

EXHIBIT 2
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HB HJ 2



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Legislative Fiscal Analyst
CLAYTON SCHENCK

DATE: April 17, 2007

TO: Representative Cohenour
House District 78

FROM: Terry W. Johnson
Principal Fiscal Analyst
Legislative Fiscal Division

RE: General Fund Revenue Trends

This memo is in response to your question about current general fund revenue receipts and how these collections are doing in relation to the revenue estimates contained in HJ 2, the revenue estimate resolution.

Throughout the fiscal year, staff monitors state and national economic activity and assesses the potential impacts of economic events on Montana's general fund revenue trends. In addition to the review of economic data, staff extracts and analyzes year to date revenue collections as reported on the state accounting system (SABHRS). This data is extracted daily but is analyzed more thoroughly at the end of each month. Since historical monthly data is readily available for the past seven years, collection patterns can be identified that provide insight to revenue trends for the remainder of the fiscal year.

As I reported to legislative leadership on February 2, 2007, general fund revenue trends as of the end of January indicated that total collections could exceed the fiscal 2007 estimated amounts contained in HJ 2 by as much as \$63.7 million. Sources expected to exceed estimates were corporation income tax, individual income tax, and treasury cash investment earnings.

As of the end of March, collections from these sources are still showing trends that would indicate that receipts could exceed fiscal 2007 HJ 2 estimates. However, I am concerned about the significant increase in individual income tax refunds that have been issued through the end of March. Refund amounts are up almost 66 percent over last year through the end of March. Possible explanations for these higher refunds include more taxpayers filing electronically and the Department of Revenue (DOR) processing returns more quickly than in previous years. Data

from the DOR on the number of refunds issued this year compared to last year definitely shows there has been an acceleration in the processing of refund claims this fiscal year.

As noted in the February report, the estimate of additional revenue is based on limited available information and that detailed tax return data for corporation and individual income taxpayers will not be available until later in the calendar year. Without tax return information, it is impossible to identify why collections are exceeding expectations. For example, wage income, capital gains income, or royalty income could all be exceeding estimated amounts thereby increasing individual income tax collections. Since this level of detail will not be available until next fall, explaining the reasons for the higher revenue growth would be based on speculation and not on the underlying economic conditions. Because of this, staff would caution the legislature to not extrapolate current trends into fiscal 2008 and 2009. A further reason for this recommendation is that current trends may be due to unusual or one-time events that may not occur in the future. Without a good explanation of why revenues are exceeding expectations, it would be unadvisable to continue these trends into the future.

Finally, total general fund revenues have been increasing by an unprecedented amount since fiscal 2004. During fiscal 2004, 2005, and 2006, total general fund revenues increased by more than 10 percent per year. The sources of revenue that have contributed to this unusual growth are individual income, corporation income, and oil and gas productions taxes. As a cautionary note, historical collection patterns show that periods of high growth are usually followed by a period of slow or negative growth. As discussed in our "Legislative Budget Analysis, 2009 Biennium", the long-term stability of general fund revenues is a significant issue the legislature should discuss. Capital gains income, corporate profitability, and oil and gas price and productions trends are economic "drivers" that can create havoc on a sustainable revenue flow. A biennium budget should not be based on the continuation of unprecedented revenue growth. Economic upturns or downturns are rarely accurately projected nor can disasters or certain world developments be anticipated. Attached for your reference is a section from our budget analysis on the long-term stability of the general fund.

Attachment