

DATE: February 7, 2014

TO: Revenue & Transportation Interim Committee Members
House and Senate Tax Members
House Appropriations Members
Senate Finance and Claims Members

FROM: LFD Revenue Team

RE: FY 2014 General Fund Revenue Update #2

PURPOSE OF REPORT

This is the second of six monthly revenue updates throughout second half of FY 2014 designed to apprise interested members of the legislature on year-to-date general fund revenue collections, recent economic trends and the outlook for FY 2014 relative to the official estimate contained in SJ 2.

SUMMARY

General fund revenue collections are nearly even with FY 2013 amounts, and are currently above the overall growth estimate contained in SJ 2. Total individual and corporation income tax collections in FY 2013 reflected one-time activity that is not expected to continue in FY 2014. As a result, collections from these two sources—as well as total general fund collections—are expected to decrease from the FY 2013 level.

YEAR-TO-DATE GENERAL FUND REVENUE

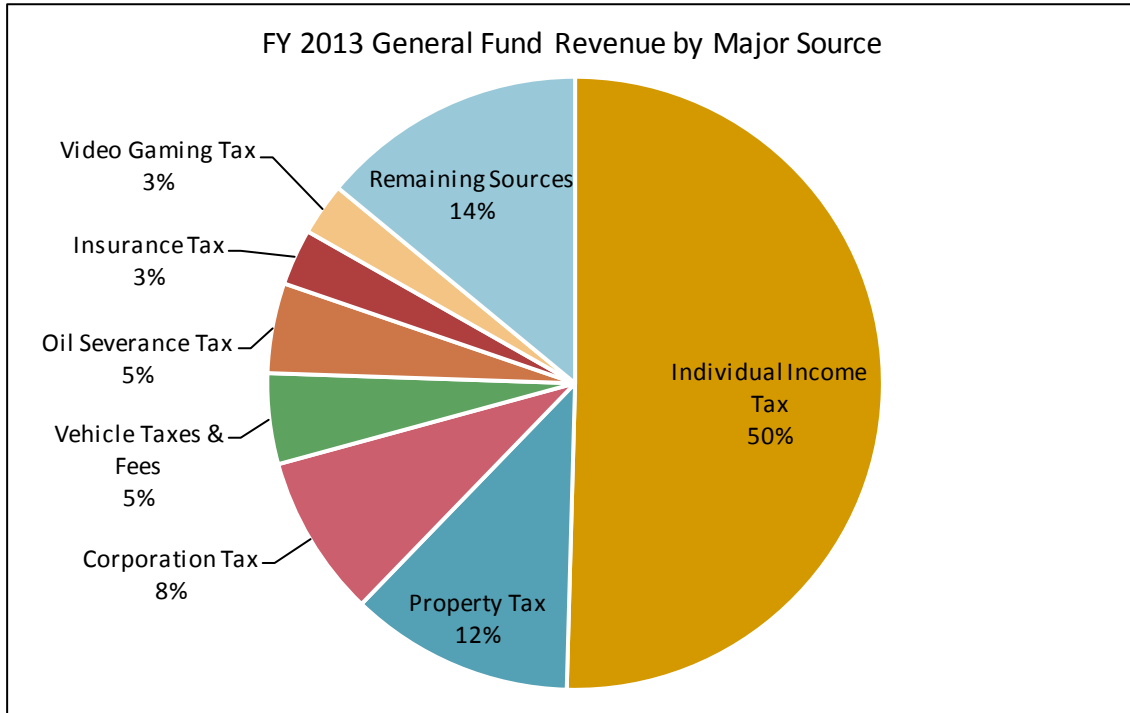
FY 2014 general fund revenues through the end of January are \$6.6 million or 0.6% ahead of FY 2013 revenues through the same period; this increase is slightly above the anticipated decline of 1.0%. All major revenue sources and any other sources with significant differences will be discussed in further detail in the next section.

General Fund Revenue Monitoring Report (in Millions)							
Revenue Source	Actual FY 2013	SJ2 Estimate* FY 2014	SJ2 Estimate % Change	1/31/2013 FY 2013	1/31/2014 FY 2014	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,047.790	\$1,039.082	-0.8%	\$695.723	\$728.534	\$32.811	4.7%
Property Tax	244.607	245.287	0.3%	130.745	129.955	(0.790)	-0.6%
Corporation Tax	177.497	154.096	-13.2%	94.807	65.716	(29.091)	-30.7%
Vehicle Taxes & Fees	99.352	102.659	3.3%	49.702	50.270	0.567	1.1%
Oil Severance Tax	98.683	99.336	0.7%	23.736	29.201	5.465	23.0%
Insurance Tax	61.678	52.021	-15.7%	25.240	20.648	(4.592)	-18.2%
Video Gaming Tax	57.261	59.929	4.7%	28.156	27.975	(0.182)	-0.6%
Other Business Taxes							
Drivers License Fee	4.527	4.435	-2.0%	2.593	2.167	(0.426)	-16.4%
Investment Licenses	6.951	7.457	7.3%	6.004	6.363	0.360	6.0%
Lodging Facilities Sales Tax	16.720	18.365	9.8%	8.135	9.146	1.011	12.4%
Public Contractor's Tax	(0.138)	3.259	-2468.7%	(0.024)	1.990	2.015	-8246.6%
Railroad Car Tax	2.179	2.320	6.5%	1.637	1.624	(0.012)	-0.8%
Rental Car Sales Tax	3.523	3.632	3.1%	1.974	1.794	(0.180)	-9.1%
Retail Telecom Excise Tax	20.652	23.236	12.5%	6.233	5.968	(0.265)	-4.3%
Other Natural Resource Taxes							
Coal Severance Tax	13.265	14.857	12.0%	7.578	7.614	0.036	0.5%
Electrical Energy Tax	5.067	4.521	-10.8%	1.896	1.920	0.024	1.3%
Metal Mines Tax	10.049	10.595	5.4%	0.037	0.019	(0.018)	-48.4%
U.S. Mineral Royalties	29.205	30.953	6.0%	14.196	13.294	(0.902)	-6.4%
Wholesale Energy Trans Tax	3.558	4.140	16.4%	1.817	1.436	(0.381)	-21.0%
Other Interest Earnings							
Coal Trust Interest Earnings	24.153	24.354	0.8%	10.746	9.180	(1.566)	-14.6%
TCA Interest Earnings	2.465	2.346	-4.8%	1.351	0.977	(0.374)	-27.7%
Other Consumption Taxes							
Beer Tax	3.033	3.067	1.1%	1.603	1.599	(0.004)	-0.2%
Cigarette Tax	31.011	30.433	-1.9%	17.784	17.267	(0.517)	-2.9%
Liquor Excise Tax	17.724	19.284	8.8%	9.441	9.847	0.406	4.3%
Liquor Profits	10.500	11.080	5.5%	-	-	-	-
Lottery Profits	13.084	14.342	9.6%	2.685	3.068	0.383	14.3%
Tobacco Tax	5.853	6.005	2.6%	3.008	3.107	0.098	3.3%
Wine Tax	2.195	2.218	1.0%	1.181	1.209	0.028	2.4%
Other Sources							
All Other Revenue	36.578	32.548	-11.0%	16.082	19.850	3.768	23.4%
Highway Patrol Fines	4.140	4.467	7.9%	2.016	1.980	(0.036)	-1.8%
Nursing Facilities Fee	4.928	4.740	-3.8%	3.022	2.101	(0.921)	-30.5%
Public Institution Reimbursement	16.212	17.802	9.8%	6.223	6.133	(0.090)	-1.5%
Tobacco Settlement	3.321	3.519	6.0%	-	-	-	-
Largest Seven Subtotal	\$1,786.868	\$1,752.411	-1.9%	\$1,048.110	\$1,052.299	\$4.189	0.4%
Remaining Sources Subtotal	290.754	303.974	4.5%	127.216	129.654	2.438	1.9%
Grand Total	\$2,077.622	\$2,056.385	-1.0%	\$1,175.326	\$1,181.953	\$6.627	0.6%

* SJ 2, Adjusted for Legislative Impacts

MAJOR SOURCES

In FY 2013, the largest seven revenue sources accounted for 86% of total general fund revenue. This section will highlight current trends with each source and further revenue detail if applicable.



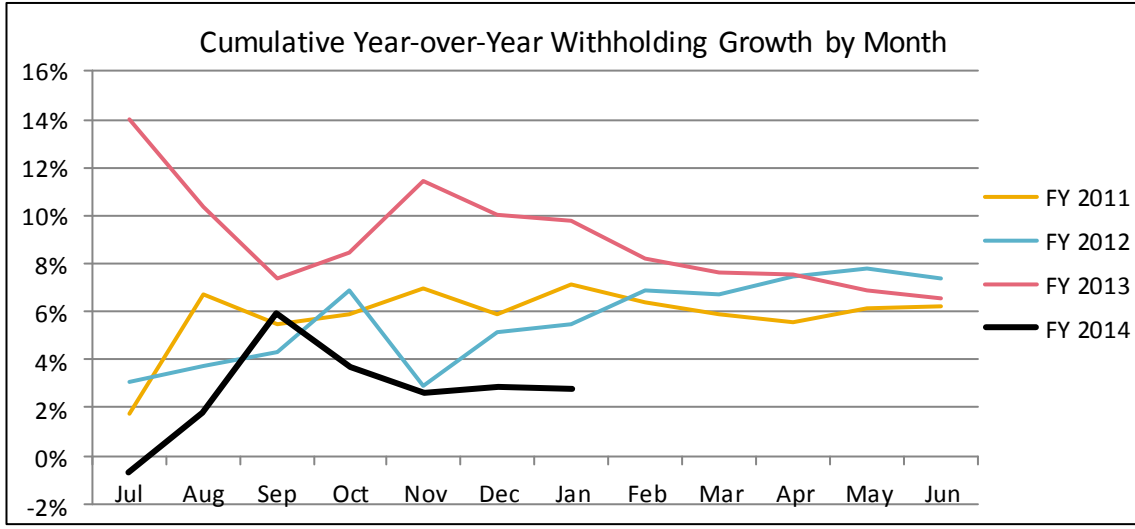
Individual Income Tax: Above Estimate, but Slow Withholding Growth

Individual income tax collections are \$32.8 million or 4.7% above last year, and above the anticipated decline of 0.8% contained in the official estimate. Withholding tax collections have slowed to 2.7% over last year. Estimated payments grew slightly over this time last year, in contrast to a small continued decline that was anticipated last month. The increase in current year payments reflect the tax due by tax year 2012 extension filers, rather than that of 2013 filers. About three-quarters of total current year payments are received in April.

Year-to-Date Individual Income Tax				
(\$ Millions)				
	FY 2014	FY 2013	Difference	% Difference
Withholding	\$451.5	\$439.5	\$12.1	2.7%
Estimated Payments	154.9	151.7	3.1	2.1%
Current Year Payments	22.3	16.3	6.0	37.1%
Audit, P&I, Amended	16.7	14.5	2.2	15.0%
Refunds	(59.7)	(61.6)	2.0	-3.2%
Refund Accrual Reversal	129.1	124.8	4.3	3.4%
Partnership Income Tax	4.4	3.9	0.5	11.6%
Mineral Royalties	9.3	6.6	2.7	41.2%
Total	\$728.5	\$695.7	\$32.8	4.7%

Withholding continues to post anemic growth over last year. The graph below illustrates the slow growth when compared to the other post-recession years. The volatility of the first months of the fiscal year is expected;

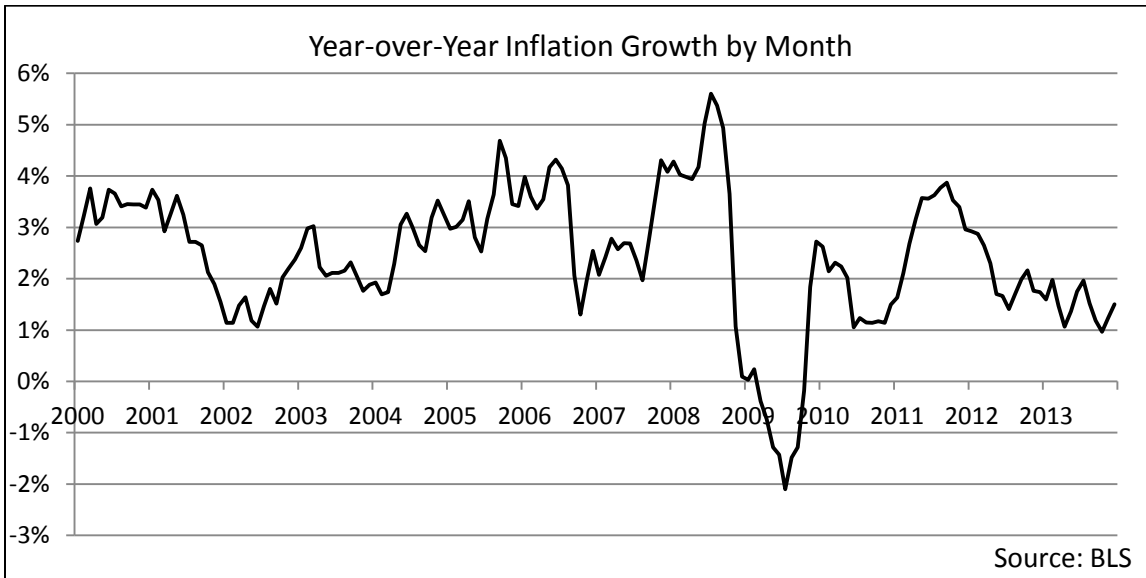
however, by February, the year-over-year growth seems to stabilize. Based on year-to-date revenue, withholding is not likely to attain the 6-8% growth of the last three years.



Withholding tax growth reflects wage growth, while wage growth is a reflection of employment growth and inflation. The chart below shows year-over-year nonfarm payroll employment growth. Note the employment recovery that finally occurred in 2012 and the subsequent slowdown in 2013:



The following chart shows year-over-year growth in inflation, as measured by the CPI. The weakened employment growth as depicted above, combined with the low inflation illustrated below, suggest sluggish wage growth in 2013—and this is likely resulting in the low withholding tax growth.



Although the slow rate of withholding growth is unlikely to bring total FY 2014 collections below the SJ 2 estimate, it will be closely monitored in the coming months. Individual income withholding tax accounts for about a third of all general fund revenue on average.

Property Tax: Appears Low Due to Missing Payment

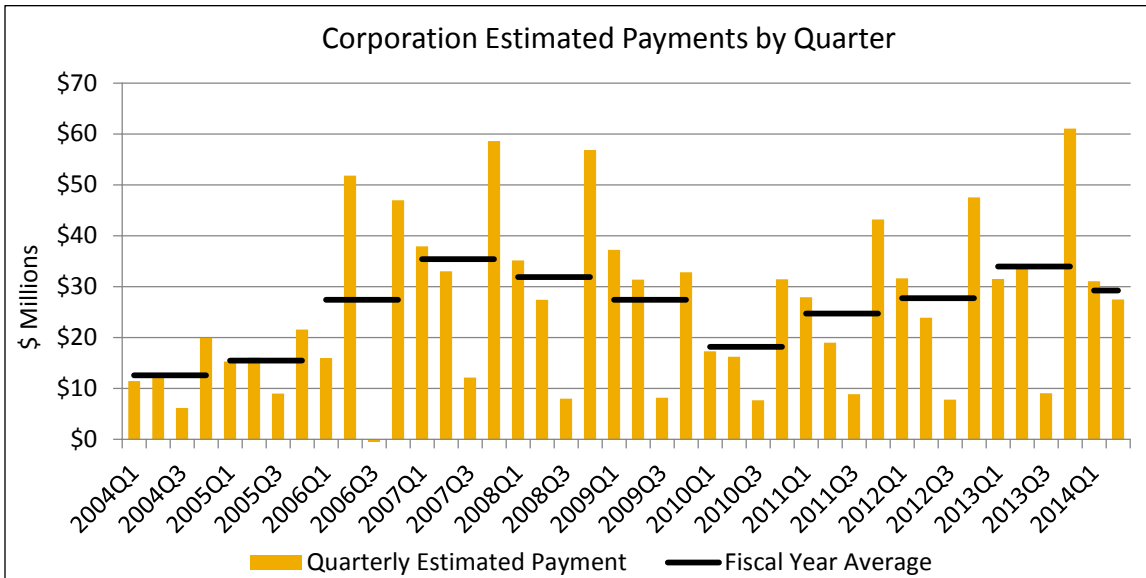
With the first of two property tax payments in, property tax collections are below last year by \$0.8 million or 0.6%, amounting to \$130.0 million. However, property tax revenue from Ravalli County had not been received by January 31st when year-to-date numbers were run. That money has been remitted to the Department of Revenue and is approximately \$4.0 million. This addition puts the collections over the FY 2013 year-to-date number, and on track to likely be slightly higher than the SJ 2 estimate.

Corporation License Tax: Below Estimate

Corporation license tax collections through the end of January are \$29.1 million or 30.7% below last year. All accounts are contributing to the reduction, as shown in the following table:

Year-to-Date Corporation Income Tax				
(\$ Millions)				
Account	FY 2014	FY 2013	Difference	% Difference
Corporation Tax	\$6.2	\$11.2	(\$4.9)	-44.2%
Estimated Payments	62.2	69.2	(7.0)	-10.1%
Refunds	(12.8)	(9.6)	(3.2)	33.6%
Refund Accrual Reversal	5.6	12.8	(7.2)	-56.0%
Audit, P&I, Amended	4.5	11.3	(6.8)	-60.3%
Total	\$65.7	\$94.8	(\$29.1)	-30.7%

The best indicator for corporation license tax collections is estimated payments, which account for nearly 80% of total corporation tax collections on average. As shown in the figure below, estimated payments have been quite volatile from year-to-year and quarter-to-quarter. Since the low point during FY 2010, estimated payments have (on average) been increasing. FY 2014 estimated payments through the second quarter are somewhat lower than the first two quarters of FY 2013; although it is difficult to infer a conclusive trend, total collections are likely to be below the FY 2013 level and may end up below the SJ 2 estimate.



Vehicle Fees & Taxes: Slightly Below Estimate

Seven months into FY 2014 vehicle taxes and fees have generated \$50.3 million in revenue. This is a 1.1% increase from this time last year. Given past years' trends, this indicates that year-end revenue will be about \$2.0 million less than what was anticipated in SJ 2.

Oil & Natural Gas Production Tax: Strong Growth

Revenue from the oil and natural gas production tax for the first quarter of FY 2014 was anticipated to be about 20% higher than the first quarter of FY 2013. It ended up being 23% or \$5.5 million higher, for a general fund total of \$29.2 million. Increased production and fairly steady prices since the adoption of SJ 2 are the main reasons for this increase. While only one quarter of data is available, this strong growth in revenue is expected to push oil and natural gas production tax revenue well above the SJ 2 estimate.

Video Gaming Tax: Slightly Below Estimate

Revenue from video gambling is nearly identical to this time last year. Current revenue in FY 2014 generated from video gambling taxes is \$28.0 million, compared to \$28.2 million at this time last year. Using past years' trends, year-end revenue from this source will likely finish around \$3.0 million less than was estimated in SJ 2.

Insurance Tax: Slightly Below Estimate, but Expected to Increase

Current insurance tax collections are 18.2% or \$4.6 million below FY 2013 year-to-date. According to the State Auditor's Office, the new taxes from Health Care Services Corporation (the group that purchased Blue Cross Blue Shield) are expected to start coming in at the end of this quarter. Total insurance tax is anticipated to exceed the SJ 2 estimate once the additional revenue is realized.

OTHER KEY DIFFERENCES

Lodging Facilities Sales Tax Up, but Rental Car Sales Tax Down?

Lodging tax and rental car sales tax typically follow similar trends, as both sources are closely tied to tourism activity within the state. Although these tax sources represent a relatively small share the general fund, they are a good indicator of the tourism sector. Further research needs to be done—likely with the [Institute for Tourism and Recreation Research](#) at the University of Montana—but one explanation has been highlighted by IHS in recent publications: an influx of Canadian consumers coming into Montana and staying at hotels as a result of a law that went into effect in June 2012 allowing Canadians to carry \$200 worth of merchandise over the border duty-free. The amount of money to be spent by individuals goes up the longer they stay in the United States.

Coal Trust Interest Earnings: Below Estimate

Coal trust interest earnings are currently \$1.6 million, or 14.6% less than this time last year. Estimates contained in SJ 2 predicted that coal trust earnings would remain virtually unchanged from FY 2013 to FY 2014. However, due to the current low yields in the bond market this source will likely finish below the SJ 2 estimate.

U.S. Mineral Royalties: Closer to Estimate with Differences Likely Due to Timing

U.S. Mineral Royalties came in at \$0.9 million or 6.4% below FY 2013 year-to-date revenues. This is much closer than year-to-date numbers were in December, as was expected due to timing issues. According to DOR, total revenue should end up close to the SJ 2 estimate.

All Other Revenue: Stronger-than-Expected Growth

In SJ 2, revenue from this source was expected to decrease by 11% from FY 2013 to FY 2014. However, year-to-date collections for all other revenue are \$3.8 million, or 23.4% larger than this time last year. This amount is expected to decrease as approximately \$1.0 million of this increase is due to corporate tax withholdings that are expected to be refunded or transferred to other revenue accounts shortly. The remaining growth is primarily due to increases in abandoned property collections and fund transfers from the Department of Natural Resources and Conservation. These transfers were from the coal shared fund balances that were deposited into the general fund following the close of FY 2013.