A significant issue discovered however, was that some withholding payments received by the state include withholding on retirement benefits for federal, state, and local government retirees. This means that the BEA and IHS data are “true” wage and salary income estimates whereas the withholding tax collections include withholding on other forms of non-wage income besides wages and salaries.
- ✓ The DOR was also contacted about Montana residents that work in North Dakota but live in Montana. Montana has a reciprocal agreement with North Dakota that allows Montana to collect individual income taxes on a resident that works in North Dakota. Conversely, a North Dakota resident working in Montana would pay individual income taxes in North Dakota. In both instances, the employee must notify their employer of their tax intentions.
- ✓ Tax return data for tax year 2010 was received from the DOR on November 15th. Analysis of this data showed that wage and salary income increased by 1.9% from calendar 2009 to calendar 2010. BEA data showed an increase of 2.0% and the IHS forecast used during the session was 2.3%. It should be noted that these percentages reflect calendar comparisons whereas the percentages shown in Figure 4a are on a fiscal year basis.
- ✓ Staff’s analysis of tax return data for tax year 2010 also showed that rents, royalties, partnership income and IRA distributed income were the categories of reported income that were higher than forecast. For deductions, home mortgage interest and federal taxes paid were less than anticipated. Combined, these items accounted for most of the estimate understatement.

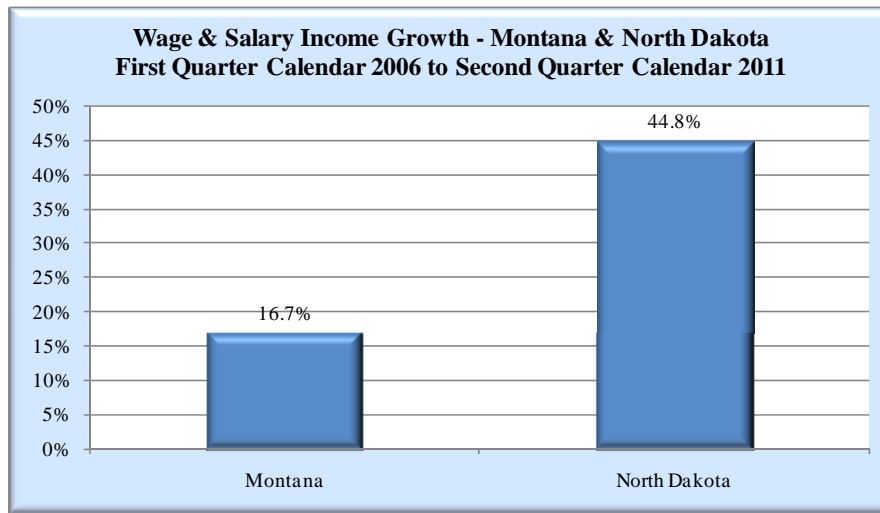
BEA , IHS, and Tax Returns

The BEA and IHS wage and salary data are quite consistent and represent a good proxy for wage and salary income as reported on individual income tax returns. However, withholding tax collections, as reported on SABHRS, are measuring more than wage and salary income growth -ie.) non-wage and salary incomes are included . To what extent other forms of non-wage incomes are skewing withholding collections is still unclear and will require further research.

North Dakota Reciprocal Agreement

The reciprocal agreement with North Dakota also has wage and salary income estimates versus withholding tax collection ramifications. This issue could be causing withholding tax collections in Montana to be greater than normal.

Figure 4b



This is because the individual would be paying taxes based on an agreement and not on a “place of work” basis. Other words, an individual earning wages in North Dakota would normally pay individual income taxes in that state and the wage and salary income would be reported in that state as part of the BEA calculation. With this agreement in place, Montana could be benefitting from the collection of the individual income taxes but yet the BEA reported wages earned are reported in the state where the work is performed. This causes a “disconnect” between the two statistics. It is unknown to what extent this practice

is occurring. Figure 4b shows the BEA data for wage and salary income as reported in Montana versus North Dakota. It is obvious that a significant part of this growth is due to the impact of the Bakken oil formation development in North Dakota. Regardless, some of this difference could be due to the reciprocal agreement and the impact it has on wage and salary income estimates as reported by the BEA.

Individual Income Tax Summary

To determine an individual income tax adjustment for FY 2012 and FY 2013, two techniques were used to derive the adjusted amounts. The first method utilized was the individual income tax simulation model but updated with a new base year (tax year 2010). The sub-models for growth factors were also updated by using the additional data point, tax year 2010. Because of time constraints, however, an evaluation of each sub-model was not done at this time. Therefore, the same sub-models for growth rates were used but with revised coefficients for the various input variables. The second method used an extrapolation of year to date trends for the various revenue types as reported on the SABHRS. In other words, a forecast was prepared for withholding taxes, estimated payments, refunds, etc and aggregated to determine a new forecast for FY 2012. A comparison between these two methods showed a relatively small difference, but a difference that will be analyzed further in subsequent months.

Based on this analysis, collections from this source could be above the HJ2 estimate by \$56.9 million in FY 2012 and \$60.4 million in FY 2013.

Further research on the North Dakota reciprocal agreement, sub-model reevaluations, and methodology comparisons will be done in subsequent months.

Property Tax

As shown in Figure 3, property tax collections are \$0.7 million or 7.5% below last year through the end of November. For most sources this would be of concern but in the case of property taxes most of these collections are received in December and June. There could numerous explanations for this difference but the more appropriate time to assess the collections will be later this month

Tax year 2011 (FY 2012) taxable value data will be available in December from the DOR.

when the official taxable value numbers from the DOR for tax year 2011 (FY 2012) are available. Since property tax revenue collections for FY 2011 were extremely close to the HJ2 estimate, there is no reason to believe FY 2012 collections will be significantly different from the HJ2 estimate for FY 2012.

Corporation License Tax

Based on November accounting data, net corporation license tax collections for FY 2012 (gross collections less refunds) were 44.2% above net collections for FY 2011 or an increase of \$15.8 million (Figure 3). The 62nd Legislature assumed that revenues would increase by 18.1% from the FY 2011 amount or an increase of \$17.7 million. This increase was anticipated because the impacts of the economic recession were anticipated to be over and corporate profitability for both state and national corporations were expected to begin a recovery. It should be noted that FY 2011 collections were higher than estimated in HJ2 which means collections would actually have to decline from the FY 2011 amount to achieve the HJ2 estimate for FY 2012.

As pointed out in previous reports, part of the strength in FY 2011 collections was explained by the auditing efforts of the DOR and the resulting unusual high audit collections. Total audit collections were \$26.1 million in FY 2011 compared to \$15.4 million in FY 2010. When audit collections are removed from FY 2010 and FY 2011 totals, then the growth for the remaining collections are 11.9%. The growth rate assumed in HJ2 for FY 2012 was 18.2%. At this time, audit collections in FY 2012 are below last year by \$1.1 million, or 23.8%.

Estimated payments that were due September 15th are \$0.2 million (negative 0.4%) below last year. Since most corporations make quarterly estimated payments, directional change in this category can be used as an indicator of the profitability of corporations.

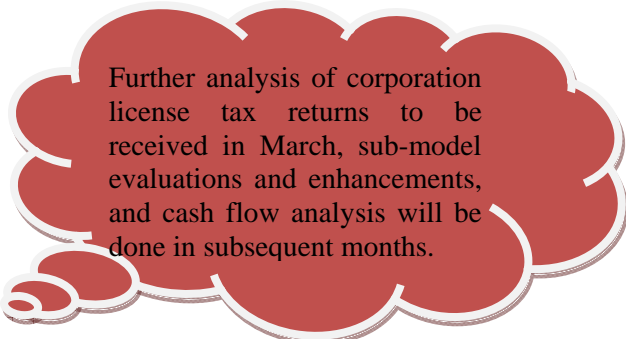
Figure 5

Corporation License Tax Comparison				
Revenue Code & Description	11/30/2010 Fiscal 2011	11/30/2011 Fiscal 2012	Difference	Percent Change
510501 Corporation Tax	220,368.48	7,526,060.79	7,305,692.31	97.07%
510505 Corporation Tax Estimated Paym	36,259,692.58	36,105,804.98	(153,887.60)	-0.43%
510502 Corporation Tax Refunds	(6,360,134.78)	3,347,719.88	9,707,854.66	289.98%
510503 Corporation Tax-Audit Collect.	5,594,092.00	4,519,352.00	(1,074,740.00)	-23.78%
Corporation Tax Refunds Adjustment	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	
Totals	\$35,714,018.28	\$51,498,937.65	\$15,784,919.37	44.20%
Percent of Actual/Estimated	30.00%	44.75%		

Figure 5a shows year over year change in estimated payments from FY 2008 to FY 2012. As shown, estimated payments for FY 2011 and FY 2012 have improved when compared to FY 2010. The next payment, due on December 15th, will provide further insight on whether corporations expect their profits to improve in FY 2012 as compared to FY 2011.

Corporation License Tax Summary

At this time, it is difficult to assess how well corporations are doing. While estimated payment collections are almost flat compared to last year, refunds are down significantly and current year payments are up significantly. Since both of these categories do not have much collection activity early in the year, it is difficult to speculate on what these changes may mean.



Further analysis of corporation license tax returns to be received in March, sub-model evaluations and enhancements, and cash flow analysis will be done in subsequent months.

However, when all of the accounting categories are added together, total corporation license tax collections through November are \$15.8 million or 44.2 % above FY 2011. Since 2010 tax return data for corporate taxpayers will not be available until March of FY 2012, corporation license tax adjustments were based on year to date collections. Using these current trends, revenue from this source could be above the HJ2 estimate by \$15.1 million in FY 2012 and \$16.8 million in FY 2013.

Vehicle Fee/Tax

As shown in Figure 6, total vehicle fees/taxes as recorded on SABHRS were \$0.6 million below last year's amount as of the end of November. Because of the economic recession and the reluctance of individuals to purchase newer vehicles, the distribution of vehicles by age group may have changed and is weighted more heavily to older age vehicles. The vehicle age distribution is relevant because light vehicle taxes are based on the age of the vehicle and not on the value (\$195 for 0 to 4 years old, \$65 for 5 to 10 years old, and \$6 over 10 years old). Therefore, the longer an individual keeps a vehicle, the taxes due will be reduced over time. The Department of Justice (DOJ) was contacted to seek information that would confirm this hypothesis. The department indicated they too were seeing a slowdown in collections and that the vehicle counts for permanent registrations and older vehicles were both up slightly. This information was based on data extracted from the motor vehicle division's computer system (MERLIN). The department also verified that there were no processing delays and that all but two counties were current with payments by the end of October. The two counties that were late were Broadwater and Powell which accounted for about \$0.1 million in collections. Based on this trend, revenue from this source could be below the HJ2 estimate by \$7.8 million in FY 2012 and \$7.8 million in FY 2013.

Figure 5a

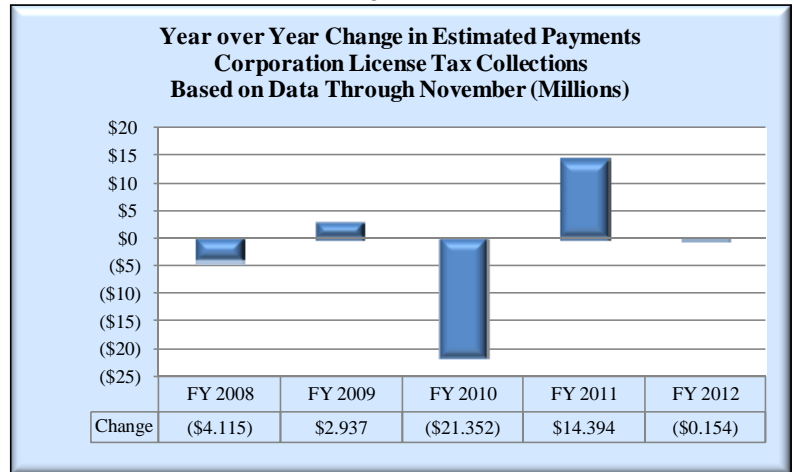


Figure 6

Vehicle Fee/Tax Collections and Estimates						
Revenue Category	Actual FY 2011	HJ 2 Estimate FY 2012	Through Nov. FY 2011	Through Nov. FY 2012	Dollar Change	Percent Change
Vehicle License Fee	85,762,322	91,945,000	31,020,608	30,136,585	(884,023)	-2.85%
Vehicle Registration Fee	<u>14,814,333</u>	<u>14,771,000</u>	<u>5,395,666</u>	<u>5,687,371</u>	<u>291,705</u>	5.41%
Total Vehicle Fees/Taxes	\$100,576,655	\$106,716,000	\$36,416,274	\$35,823,956	(\$592,318)	-1.63%

Oil and Gas Production Tax

Oil and natural gas production taxes are one of the major sources of revenue that is extremely difficult to forecast. As shown in Figure 3, oil and gas production tax collections through November of FY 2011 and FY 2012 show a zero amount. This is because of the accrual reversal process that takes place during October and is a normal process that occurs every year. Information from the DOR, which is extracted from oil and gas production tax returns submitted by the producers shows that oil and gas production taxes increased by 8.4% from FY 2010 to FY 2011. Returns for the first quarter of FY 2012 are not due until the end of November and are not totally processed until December.

As shown in Figure 7a, oil production in Montana has flattened for the last two quarters of calendar 2011 at about 5.9 million barrels per quarter. If this trend continues, the HJ2 assumption for FY 2012 oil production may be understated. The estimates contained in HJ 2 were for production to be 22.3 million barrels at an average price of \$82.24 per barrel. As shown in Figure 7b, natural gas production in Montana continues to show a decline. If this trend continues, the HJ2 assumption for FY 2012 natural gas production may be overstated. The estimates contained in HJ2 were for production to be 102.0 million MCF's at an average price of \$3.19 per MCF.

Using these trends for both oil and natural gas production amounts for the first two quarters of calendar 2011 and West Texas oil prices and the Henry Hub natural gas prices as forecast by IHS, general fund oil and gas production tax revenue would exceed the HJ 2 estimate by approximately \$5.3 million and \$19.9 million for FY 2012 and FY 2013, respectively.

Figure 7a

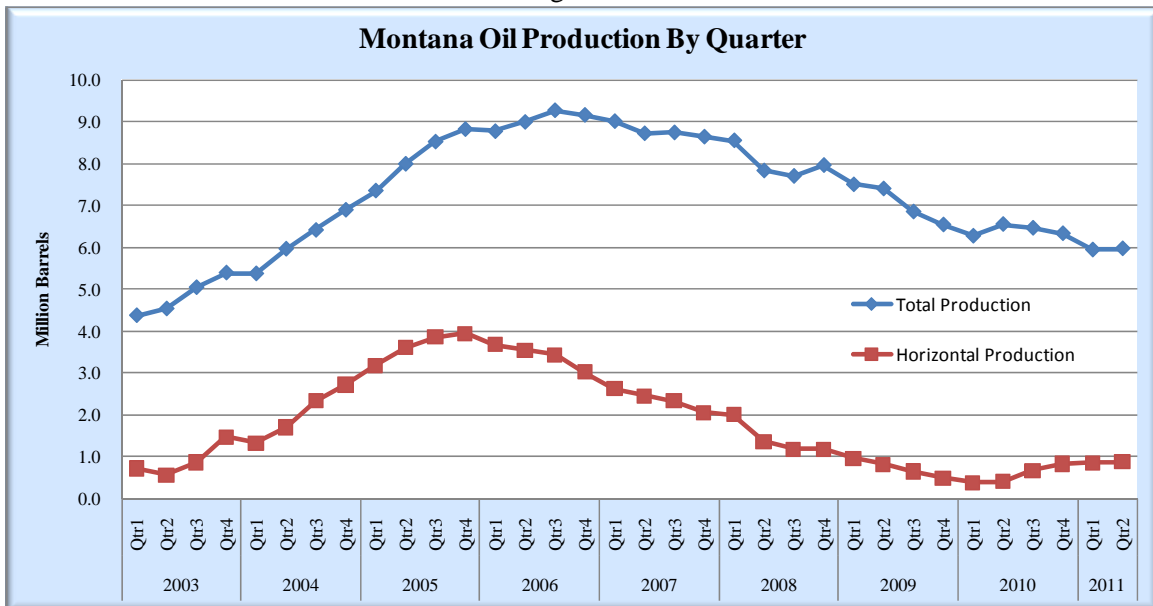
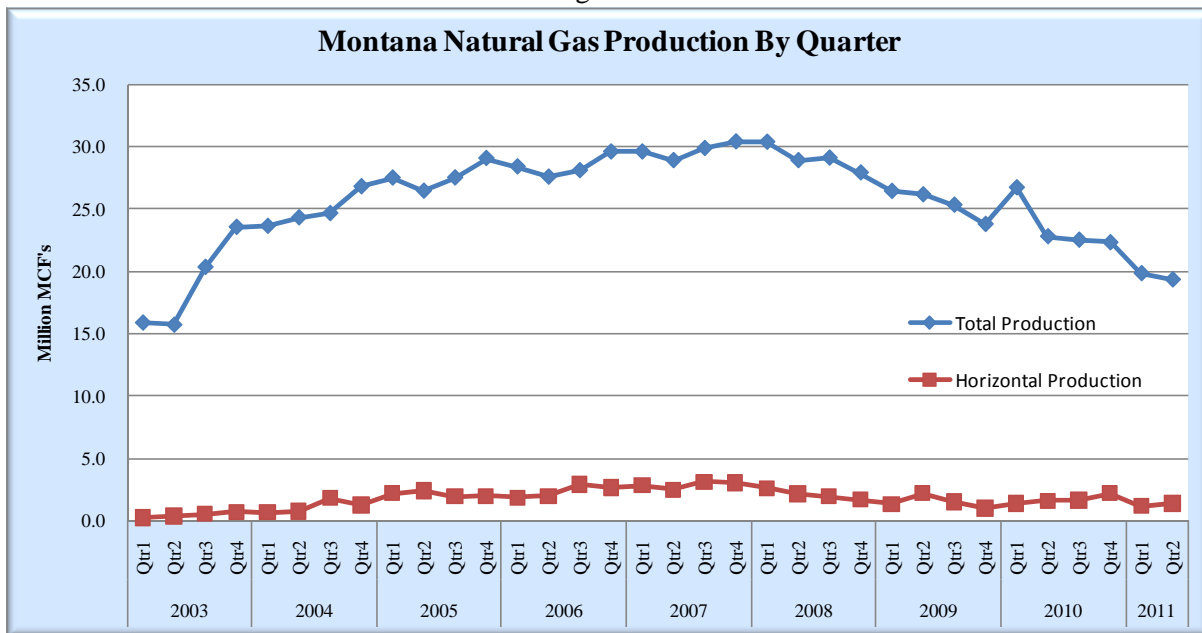


Figure 7b



Insurance Tax

As shown in Figure 8, insurance tax collections are up 2.2% from last year as of the end of November. Figure 8 also shows that the HJ2 estimate for FY 2012 is slightly below actual collections for FY 2011. This is not an indication that collections from this source were expected to decline but is because collections for FY 2011 were higher than estimated in HJ2 for FY 2011. Since no additional information is currently available on gross premiums written (request to the state auditor is currently pending), adjustments were calculated using FY 2011 as a base and extrapolated forward using year to date collection percentages. Based on this trend, revenue from this source could be above the HJ2 estimate by \$1.9 million in FY 2012 and \$2.0 million in FY 2013.

Figure 8

Insurance Tax Collections and Estimates						
Revenue Category	Actual FY 2011	HJ 2 Estimate FY 2012	Through Nov. FY 2011	Through Nov. FY 2012	Dollar Change	Percent Change
Insurance Premiums Tax	\$57,963,581	\$57,372,000	\$12,256,872	\$12,528,816	\$271,945	2.22%

Remaining Sources

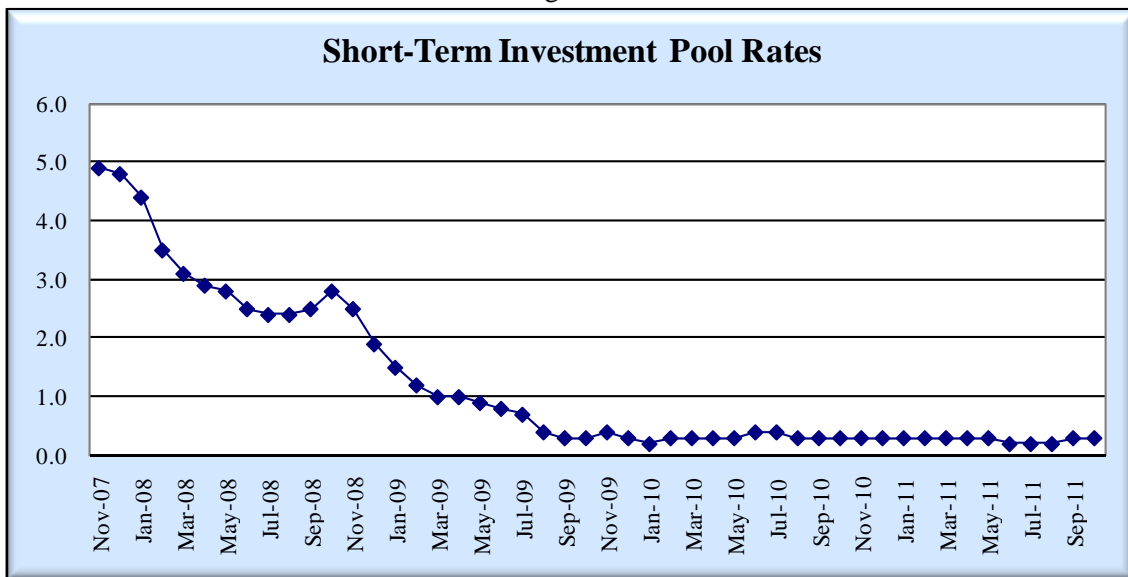
As shown in Figure 3, several sources of revenue are showing unusual collection patterns other than those sources previously discussed. Some of the larger sources are treasury cash account interest earnings and the public contractors gross receipts tax. These two sources are discussed below.

Treasury Cash Account (TCA) Interest Earnings

Based on November accounting data, TCA interest earnings for FY 2012 were 18.5% below collections for FY 2011 or a decrease of \$0.2 million. This is not a large dollar decrease but the 62nd Legislature assumed that revenues would increase by 166.7% from the FY 2011 amount or an increase of \$4.2 million. This increase was anticipated because of the higher rate of return anticipated on short-term securities.

TCA interest earnings are based on cash available for investment and the rate of return for short-term securities. Reduced earnings this year are the result of lower short-term rates and not on the investable balances. Figure 9 shows the average monthly rate of return received on the short-term investment pool (STIP) as published by the Board of Investments since November 2007. Short-term rates have plummeted from 4.9% in November 2007 to 0.3% in September 2009 and have remained close to this level since that time. Using the October short term rates as forecast by IHS, TCA interest earnings are anticipated to be below HJ2 estimates by \$4.5 million in FY 2012 and \$15.3 million for FY 2013.

Figure 9



Public Contractors Gross Receipts Tax

As shown in Figure 3, public contractor's gross receipts tax is showing a negative collection amount for FY 2012 of \$2.1 million. Discussions with the DOR indicate that refunds are currently being issued to Montana contractors for projects that were funded with federal stimulus monies. This refund activity is expected to occur in FY 2012 only with

collections returning to a more normal trend by FY 2013. The HJ2 estimate for FY 2012 is anticipated to be overstated by \$5.0 million in FY 2012 with no change for FY 2013.

In conclusion, unusual collection patterns can skew total general fund revenues when comparisons are made from month to month. These anomalies have been considered when determining the anticipated revenue adjustments shown in Figure 1. Our office will continue to monitor these issues further as well as any new issues before the next report is issued.

INTEREST AND INCOME ADJUSTMENTS

Public schools are funded with a combination of general fund, state special (guarantee account), and federal monies. When additional revenues, above the budgeted amounts, are deposited in the guarantee account, the amount of general fund spending is reduced accordingly. One of the key components of guarantee account revenue is collections from oil and gas bonus payments. The first lease sale in FY 2012 produced \$7.6 million in oil and gas bonus payments. The HJ2 estimate for each year of the 2013 biennium was \$2.1 million. This means that bonus payments after the first sale in FY 2012 are already \$3.4 million more than anticipated for the entire biennium.

The Department of Natural Resources was contacted to determine if they have any method to determine future bonus payments. Since state lands to be leased are nominated by prospective producers or speculators for a lease auction, the department does not have any way of determining the potential revenue from bonus payments. The department did indicate the next lease sale in December will also have a significant number of potential leases.

To determine a revenue adjustment for bonus payments, the past seven years of payments were averaged with the high and low years thrown out. This produced an annual estimate of \$8.5 million. If the December sale is similar to the first sale and the remaining sales are close to the average, FY 2012 bonus payments will be \$19.5 million and FY 2013 payments will be \$8.5 million. The revenue adjustment for this source of revenue is \$17.4 million in FY 2012 and \$6.4 million in FY 2013. This potential additional revenue will reduce the general fund spending for public schools and will correspondingly decrease general fund supplemental appropriations by a like amount. The reduced supplemental appropriation has been incorporated into the revised general fund balance sheet shown in Figure 2.

FINANCIAL CONSIDERATION SB 426

Senate Bill 426, by Senator Balyeat, was enacted by the 62nd Legislature. This legislation created the “Treasure State Taxpayer Dividend Program” with the provision the act be submitted to the qualified electors on the November 2012 ballot. This legislation is designed to refund surplus state government general fund balance through an income tax credit mechanism. If approved by the electors, the legislation would be applicable to fiscal years 2013 and beyond.

The Department of Administration is required to certify to the budget director, by August 1 of each year, the amount of the unaudited general fund balance for the previous fiscal year. If this balance exceeds the budgeted balance by 125%, then tax credits for individual income and property taxes paid are allowed to be claimed on subsequent tax return filings. It should be noted, however, that the excess balance must be at least \$5.0 million otherwise no tax credits are allowed. The legislation also specifies that one-half of the excess balance must be distributed “in the form of individual income tax credits related to property taxes paid on the taxpayer’s principal residence and related to the taxpayer’s individual income tax paid.” The remaining one-half of the excess balance remains in the general fund ending fund balance.

The legislation defines the procedures to be used by the Department of Revenue to determine how much of the excess fund balance is to be used for residential property tax and individual income tax relief. This calculation is based on the ratio of the total amount to be refunded divided by the sum of total residential property and total individual income taxes. For example, if residential property tax collections were \$600 million and individual income tax collections were \$800 million and the excess amount was \$276.3 million, then residential property and individual income taxpayers would be allowed to claim an income tax credit in the subsequent year equivalent to 9.9% (\$276.3 million times 50% divided by (\$600 million plus \$800 million) of their residential property and individual income taxes paid

in the previous year. This tax credit is a refundable tax credit that applies to only the subsequent tax return filed. Any potential future tax credits are determined annually based on whether there is an excess fund balance above the projected amount.

This is an important financial consideration for the 63rd Legislature. If the 2013 biennium general fund budget adopted by the 62nd Legislature develops as outlined in this report, then 50% of the additional estimated fund balance revenue (50% of \$276.3 million = \$138.2 million) discussed in this report could be used for residential property and individual income tax relief (assuming the referendum is approved by the voters in November 2012). Because taxpayers would claim the tax credit when filing their tax year 2013 return, the impact of tax relief would not be realized until FY 2014. The option does exist for the 63rd Legislature to reduce the general fund ending fund balance before the close of FY 2013 through additional spending and/or transfers. This action would have the effect of reducing the amount of tax relief provided under the provisions of SB426.

Attached to this report is a legal opinion prepared by Jaret Coles, Legislative Services, regarding a question specific to the information used in determining the surplus ending general fund balance. Based on Mr. Coles legal analysis, the fiscal year amounts utilized by the legislature in developing the biennial budget are to be used for the general fund surplus calculation and that the “Legislative Fiscal Analyst must constrain the analysis to figures that were existence when the Legislature developed the budget”. This means the revised general fund balance for the 2013 biennium as will be calculated during the 2013 legislative session cannot be used for the calculations delineated in SB 426.

SUMMARY

Total general fund revenue collections through November are exceeding HJ2 revenue estimates used by the 62nd Legislature for FY 2012. As shown in Figure 1, total general fund revenues for FY 2012 are forecast to be \$61.9 million more than anticipated by the 62nd Legislature and \$76.0 million more in FY 2013. Individual income, corporation license, oil and gas production, and insurance taxes are anticipated to be higher. Vehicle fees/taxes and some smaller sources are expected to be less than anticipated in HJ2. Property taxes appear to be on track with HJ2 estimates at this time.

Figure 10

2013 Biennium General Fund Revenue Estimates Anticipated Revenue Adjustments - In Millions					
Tax Source	FY 2012 HJ2 Estimate	% of Total	Adjustment FY 2012	Adjustment FY 2013	Adjustment 2013 Biennium
1 Individual Income Tax	\$809.322	45.3%	\$56.861	\$60.411	\$117.272
2 Property Tax	237.188	13.3%	No Chg.	No Chg.	No Chg.
3 Corporation License Tax	115.086	6.5%	15.079	16.777	31.856
4 Vehicle Fee/Tax	106.716	6.0%	(7.775)	(7.807)	(15.582)
5 Oil & Gas Production Tax	102.996	5.8%	5.329	19.917	25.245
6 Insurance Tax	57.372	3.2%	1.878	1.982	3.860
Remaining	<u>356.942</u>	20.0%	<u>(9.495)</u>	<u>(15.327)</u>	<u>(24.822)</u>
Totals	\$1,785.622		\$61.877	\$75.953	\$137.829

As shown in Figure 10, the potential 2013 biennium revenue adjustment is \$137.8 million. This represents a 3.8% upward adjustment to the revenue estimates contained in HJ2. The 62nd Legislature budgeted for an ending fund balance of \$150.4 million by the end of the 2013 biennium. Figure 11 shows the revised general fund balance sheet that incorporates the preliminary FY 2011 amounts and the anticipated revenue improvements as shown in Figure 10. The revised projected balance of \$426.7 million includes the anticipated supplemental appropriations of \$29.6 million for public schools. The supplemental appropriation amount has been decreased from the post-session estimate because of the potential additional revenue collections from interest and income bonus payments.

Figure 11

Legislative Budget - General Fund Outlook						
Figures in Millions						
	Actual FY 2010	Preliminary FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium
Beginning Fund Balance	\$396.334	\$314.880	\$343.762	\$382.887	\$396.334	\$343.762
Revenue						
HJ2 Revenue Estimate	1,627.145	1,782.559	1,785.623	1,853.138	3,409.703	3,638.761
Anticipated Adjustments			61.877	75.953	-	137.829
Total Funds Available	\$2,023.478	\$2,097.439	\$2,191.262	\$2,311.978	\$3,806.037	\$4,120.353
Disbursements						
General Appropriations - HB2	1,575.921	1,697.805	1,601.307	1,648.383	3,273.726	3,249.690
Statutory Appropriations	169.872	170.849	184.532	195.170	340.721	379.702
Transfers	88.877	46.639	17.122	12.898	135.516	30.020
Other Appropriations	-	-	2.384	1.822	-	4.206
Supplementals	-	-	5.944	23.670	-	29.614
Feed Bill	-	-	2.469	10.009	-	12.478
Reversions	(117.960)	(167.976)	(5.383)	(6.686)	(285.936)	(12.069)
Total Disbursements	\$1,716.710	\$1,747.317	\$1,808.375	\$1,885.266	\$3,464.027	\$3,693.641
Fund Balance Adjustments	8.112	(6.360)	-	-	1.752	-
Ending Fund Balance	\$314.880	\$343.762	\$382.887	\$426.712	\$343.762	\$426.712

The projected balance of \$426.7 million is a total improvement of \$276.3 million as compared to the 62nd Legislature budgeted balance. This projected balance is 11.6% of biennium disbursements.

It should be noted that as revenues exceed expectations, the structural imbalance (difference between on-going revenues and on-going expenditures) has been eliminated thereby creating a more favorable 2015 biennium budget outlook for the 2013 Legislature. As shown in Figure 2, the 2013 biennium revenues (including the revenue adjustments) exceed the 2013 biennium disbursements by \$70.9 million.

Attachment 1 shows a variety of important economic and revenue indicators for Montana. For example, pertinent price and production statistics for Montana's natural resource industry (oil, coal, and natural gas) are shown for the last completed two years. For each statistic shown, the data source, measurement unit, whether the information is by calendar or fiscal year, an amount for 2010 and 2011, change amount, and percentage change is provided. The purpose of this information is to provide the reader with some relevant data on Montana's economic climate.

Attachment 1 – Economic and Revenue Indicators

Group	Statistic	Source*	Unit	Year Type	2010	2011	Change Amount	Percent Change
General Economy Indicators								
	MT Wage and Salary Income (Q ₋₁₋₂ to Q ₋₁₋₂)	BEA	Dollars	Calendar	\$15,656,000	\$16,031,000	\$375,000	2.40%
	MT Non-Farm Employment (Q ₃ ₂₀₁₀ to Q ₃ ₂₀₁₁)	DOL	Count	Calendar	428,500	434,767	6,267	1.46%
	US Consumer Price Index (Q ₃ ₂₀₁₀ to Q ₃ ₂₀₁₁)	DOL	Index	Calendar	218.0	226.2	8.2	3.76%
	MT Housing Starts (SAAR) (Q ₋₁₋₃ to Q ₋₁₋₃)	IHS	Count	Calendar	1,330	1,280	(50)	-3.76%
	MT Existing Home Sales (Q ₂ ₂₀₁₀ to Q ₂ ₂₀₁₁)	IHS	Count	Calendar	23,200	20,000	(3,200)	-13.79%
	MT Agricultural Cash Receipts (2009 to 2010)	BEA	Dollars	Calendar	\$2,831,196,000	\$3,162,545,000	\$331,349,000	11.70%
	MT Statewide Taxable Values (2010 to 2011)	DOR	Dollars	Fiscal	\$2,234,603,497	\$2,325,021,202	\$90,417,706	4.05%
	MT Short-Term Investment Pool (STIP) Rate	BOI	Percent	Fiscal	0.34%	0.31%	-0.03%	-8.82%
Natural Resources								
	Montana Oil Production (Taxable)	DOR	Barrels	Fiscal	26,211,799	24,707,503	(\$1,504,296)	-5.74%
	Montana Oil Wellhead Price	DOR	\$/Barrel	Fiscal	\$65.27	\$80.61	\$15.34	23.50%
	Montana Coal Production (Taxable)	DOR	Tons	Fiscal	34,714,320	36,318,866	1,604,547	4.62%
	Montana Coal Price (Contract Price)	DOR	\$/Ton	Fiscal	\$9.78	\$10.92	\$1.14	11.66%
	Montana Coal Price (Free on Board)	DOR	\$/Ton	Fiscal	\$13.66	\$15.03	\$1.37	10.03%
	Montana Natural Gas Production (Taxable)	DOR	MCF's	Fiscal	98,561,962	84,007,213	(14,554,749)	-14.77%
	Montana Natural Gas Wellhead Price	DOR	\$/MCF	Fiscal	\$3.24	\$3.38	\$0.14	4.32%
Consumption								
	Cigarettes Sold (Taxable)	DOR	Packs	Fiscal	46,158,900	44,946,750	(1,212,150)	-2.63%
	Other Tobacco Products (Value)	DOR	Dollars	Fiscal	6,964,334	6,631,728	(\$332,607)	-4.78%
	Other Tobacco Products (Roll)	DOR	Ounces	Fiscal	849,398	535,514	(313,884)	-36.95%
	Other Tobacco Products (Moist)	DOR	Ounces	Fiscal	9,452,007	9,923,938	471,931	4.99%
	Lottery Ticket Sales	SABHRS	Dollars	Fiscal	\$45,192,762	\$46,035,297	\$842,535	1.86%
	Video Gaming Net Income	Computed	Dollars	Fiscal	\$349,306,657	\$332,162,069	(\$17,144,588)	-4.91%
	Liquor Sales	DOR	Dollars	Fiscal	\$90,117,585	\$92,955,786	\$2,838,201	3.15%
	Beer Produced/Imported	DOR	Barrels	Fiscal	969,379	951,728	(17,651)	-1.82%
	Wine Imports	DOR	Liters	Fiscal	10,574,996	11,103,984	528,988	5.00%
	Rental Vehicle Sales (Taxable)	DOR	Dollars	Fiscal	\$73,278,756	\$81,696,925	\$8,418,169	11.49%
	Lodging Facility Sales (Taxable)	DOR	Dollars	Fiscal	\$438,052,856	\$481,639,618	\$43,586,762	9.95%
	Gasoline Gallons (Taxable)	DOT	Gallons	Fiscal	492,223,774	498,312,840	6,089,066	1.24%
	Diesel Gallons (Taxable)	DOT	Gallons	Fiscal	252,134,082	268,209,992	16,075,910	6.38%
Source *								
BEA - US Department of Commerce, Bureau of Economic Analysis								
DOL - Montana Department of Labor and Industry								
IHS - IHS Global Insight								
BOI - Board of Investments								
LFD - Legislative Fiscal Division								
DOR - Montana Department of Revenue								
SABHRS - Statewide Accounting, Budgeting, Human Resource System								
Computed - Computed using collections and tax rate								
DOT - Montana Department of Transportation								