

2017 OUTLOOK REVENUE DETAIL

A Report Prepared for the
Revenue & Transportation Interim Committee

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INTRODUCTION

This report provides more detail for the outlook revenue contained in the [2017 Biennium Outlook Report](#).

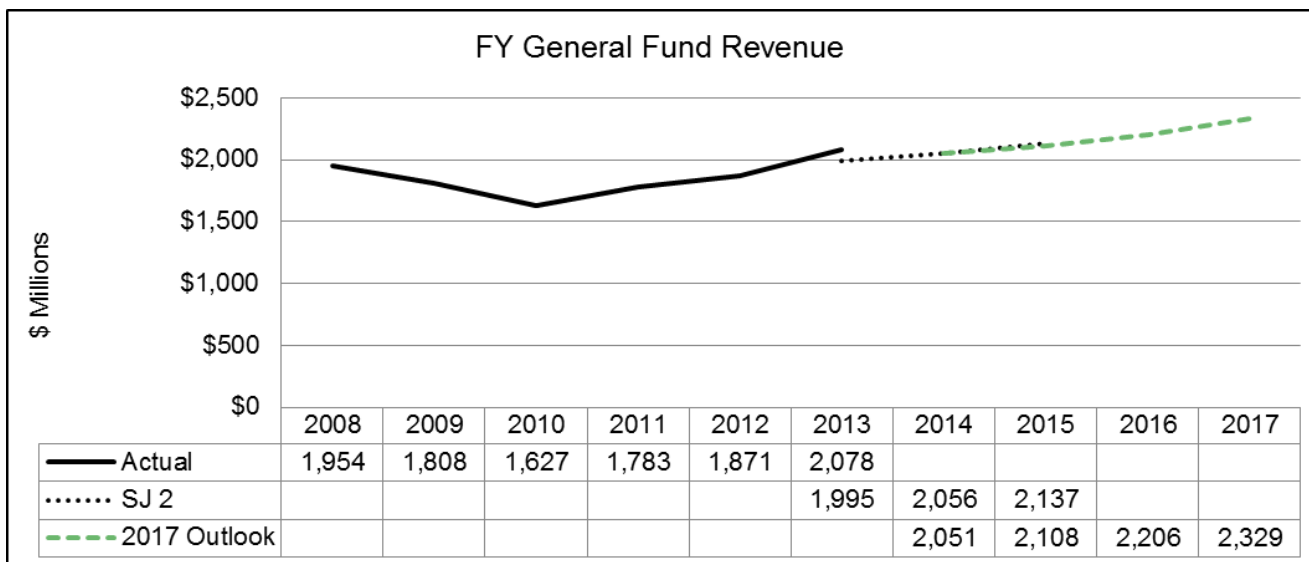
2017 OUTLOOK REVENUE

The outlook revenue for each source is generally consistent with the modeling methods and actual fiscal year data available for the [Revenue Trend Update](#) in December 2013. Changes from the December report include new forecast data from IHS and changes to the corporation tax model. While it is instructive to see the impact of the new data on expected revenue trends, it is important to note that no changes have been made to the official estimate contained in SJ 2. The outlook revenue trends provided in this report are informational only.

All revenue outlook graphs show actual collections from FY 2002 to FY 2013, the SJ 2 estimate for FY 2013 through FY 2015, and the outlook revenue for FY 2014 through FY 2017. Although FY 2014 is now over, the accrual process will not be complete until the end of this month; therefore, final collections are not available for this report.

Updated 2017 biennium revenue estimates for the general fund will be produced in November 2014. These estimates will be updated throughout the legislative session using a monthly review of year-to-date revenue collections and updating models with new economic data from IHS and other sources. The chart below shows the difference between the current outlook and SJ 2.

The outlook for annual growth in general fund revenue for FY 2014 is -1.3%, FY 2015 is 2.8%, for FY 2016 is 4.7% and for FY 2017 is 5.6%. The outlook's projected revenue decline in FY 2014 primarily reflects the assumption of income shifting from FY 2014 to FY 2013 due to the federal "Fiscal Cliff."

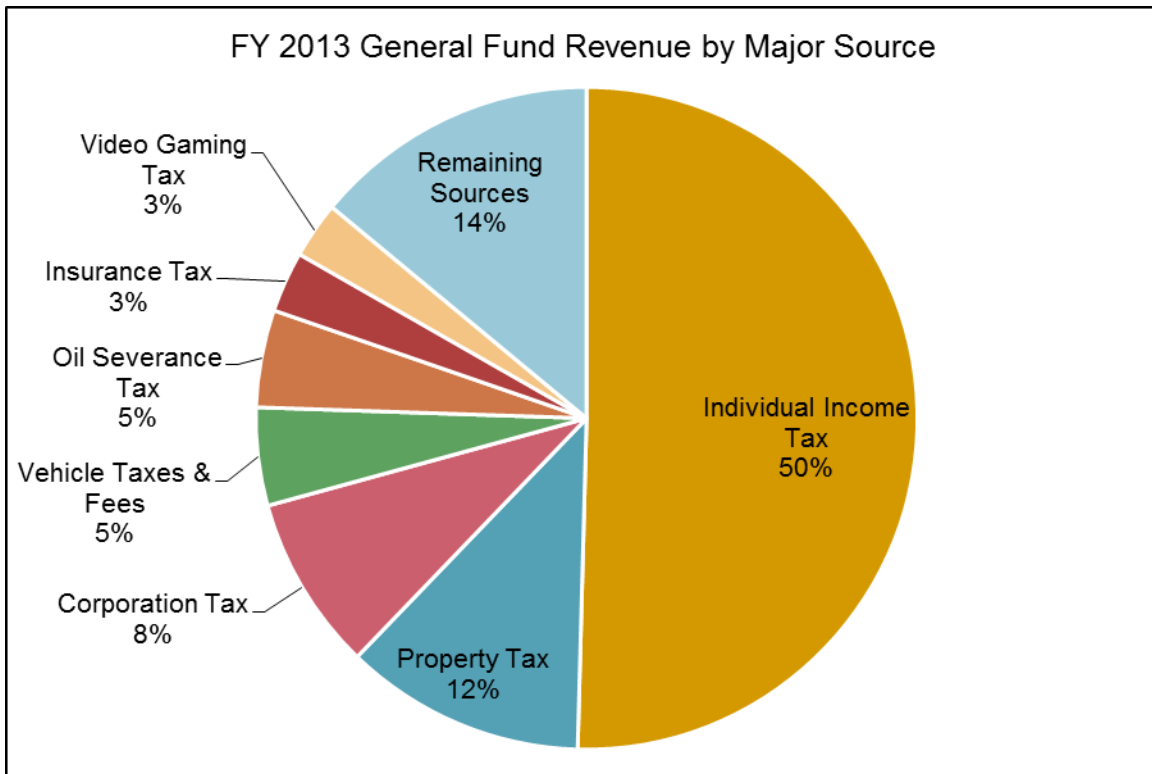


The 2017 biennium revenue outlook by source is shown in the following table:

2017 Biennium Outlook for General Fund Revenue					
(\$ Millions)					
Source of Revenue	Actual FY 2013	Outlook FY 2014	Outlook FY 2015	Outlook FY 2016	Outlook FY 2017
Large Sources					
Individual Income Tax	\$1,047.790	\$1,028.923	\$1,074.711	\$1,147.997	\$1,224.241
Property Tax	244.607	248.072	251.161	262.638	274.653
Corporation Income Tax	177.497	153.100	151.506	149.345	152.892
Vehicle Taxes & Fees	99.352	100.352	101.150	101.958	102.830
Oil & Natural Gas Production Tax	98.683	104.857	99.186	95.585	98.072
Insurance Tax & License Fees	61.678	53.927	58.904	59.107	59.237
Video Gambling Tax	57.261	61.076	63.571	68.206	73.497
Other Business Taxes					
Driver's License Fee	4.527	4.267	4.568	4.339	4.641
Investment License Fee	6.951	7.097	7.252	7.406	7.560
Lodging Facility Use Tax	16.720	16.720	17.349	18.115	18.934
Public Contractors Tax	(0.138)	3.591	3.642	3.693	3.744
Railroad Car Tax	2.179	2.316	2.388	2.454	2.537
Rental Car Sales Tax	3.523	3.656	3.784	3.940	4.107
Telecommunications Excise Tax	20.652	21.114	21.223	21.307	21.369
Other Natural Resource Taxes					
Coal Severance Tax	13.265	15.478	17.043	17.688	18.293
Electrical Energy Tax	5.067	4.448	4.577	4.614	4.610
Metalliferous Mines Tax	10.049	8.518	8.332	8.286	8.201
US Mineral Royalty	29.205	31.442	30.077	28.680	28.235
Wholesale Energy Tax	3.558	3.432	3.575	3.616	3.632
Other Interest Earnings					
Coal Trust Interest	24.153	21.898	22.516	23.185	23.996
Treasury Cash Account Interest	2.465	2.181	3.839	14.244	31.281
Other Consumption Taxes					
Beer Tax	3.033	3.100	3.115	3.140	3.172
Cigarette Tax	31.011	31.049	30.909	29.678	30.176
Liquor Excise & License Tax	17.724	18.575	19.314	19.956	20.677
Liquor Profits	10.500	10.729	11.274	11.718	12.217
Lottery Profits	13.084	14.027	14.772	15.657	16.683
Tobacco Tax	5.853	6.065	6.255	6.430	6.593
Wine Tax	2.195	2.263	2.336	2.404	2.469
Other Sources					
All Other Revenue	36.578	38.364	39.153	39.802	40.179
Highway Patrol Fines	4.140	4.555	4.514	4.526	4.640
Nursing Facilities Fee	4.928	4.803	4.653	4.504	4.355
Public Institution Reimbursements	16.212	17.496	18.003	18.512	18.567
Tobacco Settlement	3.321	3.104	3.195	3.164	3.132
Total General Fund	\$2,077.622	\$2,050.595	\$2,107.844	\$2,205.895	\$2,329.422

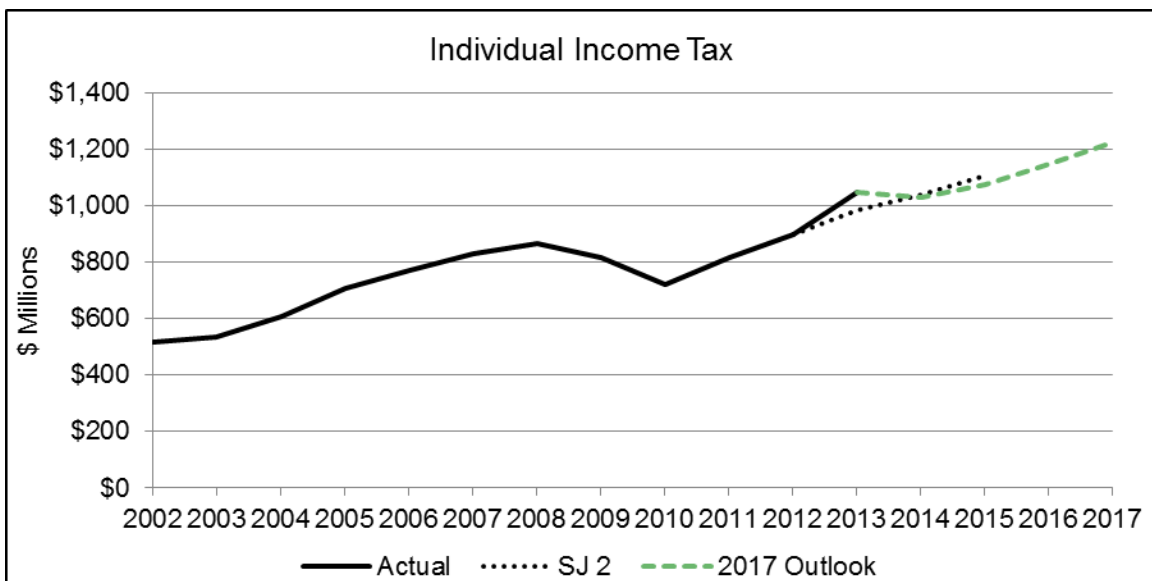
Large Revenue Sources

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



Individual Income Tax

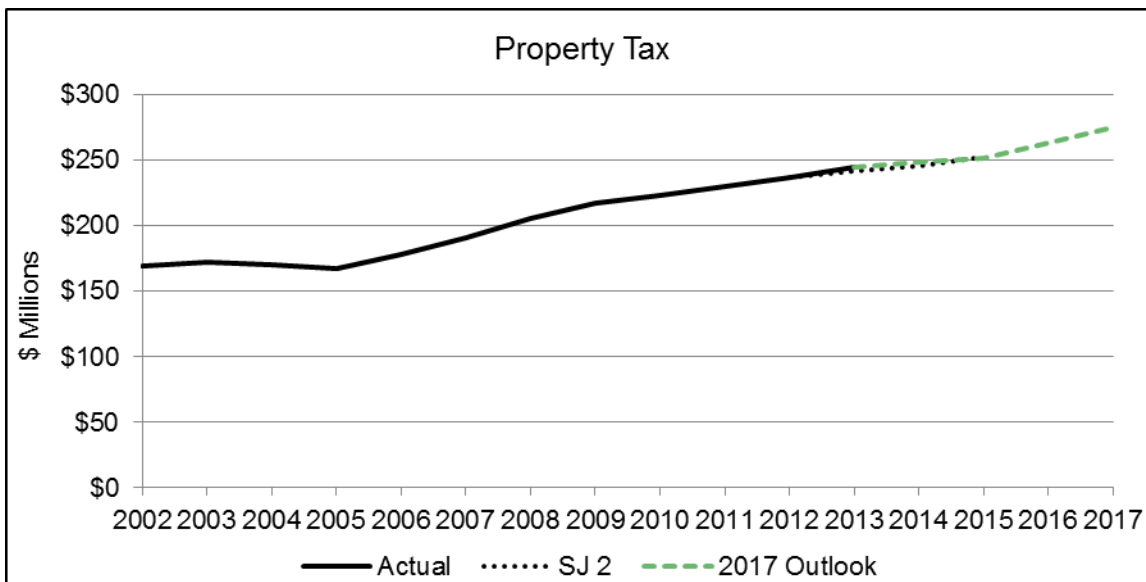
The outlook revenue based on the new data and revised modeling is just slightly below the estimate contained in SJ 2, with moderate growth thereafter.



Property Tax

The revenue outlook has property tax collections close to SJ 2 for both FY 2014 and FY 2015. The outlook revenue is slightly above SJ 2 in FY 2014 due to federal forest receipts that were expected to fall to \$0.5 million in FY 2014, but due to a one-year federal extension payments are expected to be \$3.5 million. This extension is not continued into FY 2015, so several decreases in taxable property value including some reductions in metal mines and electrical energy production due to a settlement, result in slightly lower FY 2015 revenue compared to SJ 2.

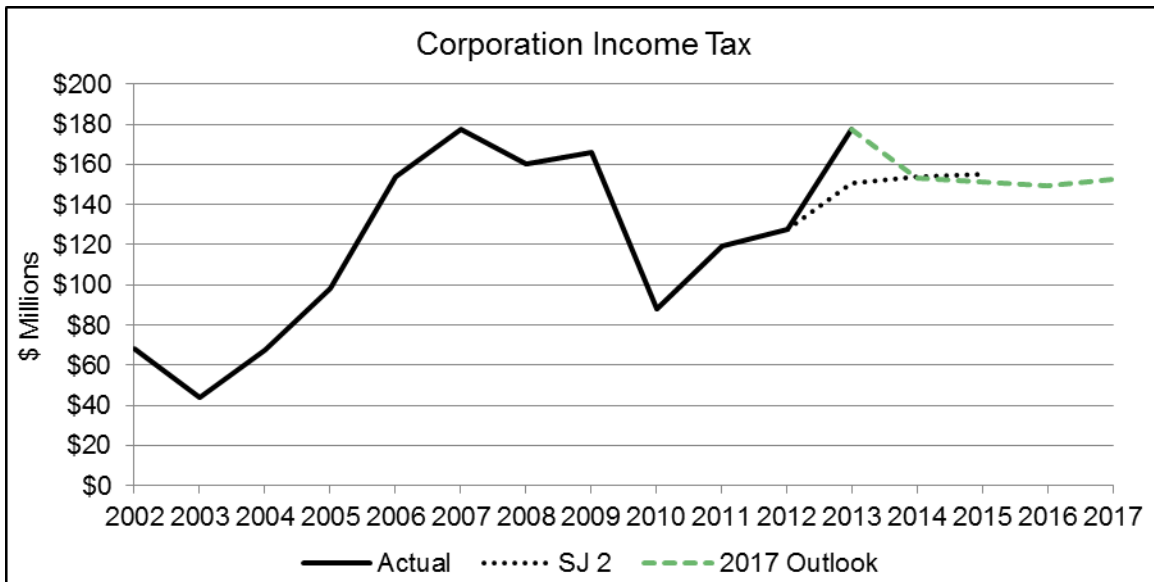
Going forward through FY 2016 and FY 2017 there is accelerated growth in property tax collections. This is due to estimated reappraisal effects; the estimate is based on current law and assumes no reappraisal mitigation.



Corporation Income Tax

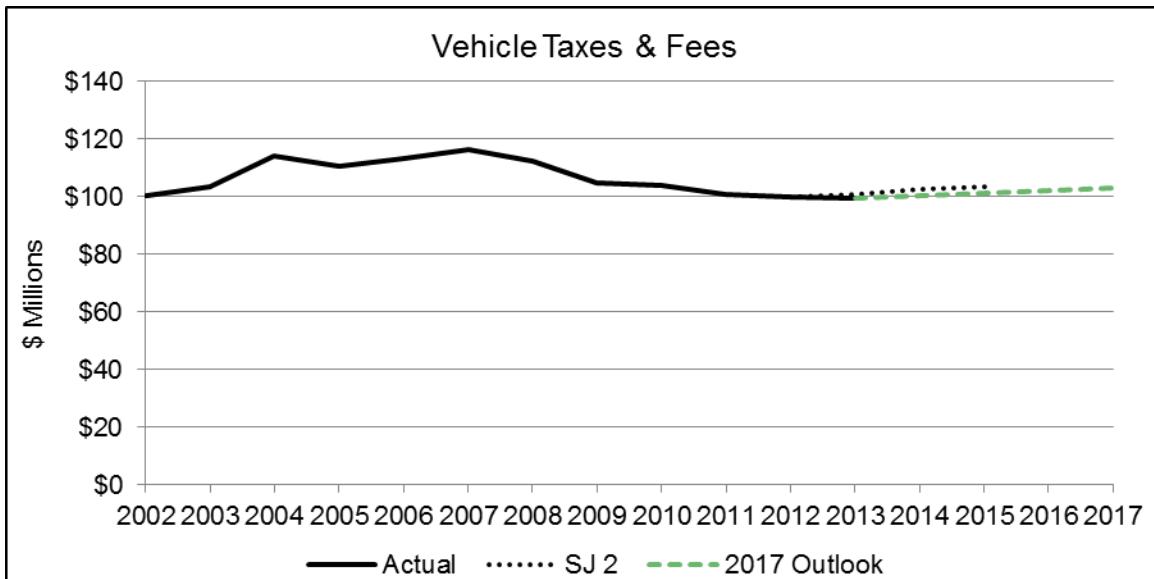
Recently this model has been adjusted in an attempt to minimize the error associated with forecast estimates. Numerous IHS economic variables are used to predict various corporate sectors, and the sectors' estimates are combined to form a final estimate. These variables include, but are not limited to, West Texas Intermediate oil price, Montana median home price, retail sales, and Montana population. Predictive variables were chosen based on their predictive power and historical error. Finally, numerous models' resulting error distributions were compared to choose a model that had narrow confidence bands and high accuracy.

For more information, see the report on the updated methodology here: [Corporation Tax Estimating: Using Confidence Intervals to Minimize Forecasting Error](#).



Vehicle Taxes & Fees

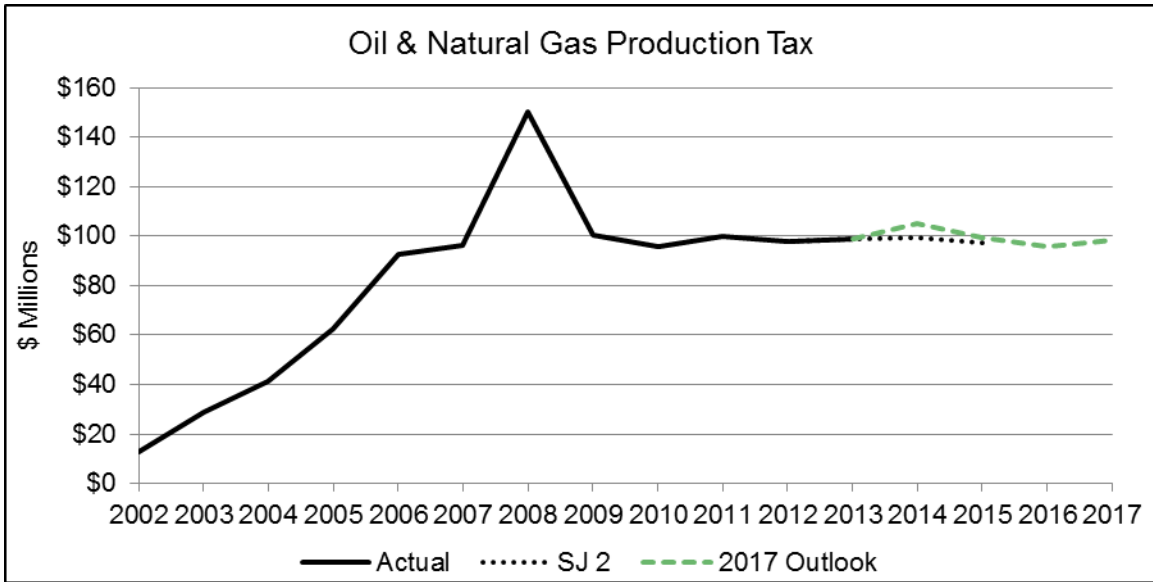
Combined revenue collections from vehicle fees and taxes were \$1.5 million less than anticipated in SJ 2 for FY 2013. Revenue from this source is forecast based on IHS estimates for new and used Montana car sales. Using these estimates, a growth rate in Montana’s vehicle stock is developed to apply to forecast years.



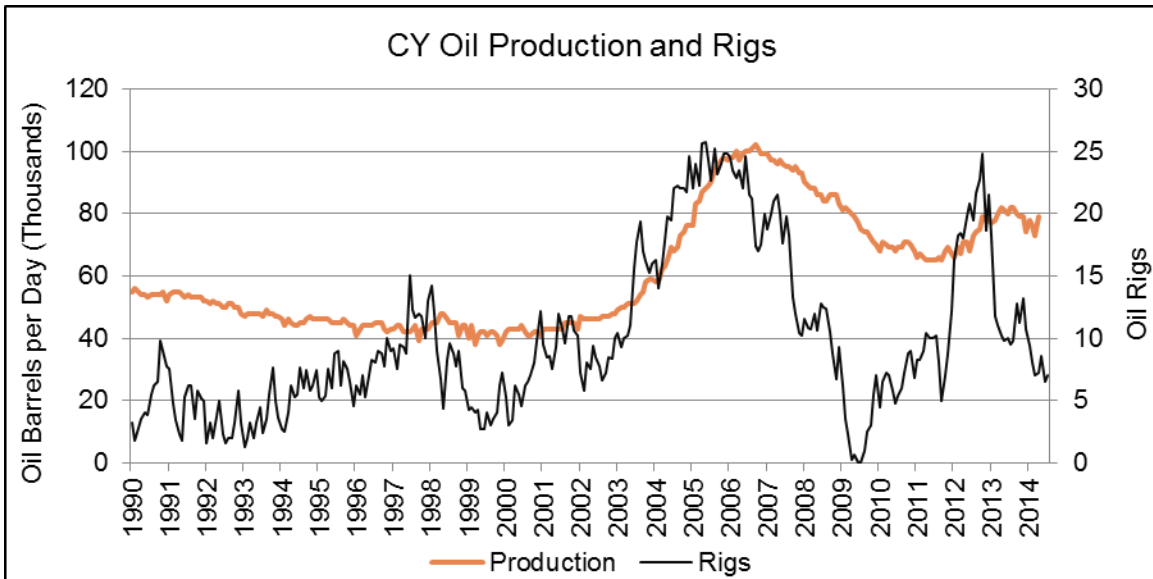
Modeling for this revenue source has not changed. The decline in outlook revenue compared to SJ 2 estimates results from revised estimates regarding Montana’s vehicle stock and the smaller-than-expected revenue in FY 2013. Modeling will be updated before the 2015 session to include detailed registration data available from the Department of Justice.

Oil & Natural Gas Severance Tax

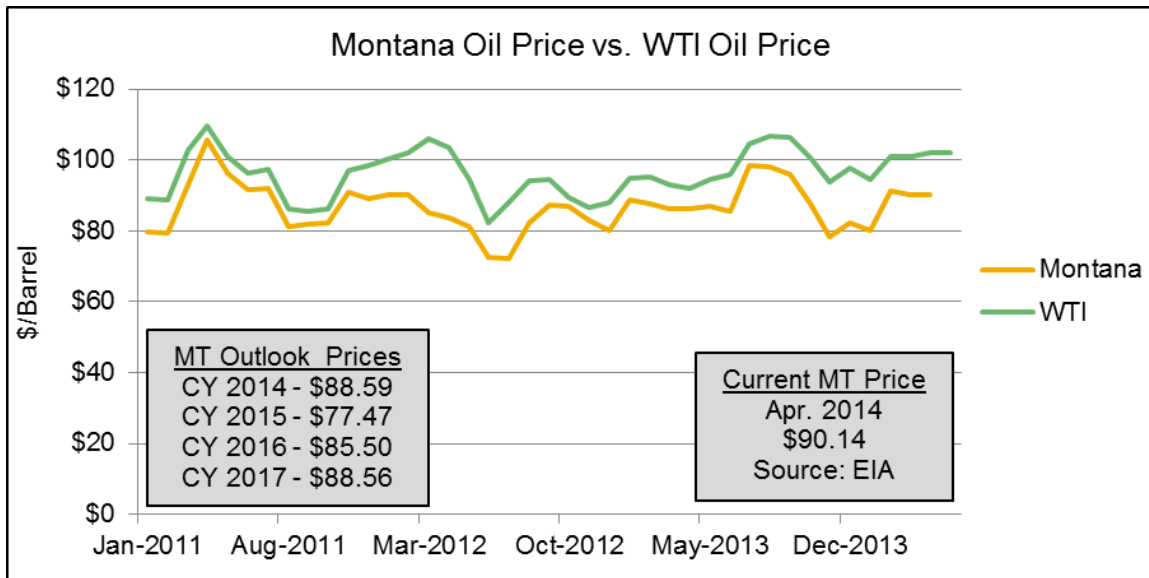
Oil and natural gas production tax collections were \$0.1 million below the SJ 2 estimate in FY 2013. The outlook numbers for FY 2014 is higher than SJ 2 by \$5.5 million. The bulk of that increase occurred in the first quarter of FY 2014.



The outlook estimates have oil and natural gas tax collections declining from the FY 2014 value for both FY 2015 and FY 2016. This is due in part to slight declines in production from the CY 2013 high, shown in the chart below, following the bump in oil rigs.



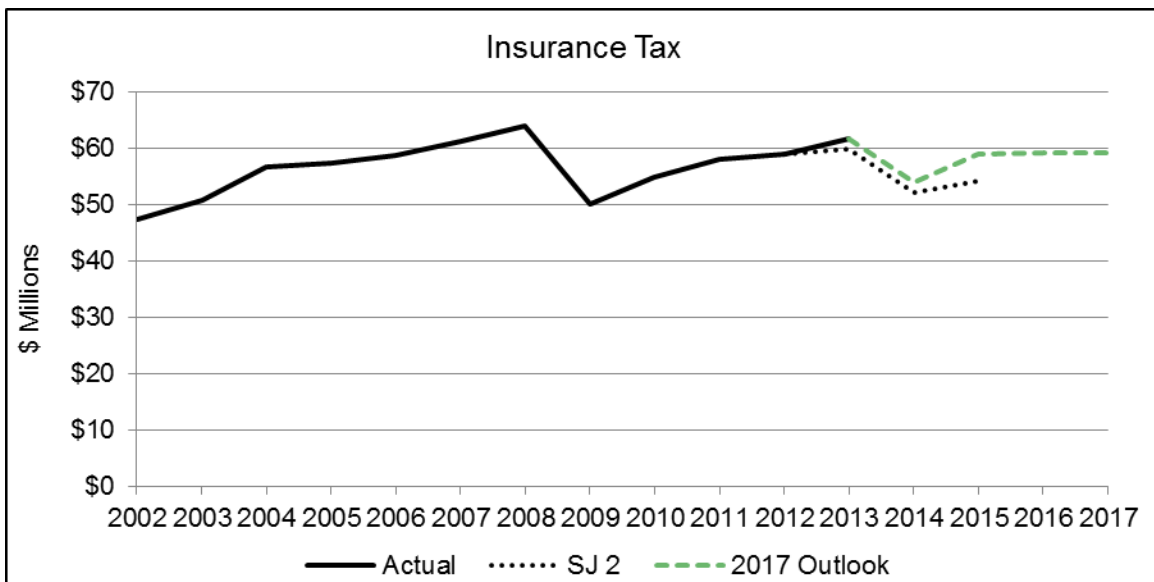
Declining collection in the outlook period is also due to weaker price forecasts in CY 2015 which influences the 2015 and 2016 fiscal years. Prices are expected to rebound in CY 2016 and beyond, increasing the tax collection forecast for FY 2017. Prices are also shown below with comparisons to West Texas Intermediate (WTI) prices.



Insurance Tax

There are a number of changes that will impact future general fund insurance tax revenue:

- The reversion of the share of the tax deposited into the state special revenue fund for the Children’s Health Insurance Program (CHIP) back to its original 33% (up from 16.67%) in FY 2014
- The buyout of Blue Cross Blue Shield of Montana (BCBS) by Health Care Service Corporation (HCSC); as part of the deal HCSC will pay tax from which BCBS was exempt
- The implementation of the Affordable Care Act (ACA)
- The eventual elimination of Montana Comprehensive Health Association (MCHA) offset

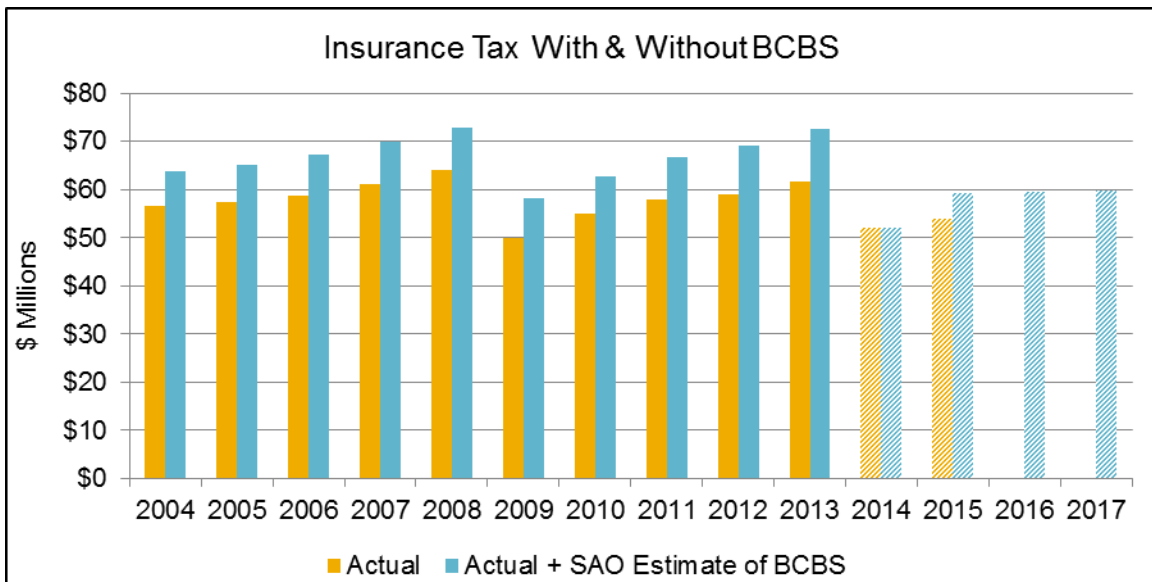


CHIP

This is the only major change that was known at the time of the SJ 2 revenue estimate. Doubling the proportion of insurance tax revenue allocated to CHIP was the primary driver of the decreased forecast in SJ 2.

BCBS Merger

In August 2013, BCBS merged with Health Care Service Corporation (HCSC). As a non-profit, BCBS has historically been tax exempt. While that non-profit status continues, the terms of the buyout are that the company will now pay taxes. Steve Matthews, the Chief Financial Examiner at the State Auditor's Office (SAO), has examined BCBS premiums since FY 2004 to calculate the tax the company would have paid had it not been exempt. The outlook trend is based on the SAO calculation of what insurance tax revenues would have been if those taxes had been collected. The trended point for FY 2014 takes into account that BCBS will only be contributing for 5 of the 12 months of the fiscal year.



Affordable Care Act

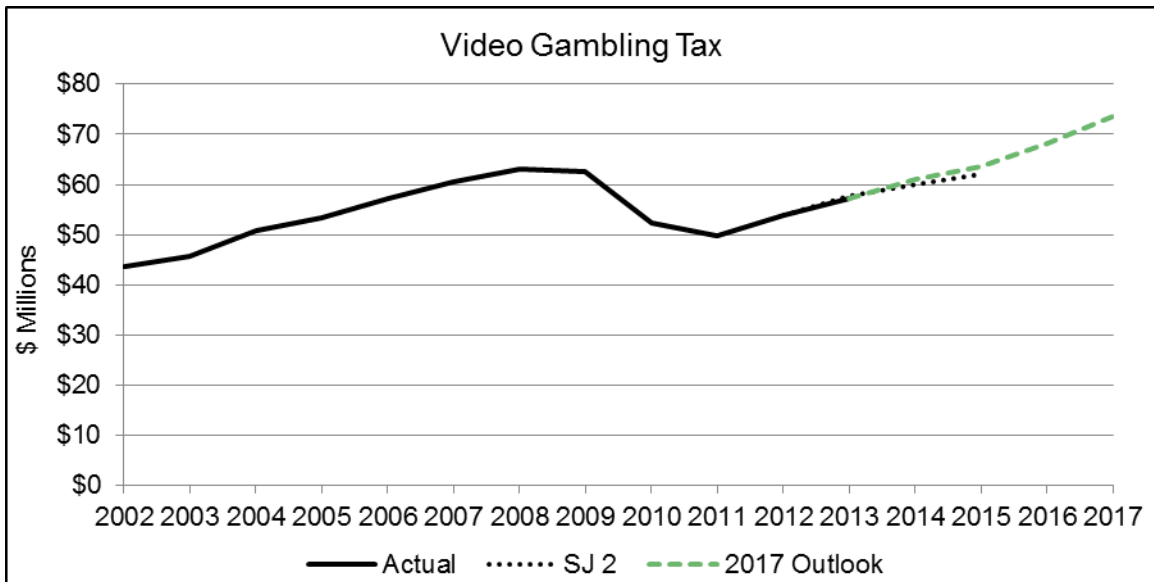
Two of the three companies on Montana's health exchange are tax exempt; however the majority of new policies enrolled both on and off the website – about 50,000 of about 70,000 – were through BCBS making them taxable. Analysis is currently being conducted by the SAO to determine how many of these policies were new rather than migratory. When complete this will help inform potential general fund impacts, at this time any possible effects are not included in the revenue outlook.

MCHA Offset

The MCHA offered policies to people who had historically been denied coverage by other insurers. The group ceased business at the end of CY 2013 when people were no longer denied due to the ACA. Historically, insurance companies have paid part of their tax directly to the MCHA—usually a total amount between \$1.5 and \$2.5 million annually—that will now go into the general fund.

Video Gambling Tax

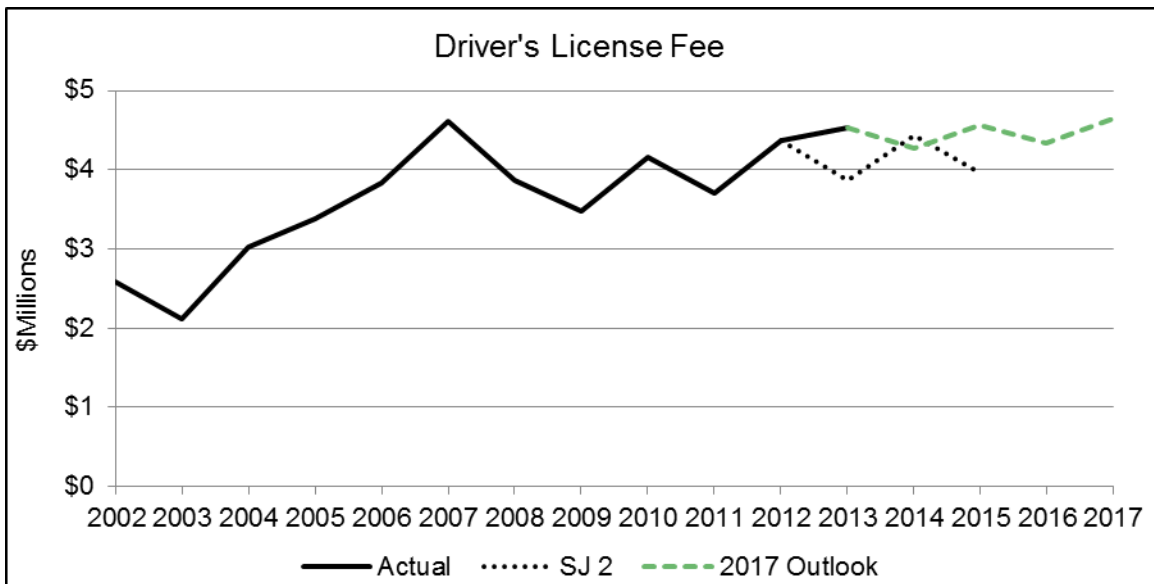
Video gambling revenue was \$0.4 million less than anticipated in SJ 2. Revenue from this source is estimated using IHS forecasts for Montana personal income as well as historical permit and license data. The 2017 outlook is above SJ 2 due to the higher IHS forecast of personal income.



Other Business Taxes

Driver's License Fee

Total driver's license revenue exceeded the estimate contained in SJ 2 by \$0.7 million for FY 2013. Since fees are fixed, this increase was caused by a larger-than-expected number of Class D (standard) driver's license purchases. The SJ 2 estimate was based on IHS forecast of Montana residents over the age of 16.

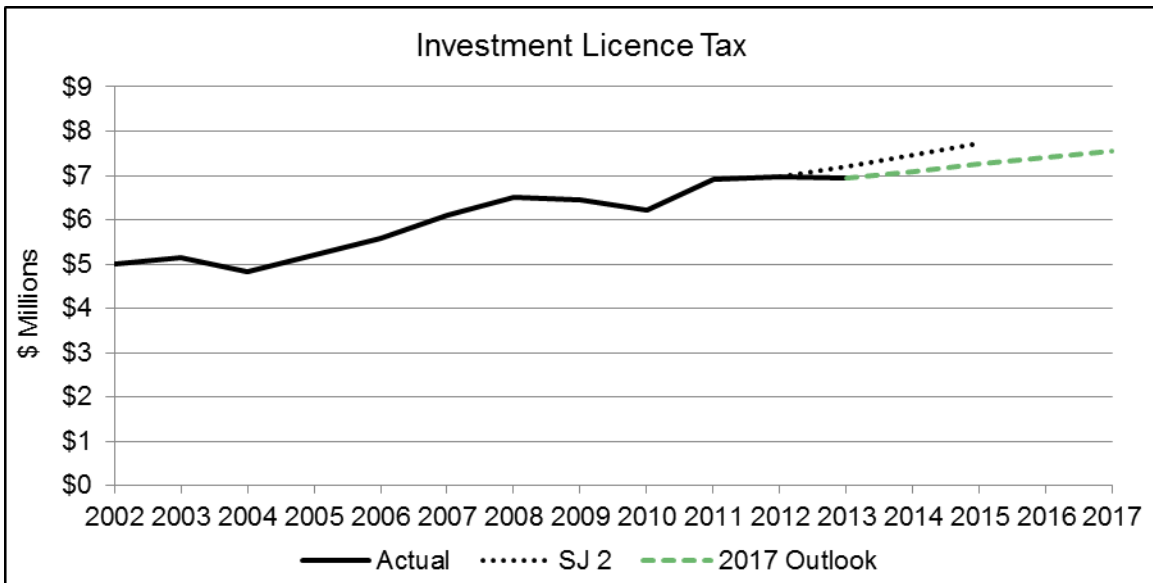


The 2017 outlook is based on forecast population data and historical ratios between licenses and actual populations. Actual ratios from the most recent fiscal years are applied accordingly to forecast years.

Investment License Fee

Investment license fee collections were \$0.3 million below the estimate contained in SJ 2 in FY 2013. According to Lynne Egan, the Deputy Securities Commissioner at the State Auditor's Office (SAO),

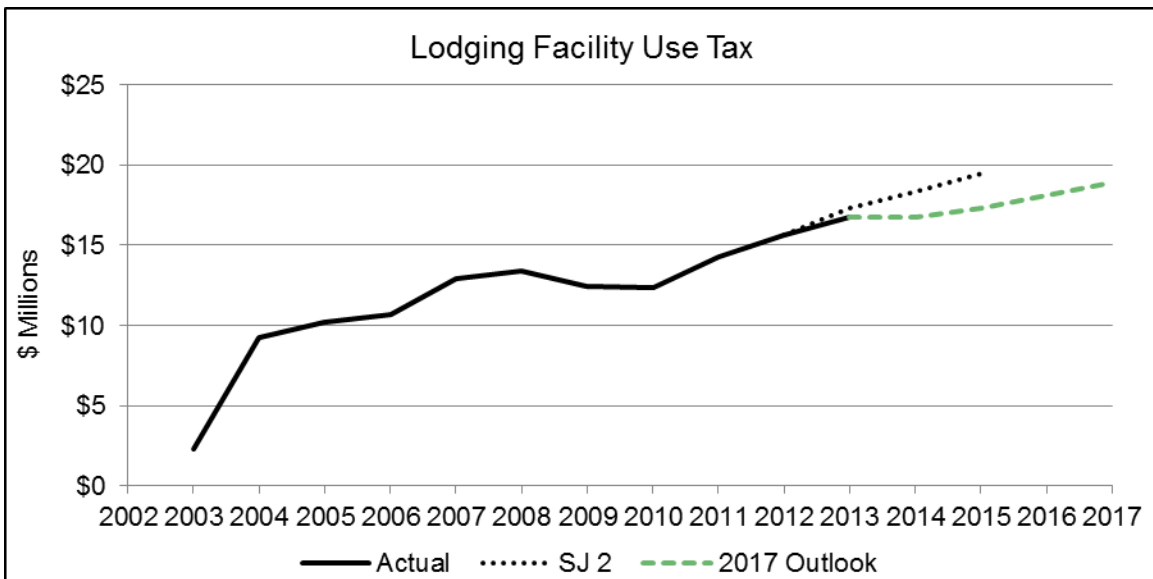
the reduction in revenue is a reflection of broader changes in the investment industry. As larger investment firms continue to acquire smaller firms, and the large firms merge, the total number of firms has been steadily declining. This trend is expected to continue. The growth in the number of individual brokers had been offsetting the reduction in revenue; however, this growth has slowed recently, resulting in the slower investment fee growth.



Collections were forecast in SJ 2 based on the S&P 500 Index and CPI. With the information from SAO, the 2017 outlook model also accounts for the declining number of firms.

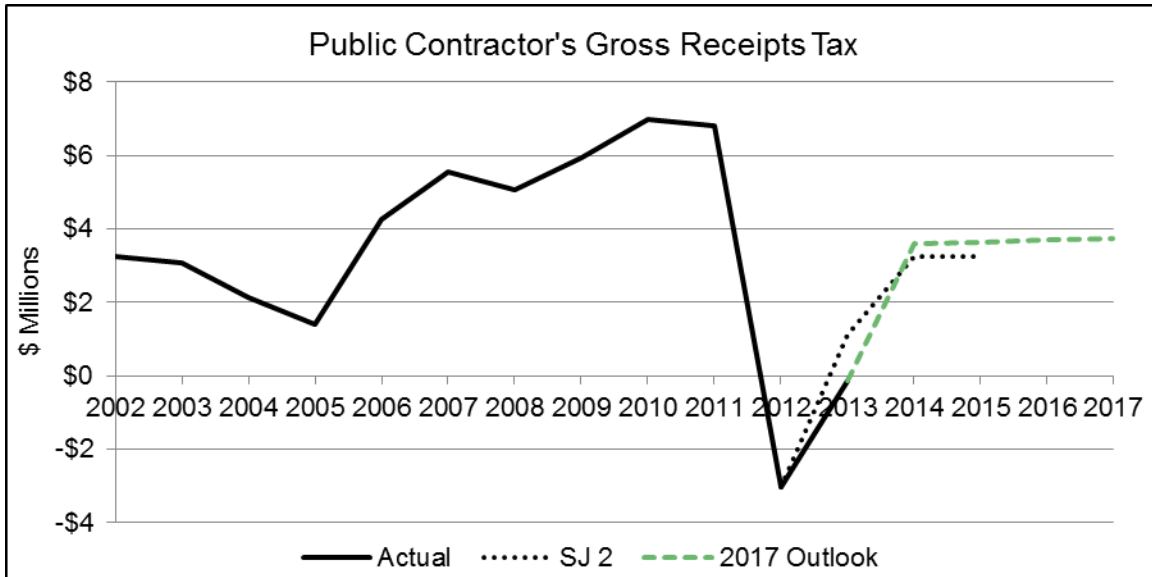
Lodging Facilities Sales Tax

Lodging facilities sales tax collections were \$0.6 million below the estimate contained in SJ 2 in FY 2013. This revenue source was forecast in SJ 2 based on Montana retail sales, as well as two other variables. The revised model is only based on the IHS forecast of Montana retail sales.



Public Contractor's Tax

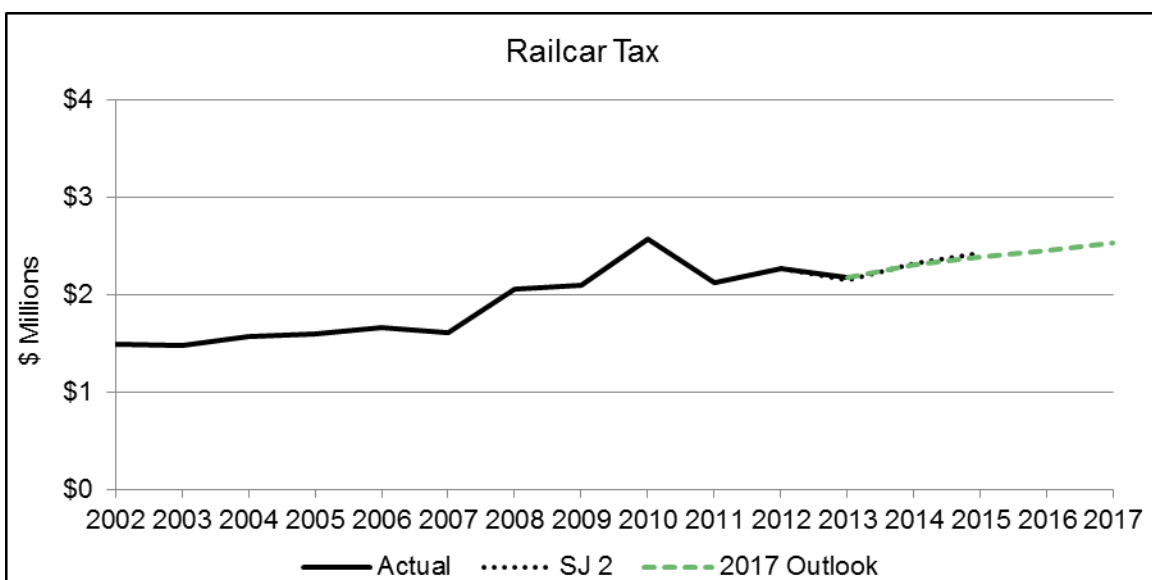
Public contractors' gross receipts tax collections were \$1.3 million below the estimate contained in SJ 2 in FY 2013. Higher levels of credits & refunds due to the increased number of public projects funded through the American Recovery & Reinvestment Act (ARRA) in 2009 and 2010, coupled with the subsequent decrease in publicly funded projects may account for a majority of the negative income.



This source was estimated in SJ 2 based on budgeted highway construction spending and a ten-year average of other construction. The model was partially revised to account for a strong historical trend in highway construction.

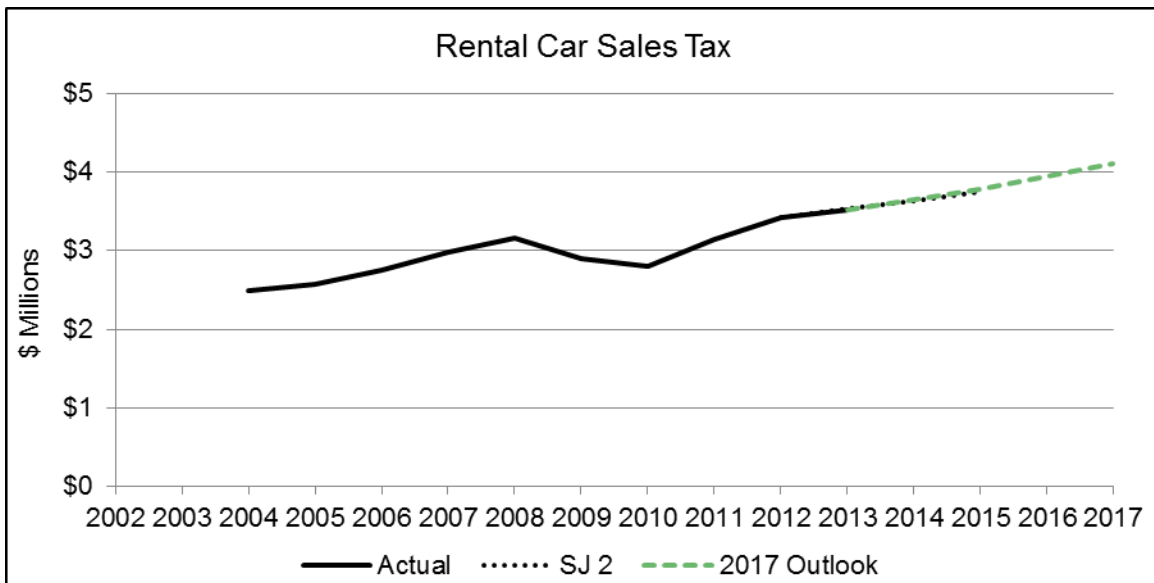
Railroad Car Tax

Railroad car tax revenue has been reasonably consistent over the last several years, and FY 2013 was no exception. Actual FY 2013 collections were less than 1% above the SJ 2 estimate. The outlook revenue based on the IHS forecast of Montana retail sales and the calculated railcar tax rate is very similar to that found in SJ 2, as a small decrease in the tax rate is mostly offset by an increase in forecast retail sales.



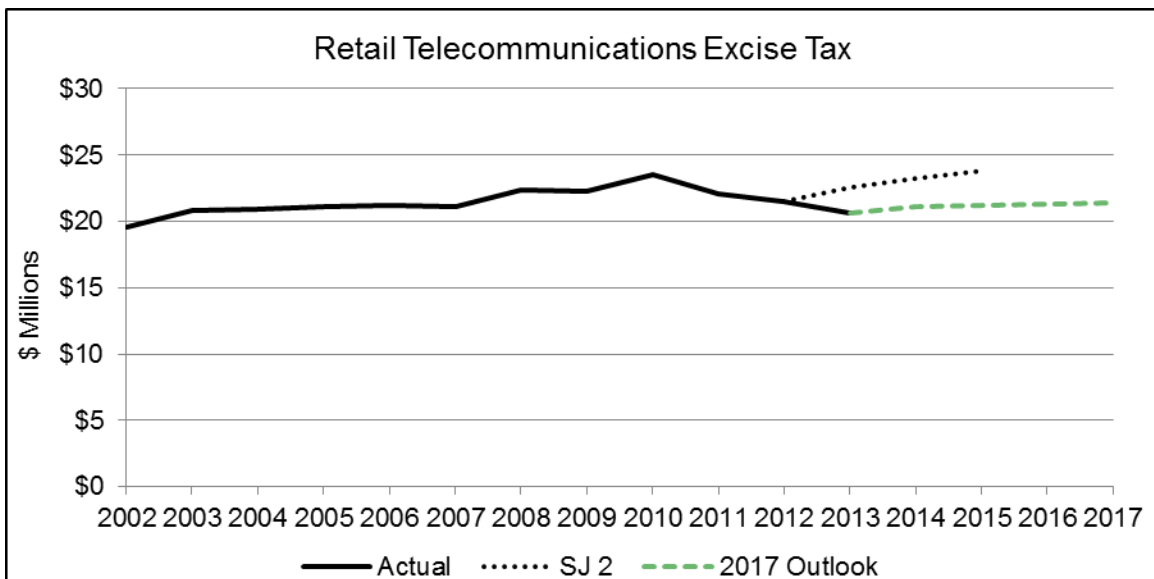
Rental Car Sales Tax

Rental car sales tax collections were very close to the estimate contained in SJ 2 in FY 2013. Rental car sales tax was forecast in SJ 2 based on Montana retail sales; the modeling method for the 2017 outlook has not changed.



Retail Telecommunications Excise Tax

Retail telecommunications excise tax collections were \$2.0 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decline in revenue since FY 2011 is the state's 2011 loss of a court case to allow charging the tax on the pre-paid wireless service. According to the Department of Revenue, the impact of the case is an annual reduction in revenue of approximately \$1.0 million.

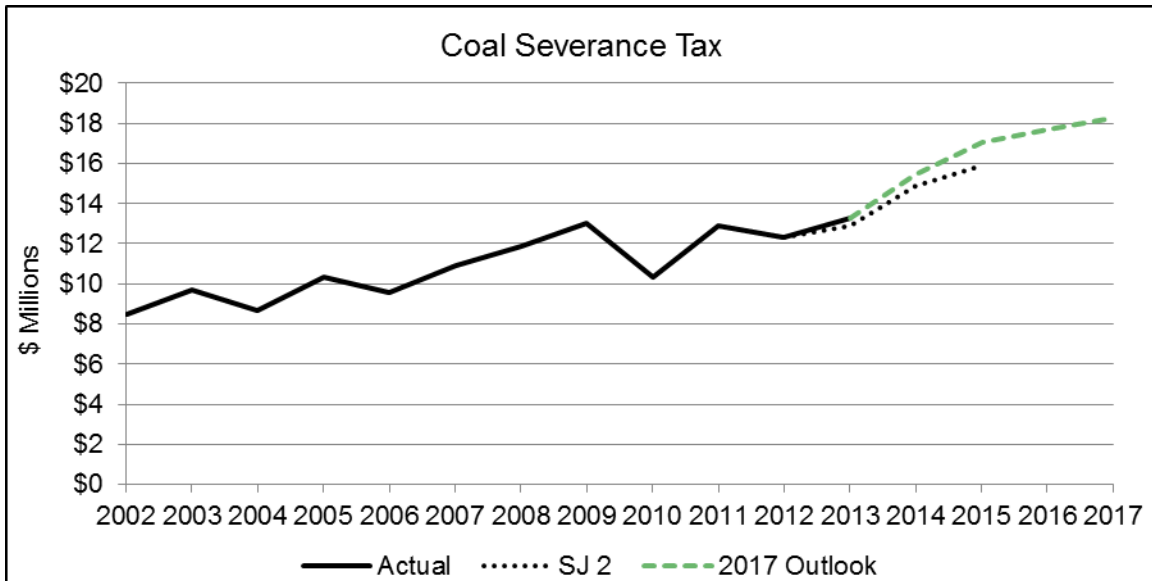


Collections were forecast in SJ 2 based on GSP for the information sector. Revised modeling based on U.S. Census Bureau data for landline use decline and cell phone use growth, and the IHS forecast of Montana population growth suggests slower growth, which is consistent with recent trends.

Other Natural Resource Taxes

Coal Severance Tax

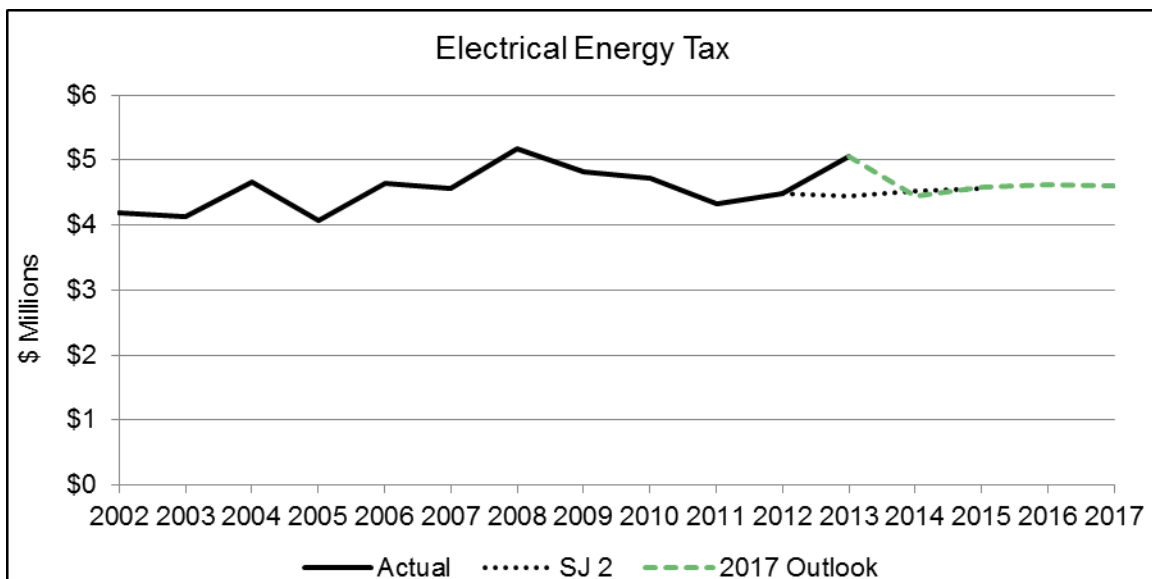
The coal severance tax was above the SJ 2 estimate by \$0.4 million for FY 2013. The revenue outlook continues the increased growth, based on higher production estimates from coal producer surveys; the contract sales price is consistent with the estimate in SJ 2.



Contributing to the general fund growth is SB 100 from the 61st Legislature (2009), which increased the coal severance tax allocation to the Coal Natural Resource account from 2.9% to 5.8%, and expired September 2013. As a result, the allocation the Coal Natural Resource account has reverted to 2.9%, with the other 2.9% returning to the general fund.

Electrical Energy Tax

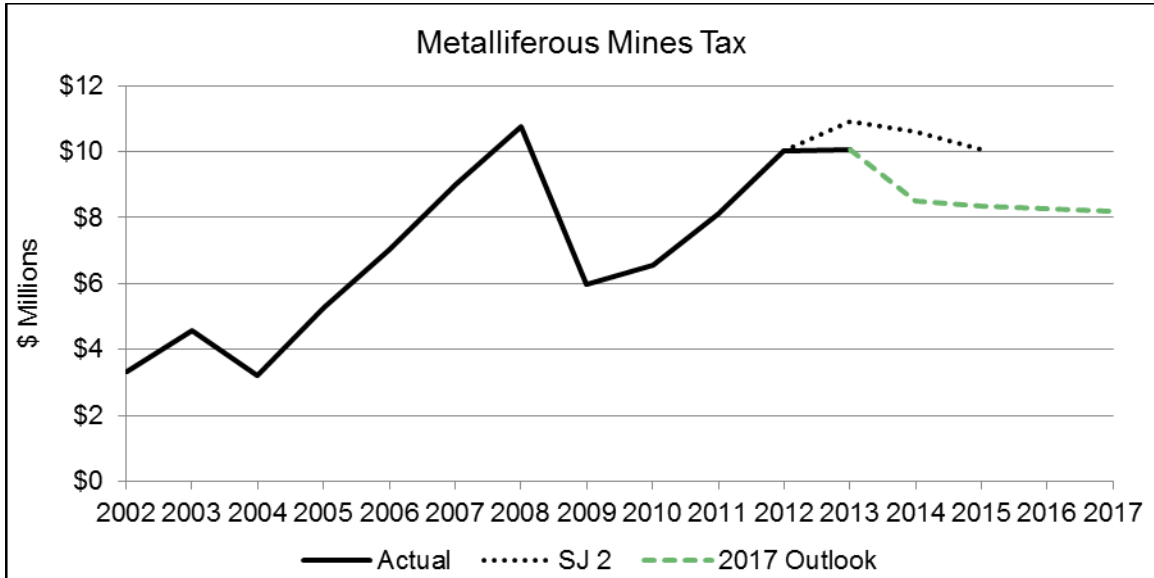
Taxable energy production was below forecast in FY 2013; however, the general fund tax revenue was \$0.6 million (14.1%) above forecast due to an unusual accrual.



The forecast is driven by surveys of electricity producers. New surveys have been conducted, and despite an upturn in production in FY 2013, producers are expecting similar production to the levels contained in SJ 2.

Metalliferous Mines Tax

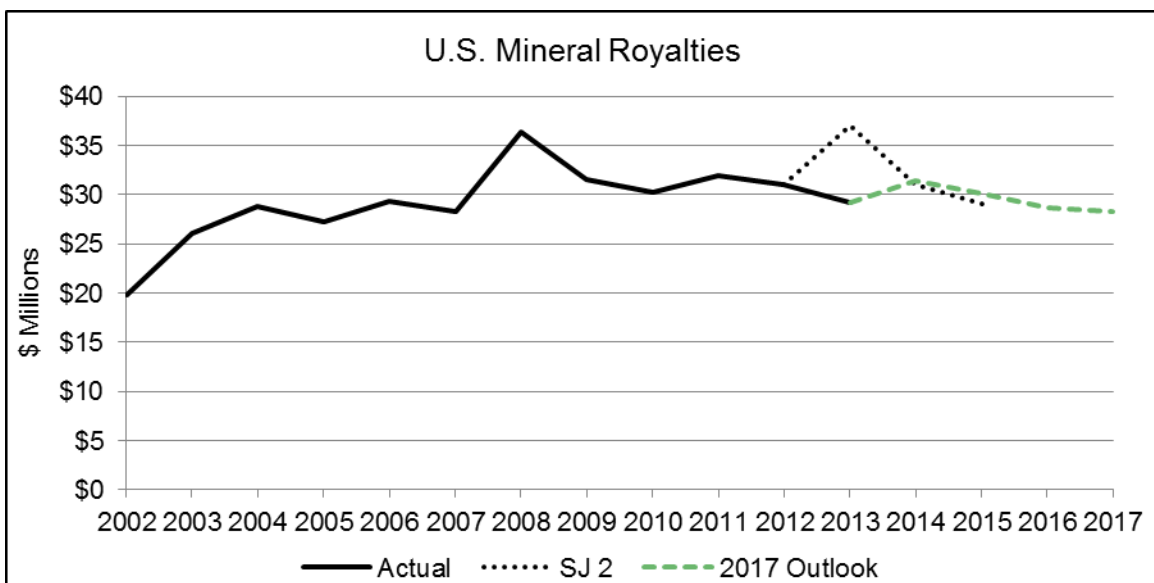
Metal mines tax collections were \$0.9 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decrease in revenue was the lower-than-forecast prices for most metals.



Based on updated survey information provided by each of the major metal mines producers in the state, overall production will decline for some metals in the 2017 outlook period. The decline in production is driving the reduction in expected tax revenue.

U.S. Mineral Royalties

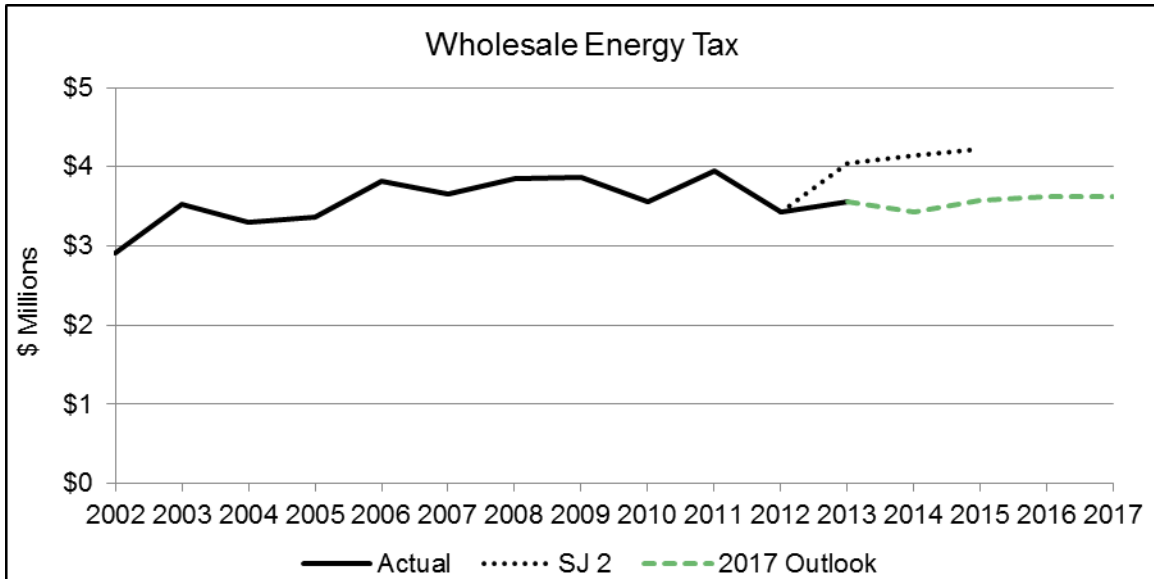
Revenue from U.S. mineral leases in the state was below estimate in FY 2013 by \$7.8 million. The decline was primarily due to two factors: a \$1.6 million decrease in payments due to the sequestration and the loss of a large oil and gas lease that failed to materialize in McCone County.



The revenue outlook includes an increase in FY 2014 primarily due to the \$1.6 million return of the previously sequestered funds, and then declines somewhat in FY 2015 through FY 2017.

Wholesale Energy Transaction Tax

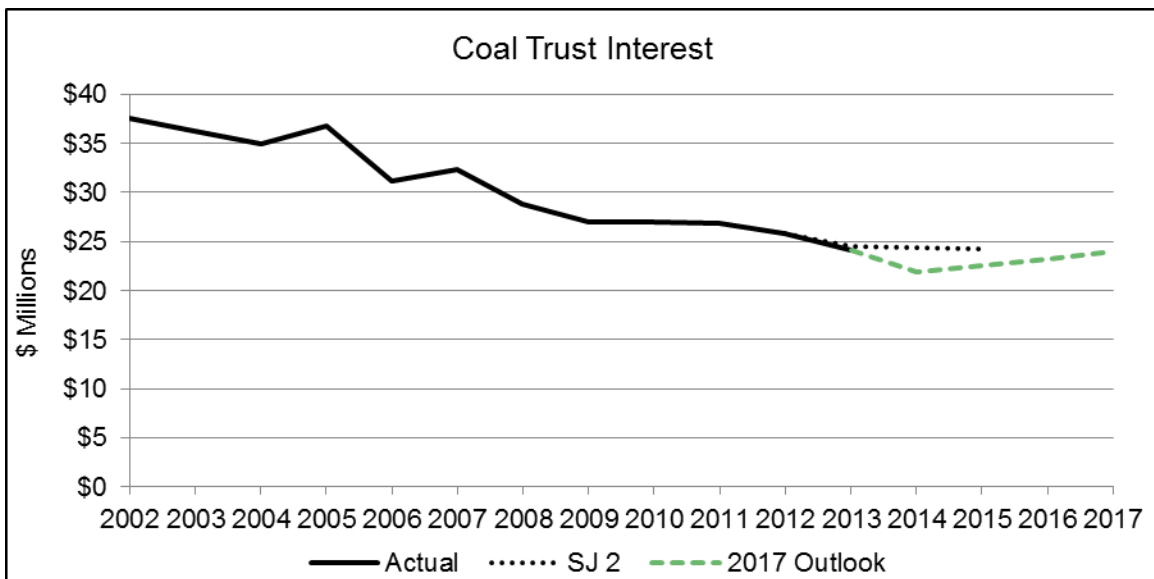
Wholesale energy transaction tax, imposed on transmission services providers, was \$0.5 million below the SJ 2 forecast in FY 2013. The combined kilowatt hours for electrical transmission companies have been revised downward, based on 2013 surveys. The decrease—primarily attributable to out-of-state transmissions—is driving the reduction in the 2017 outlook.



Other Interest Earnings

Coal Trust Interest Earnings

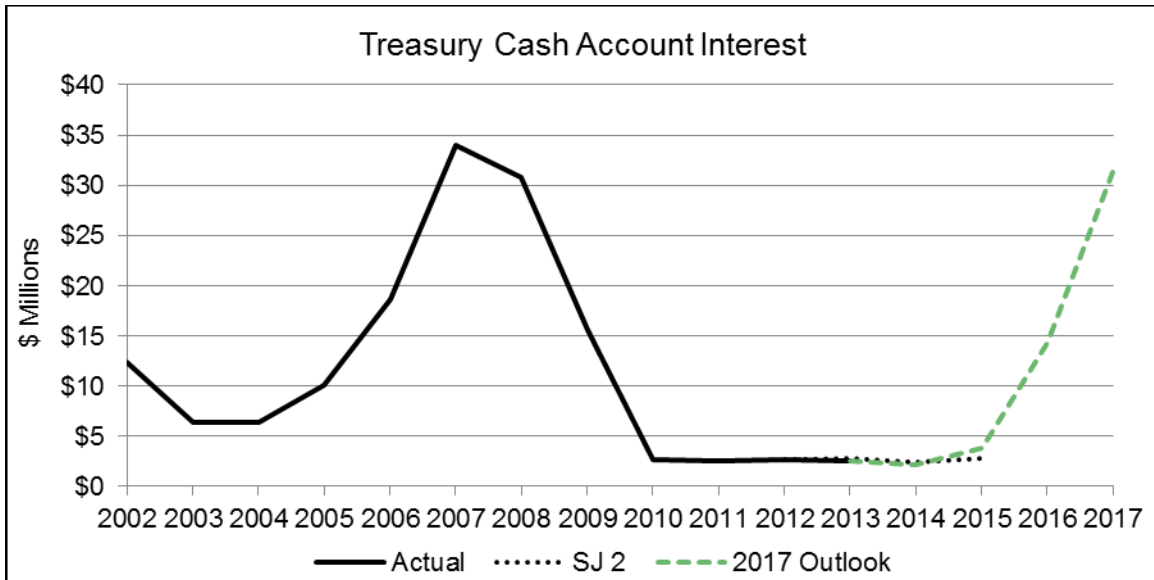
Coal trust earnings were below the estimate contained in SJ 2 by only \$0.3 million in FY 2013. Revenue from this source is estimated using year-end balance amounts and forecast interest rates based on IHS estimates and suggestions from the Board of Investments (BOI).



The model used for this revenue forecast has not changed. The decrease between SJ 2 estimates and the 2017 outlook is due to a slightly smaller return rate than was forecast in SJ 2.

Treasury Cash Account Interest

Based on year-end data for FY 2013, revenue from TCA interest earnings was \$0.3 million below the estimate provided in SJ 2. Low interest rates continue to yield less-than-favorable rates of return for TCA interest earnings.



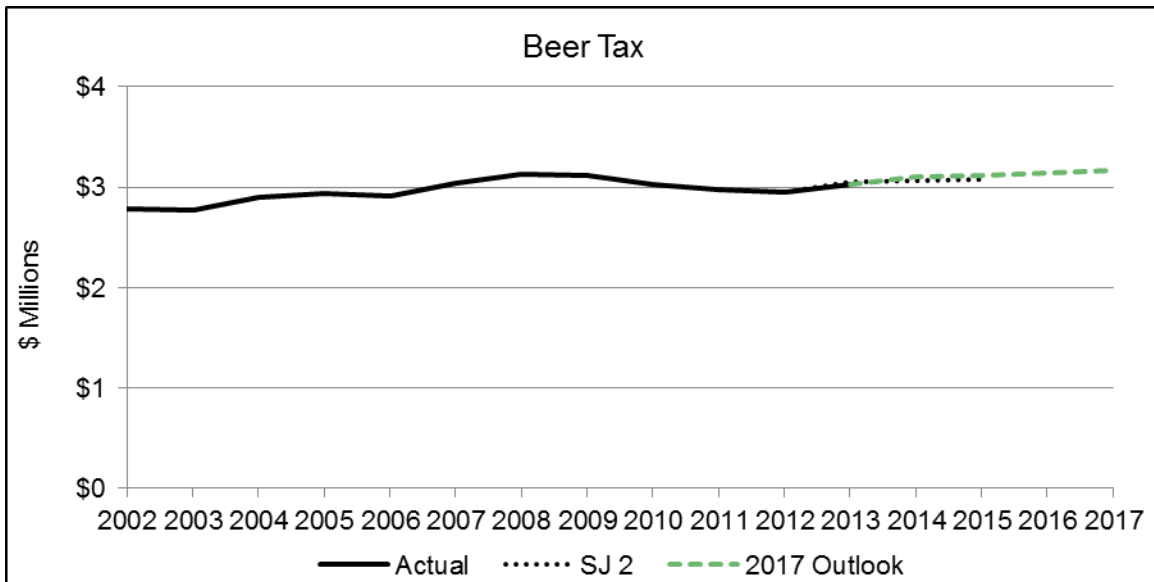
The revenue outlook is based on general fund projections as there is a strong correlation between the average treasury cash balance and total general fund revenue. Using the cash balance estimate, interest rates are forecast using IHS estimates and applied accordingly. The increase in revenue back to levels seen in FY 2006 through FY 2009 is based on the IHS forecast that short-term interest rates will eventually rebound. However, historical IHS forecasts have predicted a rebound in short-term interest rates for the last several years, only to see them remain near zero.

If the IHS forecast for short term interest rates remains strong at the time of the November RTIC revenue estimating meeting, alternative estimates using reduced interest rates may be presented.

Other Consumption Taxes

Beer Tax

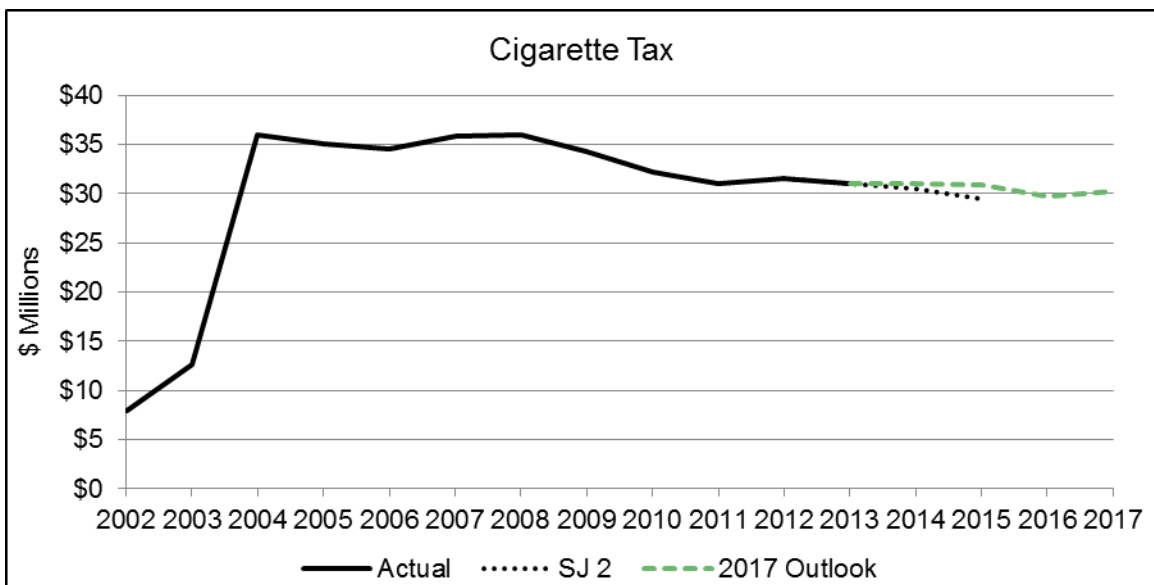
FY 2013 beer tax revenue came in just below the SJ 2 estimate. Although the estimate was low for actual number of barrels sold, it was high for the effective tax rate. Both the SJ 2 estimate and the revenue outlook use a regression of a proxy for barrels sold against Montana retail sales and Montana’s over-21 population. The increase in the outlook revenue is primarily due to the increase in forecast retail sales and population provided by IHS.



Also built into the 2017 outlook is a trend for the changing effective tax rate. The tax rate for distributors moving less than 5000 barrels per year is only \$1.30 per barrel, and for those distributing between 5,001 and 10,000 the rate is \$2.30, much less than the nominal \$4.30 for larger distributors. There is a small but steady decline in effective tax rate as the number of smaller breweries, and therefore smaller distributors, increases. The revised effective tax rate is based on growth trends for the various distributor sizes.

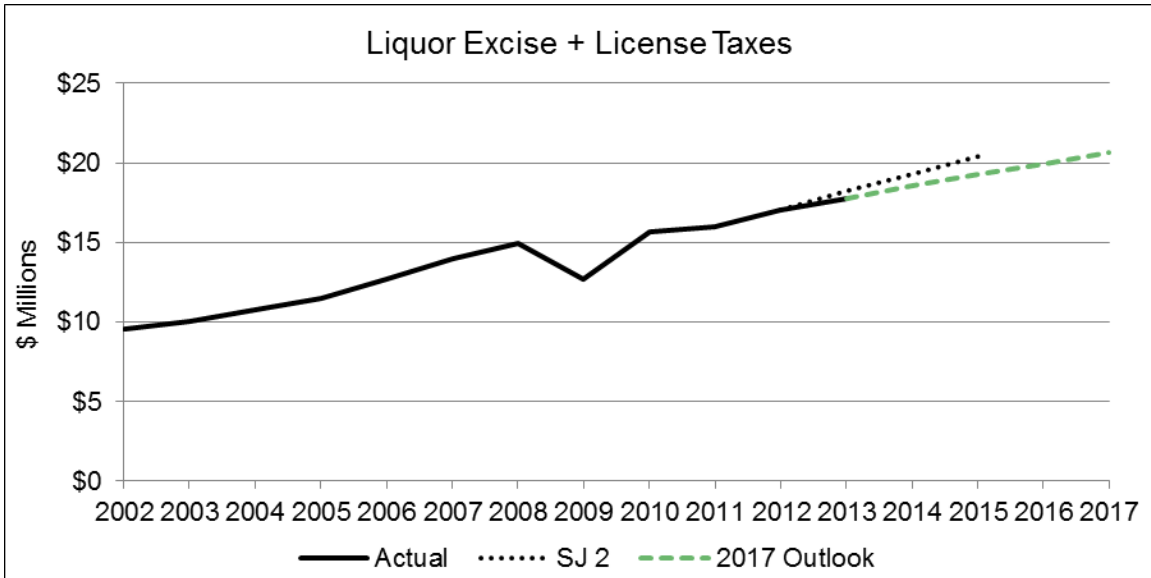
Cigarette Tax

Cigarette taxes slightly exceeded the SJ 2 revenue estimate in FY 2013. For SJ 2, this revenue source was forecast using the independent ratio of the Consumer Price Index (CPI) for tobacco to consumer spending on tobacco products. The 2017 outlook also incorporates the actual packs sold in the previous fiscal year.



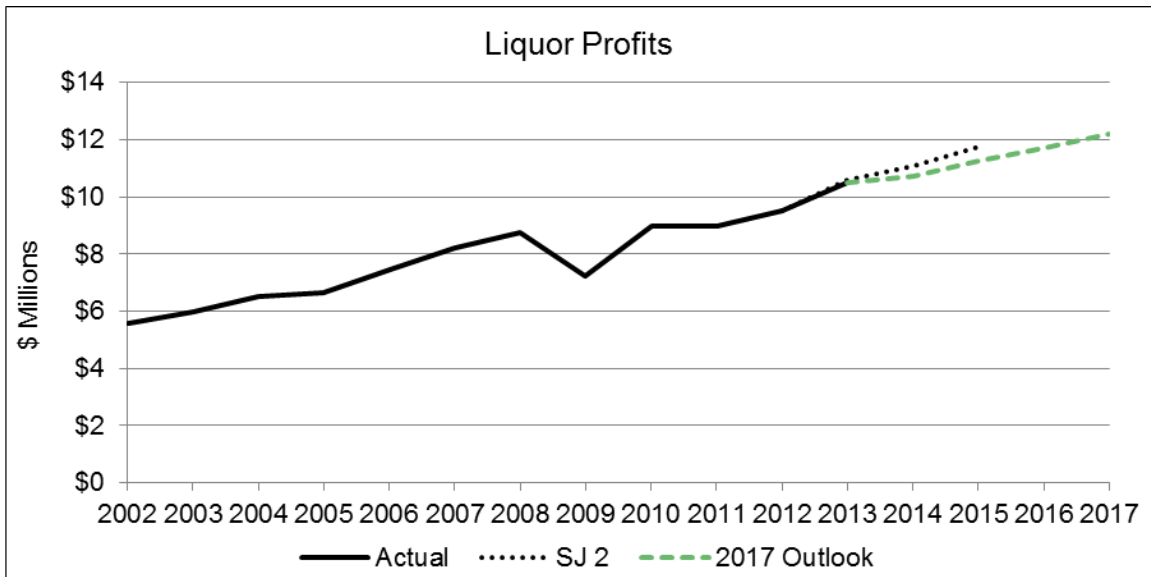
Liquor Excise & License Tax

Liquor excise tax revenue came in \$0.5 million under the FY 2013 estimate in SJ 2. The 2017 outlook is simply adjusted to account for FY 2013 actual collections.



Liquor Profits

FY 2013 liquor profits came in at \$0.1 million below the estimate contained in SJ 2. Since the license and excise rates are constant, the outlook revenue is simply accounts for the FY 2013 actual collections.



Lottery Profits

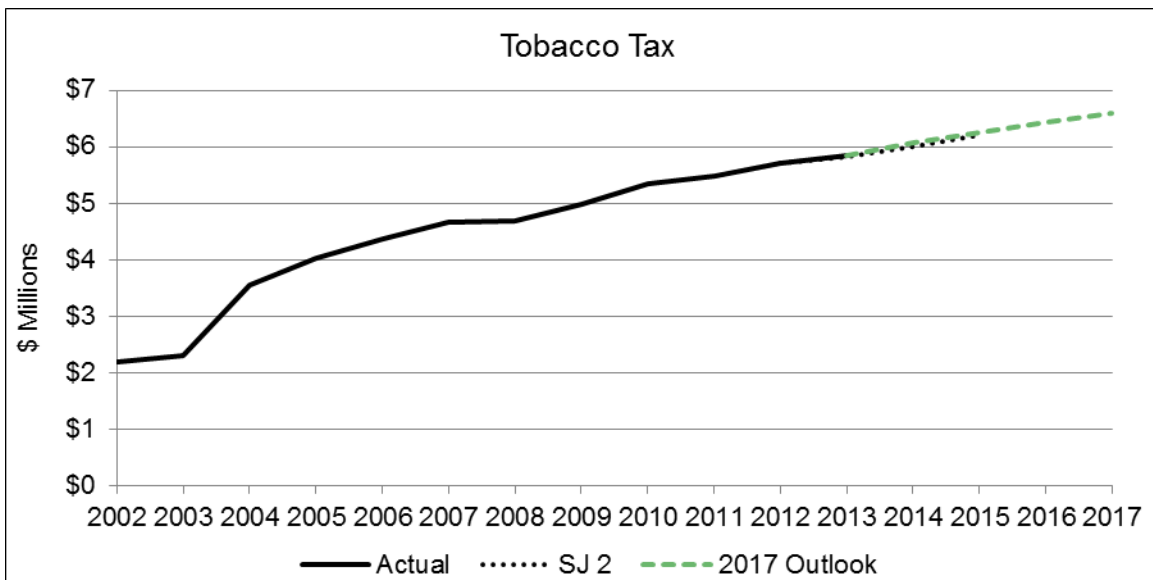
Lottery profits for FY 2013 came in \$1.4 million under the SJ 2 revenue estimate. In FY 2012, there was a transfer of \$0.5 million in appropriation authority from FY 2013, and in FY 2013 the Lottery received supplemental authority for \$2.0 million, of which it spent \$0.8 million. As a result, profits transferred in FY 2013 were reduced by about \$1.3 million. At the time of the SJ 2 estimate, information regarding the FY 2012 transfer was available; however, an adjustment was not incorporated into the estimate. The supplemental appropriation had not yet been made at the time of SJ 2.

Disregarding the one-time-only transfer and supplemental appropriation, the outlook revenue is still lower than the SJ 2 estimates for the next two years. FY 2013 sales were higher than projected in SJ 2, but the prize/ticket ratio was also higher, and incorporating those new numbers into the trend bring profits down slightly. The trended outlook into 2017 is informed by projections for retail sales in the state provided by IHS.



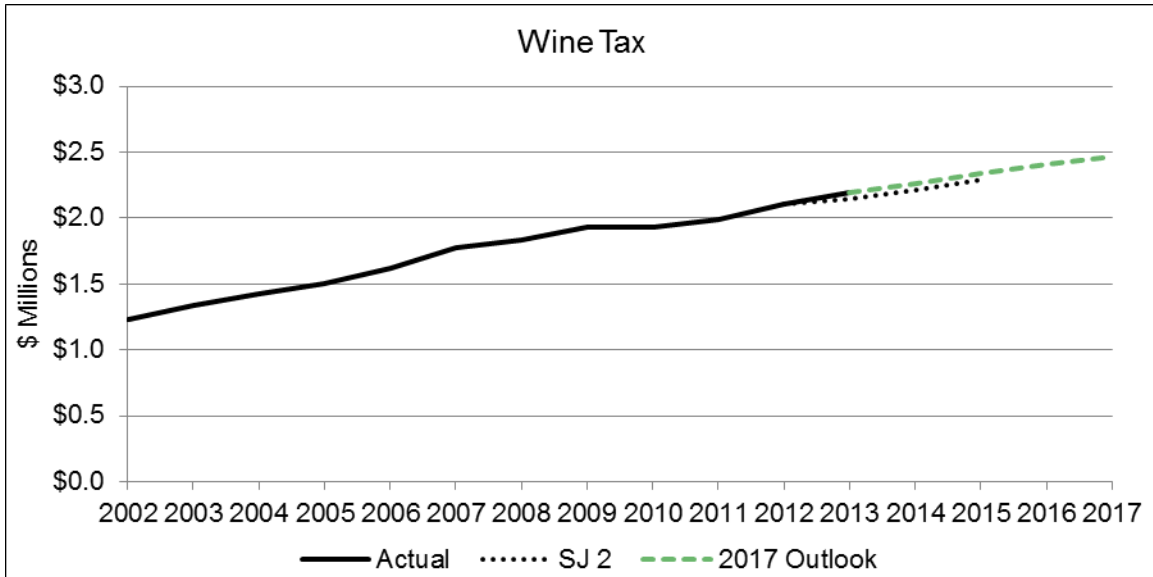
Tobacco Tax

Tobacco tax revenue came in over the SJ 2 estimate in FY 2013 by a very small amount. The underestimate for moist snuff balanced the overestimate for other non-cigarette tobacco products, resulting in a close overall estimate. The methodology for this revenue source has been updated, but the trend has not changed much. Both moist snuff and other tobacco (non-cigarette) products are now forecast using the same variables—Montana retail sales and Montana’s over-18 population—then the respective tax rates are applied and the resulting amounts summed.



Wine Tax

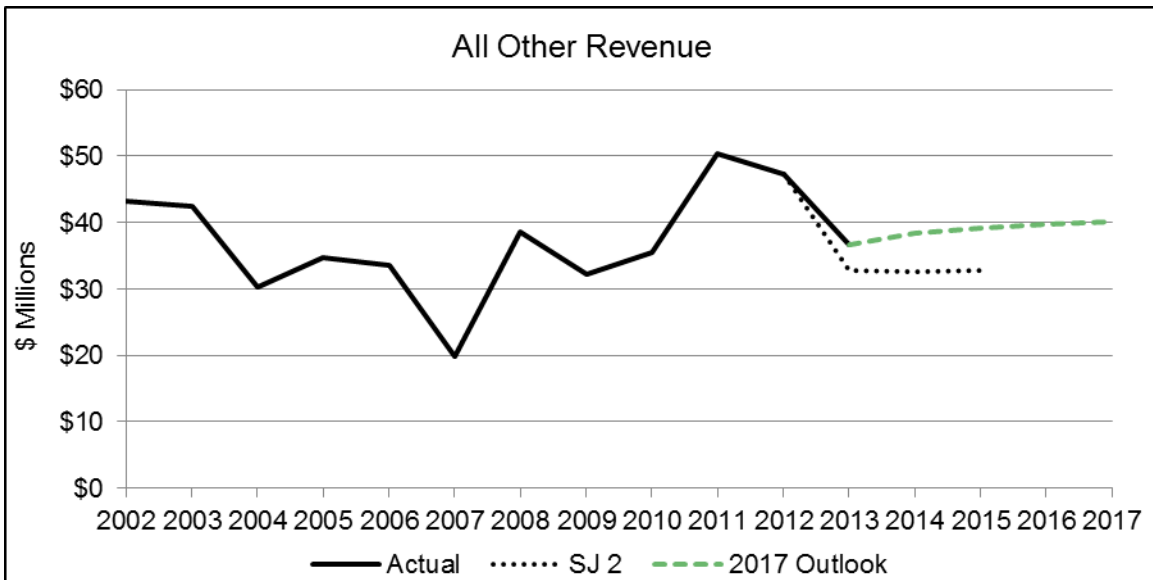
FY 2013 wine tax revenue was above the SJ 2 estimate by \$0.1 million. The 2017 outlook includes FY 2013 actual collections and the updated population estimate from IHS.



Other Sources

All Other Revenue

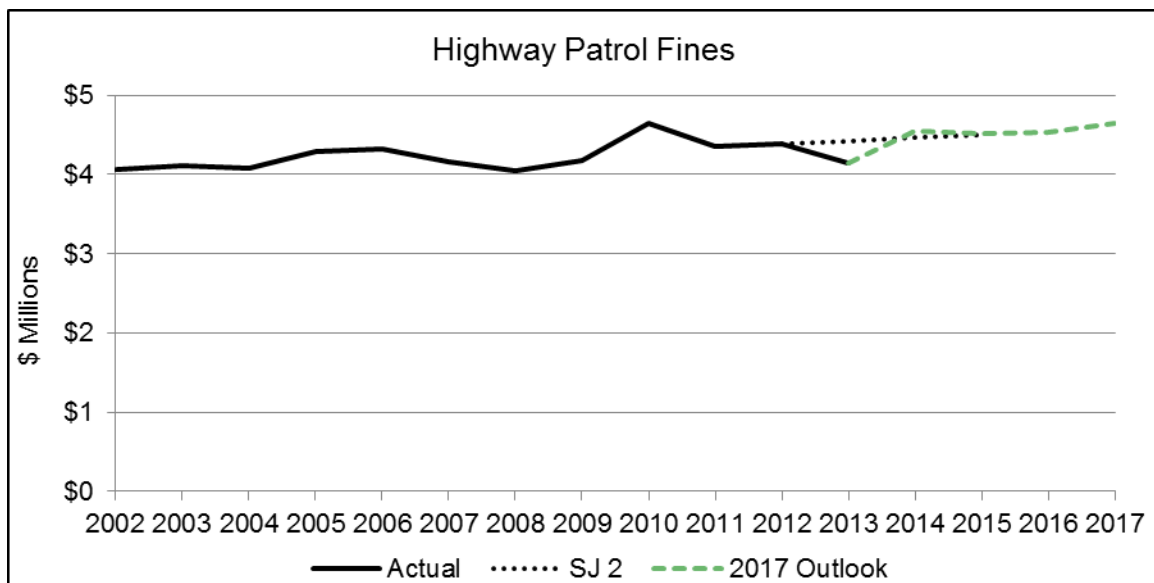
Combined revenue from all other general fund sources exceeded the SJ 2 estimate by \$3.7 million. This was due primarily to increased transfers to the general fund.



The modeling for this source has changed. Previously, numerous sources earning under \$1.0 million were estimated independently. They are now estimated aggregately. The remaining seven sources that typically earn over \$1.0 million are still estimated on an individual basis. The increase in outlook revenue is primarily driven by actual collections in FY 2013.

Highway Patrol Fines

Revenue generated from highway patrol fines in FY 2013 was \$0.3 million less than the estimate provided in SJ 2. The old model used the most recent per capita fine rate in forecast years. The revised model attempts to account for historical fluctuations to estimate the fine rate.



Nursing Facilities Fee

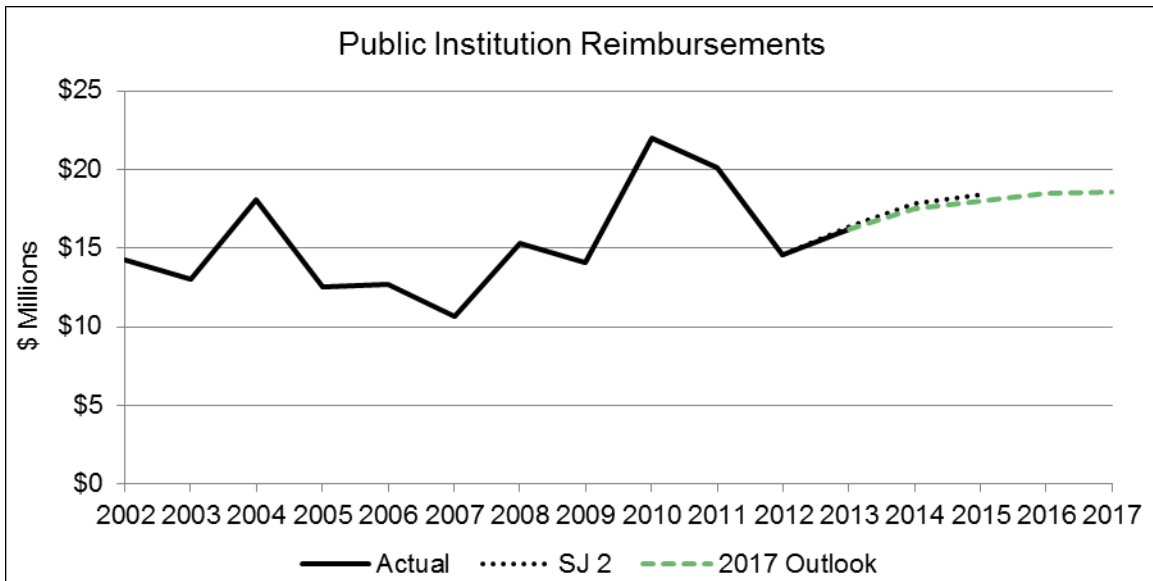
Nursing facilities fees came in \$0.1 million over the SJ 2 revenue estimate in FY 2013. This source has been on a linear decline since 2007; the update continues to use the same linear time trend approach from earlier estimates and includes FY 2013 collections.



Public Institution Reimbursements

Public institution reimbursements were \$0.1 million less than SJ 2 in FY 2013. The revenue outlook is slightly higher than the SJ 2 estimate due to including the FY 2013 actual collections and higher-than-anticipated Medicaid payments. The increase in Medicaid payments appears to be due to higher costs per capita rather than an increase in bed days.

FY 2013 bed days were fewer than anticipated by the SJ 2 estimate, but three of the five facilities saw increases in Medicaid- or Medicare-eligible bed days. Additionally, per-bed-day contributions from Medicare and Medicaid due to changes in coverage were higher than forecast, and higher than previous years.



In general, bed days are expected to continue to decline as community-based services become more available and better funded.

Tobacco Settlement

Tobacco settlement revenue was below the SJ 2 estimate by \$0.2 million for FY 2013 due to a decrease in market share. Changes in the tobacco settlement received by Montana are based on market share of the participating manufacturers and volume of cigarettes sold. The 2017 outlook is slightly below that from SJ 2 due to including actual collections from FY 2013.

