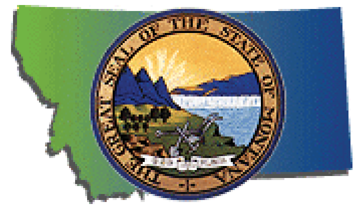
State Revenue Perspectives



Major revenue source contributors to the state general fund (and interrelated state special funds) have experienced deep declines from FY 2008 levels. The revenues declined in FY 2009 and FY 2010. They are expected to increase in FY 2011, but will still be below the FY 2008 level by FY 2013. Rapidly deteriorating economic conditions statewide, nationwide, and worldwide bodes ill for the revenues that finance many state-provided services. Such unprecedented turmoil also complicates the accurate prediction of future revenues and, hence, complicates the budgeting process faced by the legislature. Throughout the 2011 legislative session, LFD revenue staff will periodically update the legislature on changing economic conditions and, if warranted, offer recommendations for amending HJ 2, the official revenue estimates introduced by the Revenue and Taxation Interim Committee (RTIC).

In the sections that follow, the executive's general fund revenue estimates and proposed revenue-related changes are discussed

THE EXECUTIVE'S GENERAL FUND REVENUE FORECAST

EXECUTIVE BUDGET ASSUMPTIONS AND ESTIMATES

The RTIC met on November 19, 2010, and adopted numerous economic assumptions that produced the revenue estimates contained in HJ 2, the revenue estimating resolution. At this meeting, state economists as well as representatives of the executive provided input to the committee with their respective views on Montana's current economic conditions and the outlook for the 2013 biennium. After receiving testimony from the various individuals, the RTIC unanimously adopted the recommendations of the Legislative Fiscal Division staff. These estimates, when compared to the executive, showed a difference for all general fund sources over the three year period FY 2011 through FY 2013 of $45.5 million or 0.87%.

On December 15, 2010, the executive proposed some additional budget adjustments to its November 15 recommendations. Contained in those recommendations were increased revenue estimate adjustments of $118.7 million. The executive revenue estimates are now $164.2 million (3.1%) more than the estimates adopted by RTIC on November 19, 2010.

These upward revisions were based on year-to-date revenue collections for FY 2011. The executive's view is that economic information such as "predictions of economic growth, oil prices, and the like" is not timely enough, and that this information impacts revenue estimates "only indirectly, not directly." The executive also points out that current revenue collections are a good indicator of what is happening today – "a key data point that is not lagging and that is not a proxy for revenue collections." Although these arguments may have some validity, the following points should be considered before making conclusions that significantly impact the services provided to the citizenry of Montana.

A fundamental principle of revenue estimating is that all revenue sources (taxes, fees, investment earnings, etc.) are driven by underlying economic conditions—conditions that are prevalent at the state, national, or global level. To assume that these conditions have only an "indirect" impact is erroneous. Each revenue source has a set of economic drivers that determines its collection pattern. For example, individual income tax or oil production tax or investment earnings cannot be estimated without understanding the relationship between the revenue and its respective driver—wage income, oil prices, or interest rates—and external economic conditions.

Using year-to-date revenue collections as a validation or reference point is not inappropriate, nor is it new. In fact, this process should be used to verify that the economic relationships and the mathematical models used to determine anticipated revenue collections have been developed appropriately. To abandon the models and revert to a validation technique, however, is inappropriate, prone to non-economic variability, and highly speculative. This would be analogous to a physician deciding to perform a surgical procedure without performing the necessary test to determine what is wrong with the patient. An appropriate revenue estimating process determines what economic conditions are causing the change in year-to-date revenue collections.

The revised revenue estimates by the executive are not based on new or revised economic conditions. The argument is that collections are above last year through November; therefore, collections will to be higher for the remainder of the year. Future revenues are extrapolated from year-to-date collections based on a historical average observed over several years. This new base is higher in FY 2011 than the initial estimate, and FY 2012 and FY 2013 are driven off the higher base year resulting in higher estimates for those two years. This approach disconnects the executive revenue estimates from any quantifiable relationship between economic conditions and anticipated revenue collections.

This technique provides a new executive estimate that is $118.7 million greater than originally estimated just a month ago. The obvious question would be what economic conditions have changed recently that would improve the revenue outlook so dramatically. Has Montana's unemployment rate declined, have oil prices increased substantially, or have interest rates moved upward?

It is clear that the executive methodology is dependent upon an accurate extrapolation of current year trends. If the new base year (FY 2011) is flawed, then the entire forecast period (FY 2011 through FY 2013) is inaccurate. As previously mentioned, using current year collections as a revenue estimating methodology is inappropriate and highly sensitive to historical collection patterns as well as anomalies in current collections. For example, during FY 2010, the Department of Justice was implementing a new computer system (MERLIN) for the processing of motor vehicle fees and taxes. Part of this system was designed to interface with the state accounting system (SABHRS). This interface was not working correctly during FY 2010 but was eventually corrected by the end of FY 2010. A comparative analysis of collections through November of this year versus last year showed that this year's collections are up almost $30 million or 440% over last year. This increase was due to the interface problem of the new system and had nothing to do with an improvement in economic conditions. Adjusting the comparison analysis for this issue changes the total general fund year to date growth rate from 12.7% to 5.1%. With this one adjustment (there are many others), the adjusted percentage (5.1%) portrays an entirely different revenue picture versus using the unadjusted percentage (12.7%).

The executive shows that, on average, 26.5% of total fiscal year collections are received by the end of November. Using this percentage, it is simple to extrapolate year-to-date collections to a FY 2011 amount of $1,732 million ($459.245 million through November divided by 26.51%). But this calculation is based on the accuracy of the historical percentage and a "normal" amount collected through November. A 1% increase in the historical percentage decreases the FY 2011 extrapolation by $63 million from $1732 million to $1669 million. This small variation in the historical percentage would decrease the total executive revenue estimates for the three year period by $189 million. The probability of a 1% variation in this percentage is high. The standard deviation (a measure of how widely values are dispersed from the average value or mean) is 1.5%. The higher the standard deviation, the greater the variation is in the data series.

In additional to the variability problems associated with a historical percentage, any unusual year to date collections can also skew the FY 2011 extrapolation technique. For every $1.0 million variation in year-to-date collections, the FY 2011 estimate will change by $3.8 million. Other words, if FY 2011 year to date collections were overstated by $10 million by the end of November, the extrapolation technique would produce a higher estimate for FY 2011 of $38 million or $114 million for the three year period.

Finally, any revenue estimating analysis should be focused on understanding what economic conditions determine the level of anticipated revenue. This analysis should include a thorough review of all current economic conditions as well as the outlook for the future. Montana subscribes to national forecasting firms, IHS Global Insight and Moody's Analytics. Both of these companies provide monthly economic updates to staff of the Legislative Fiscal Division as well as the executive. In addition to this information, the Bureau of Business and Economic Research (Missoula), Department of Agricultural Economics (Bozeman), and the Department of Labor and Industry have all provided valuable information and perspectives into the revenue estimating process. It has been made extremely clear by all entities that the current economic recovery is going to be very slow and gradual both at the state and national level. To arbitrarily ignore the wealth of information and justification provided by these professionals should not be ignored by the legislature. If a consistent trend of improved year-to-date revenue collections becomes apparent during the legislative session, the legislature needs to fully understand the economic conditions that are causing the change. These changes can then be amended into HJ2 to provide an appropriate audit trail as well as transparency in the legislative budgeting process. Year-to-date revenue collections are not the reason – they are the result.

As shown in Figure 1 below, the executive has revised its revenue estimates from those presented to the RTIC in November. The revision is based on year-to-date collection activity; the *Governor's Executive Budget, Fiscal Years 2012 – 2013* now projects that

Montana state government will receive $3.684 billion in general fund revenue in the 2013 biennium, an increase of $324.8 million, or 9.7%, from the 2011 biennium.

Figure 1

Executive Revised Revenue Estimate Recommendations - General Fund

Figures in Millions

	Actual FY 2010	Estimated FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium	Biennial $ Change	Biennial % Change
Individual Income Tax	$717.834	$741.072	$767.443	$819.359	$1,458.907	$1,586.802	$127.895	8.8%
Property Tax	222.510	231.464	238.437	242.531	453.974	480.968	26.994	6.0%
Corporation Income Tax	87.901	111.654	125.831	132.679	199.555	258.510	58.954	29.5%
Vehicle Tax and Fees	103.862	107.298	110.491	111.288	211.159	221.779	10.620	5.0%
Oil and Gas Production Tax	95.491	98.223	104.910	110.297	193.714	215.208	21.494	11.1%
Remaining Sources	399.547	404.394	409.993	429.990	803.941	839.983	36.042	4.5%
Upward Revision		37.930	39.370	41.410	37.930	80.780		
Total	**$1,627.145**	**$1,732.035**	**$1,796.475**	**$1,887.554**	**$3,359.180**	**$3,684.029**	**$324.849**	**9.7%**

PROPOSED REVENUE-RELATED CHANGES

The Executive Budget contains a number of proposals that would impact state general fund revenue, most of which are on-going in nature. As shown in Figure 2, these proposals would increase general fund by a net $23.8 million in the 2011 biennium and $24.8 million in the 2013 biennium. It should be noted that on-going changes will reduce general fund revenue by $26.5 million in the 2013 biennium and $46.8 million in the 2015 biennium and beyond. The proposals are as follows:

Tax Proposals

- $36.0 million loss in revenue (on-going) due to a credit for homeowners. This proposal would provide a $50 credit to homeowners on their 2011 individual income tax returns and $100 credit in subsequent years.
- $22.0 million loss in revenue (on-going) due to proposed business equipment exemption threshold increase. The proposal would increase the threshold from $20,000 to $200,000 beginning in 2012, and further increase it to $500,000 beginning of 2013. As of this writing, the executive has not determined all the details of the change.
- $5.8 million in new revenue (on-going) due to proposed legislation that would move the corporate statute of limitation from 3 to 5 years to match the law for individuals
- $5.6 million in new revenue (on-going) due to proposed legislation that would require non-residents who sell an interest in a Montana business to report and pay taxes on the gain
- $5.3 million in new revenue (on-going) due to proposed legislation that would counter a number of tax sheltering techniques used by companies to shift income earned in the U.S. to overseas locations

- $5.0 million in new revenue (on-going) due to proposed legislation that would enhance tax compliance
- $4.3 million in new revenue (one-time) due to proposed legislation that would eliminate corporate net operating loss carrybacks
- $4.0 million in new revenue (on-going) due to proposed legislation that would equalize the federal income tax limitations for trusts with the limit for individuals
- $3.0 million in new revenue (on-going) due to proposed legislation that would require withholding on non-residents for sale of property greater than $250,000

Transfers to the General Fund

- HB 5—Long Range Building Program
- HB 10—Long Range IT Program
- HB 11—TSEP
- HB 11—Regional Water
- HB 42—Coal Bed Methane Account
- HB 48—Fire Supression Account
- HB 140—Big Sky Economic Development
- Natural Resource Damage
- Health Care & Benefits

Additional details of these transfers can be found in Chapter 6—Major Issues *Facing the Legislature.*

State Special Revenue Changes

Oil and Gas Proposal

The executive proposes to remove the payment of the quality educator payment from the state general fund and pay for it from a new state special revenue fund called the Teach Montana Fund, beginning in FY 2012. The revenue to pay for this payment would come from oil and natural gas revenues that currently are distributed to school districts. The executive proposes to reduce the school districts' shares by an average of 90 percent and readjust the other distribution percentages so that the state general fund, other state accounts, county governments, and county education accounts receive the same revenue as under current law.

The executive does not say how much revenue this would generate for the Teach Montana fund. The table below shows actual receipts by school districts in all school funds of oil and gas revenues between FY 1997 and FY 2010. There were only two years in which total revenues equaled or exceeded the amount of revenue needed to fully fund the quality educator payment at $38.3 million per year. During FY 2010, ninety percent of oil and gas revenues would have supplied only $30.2 million to the Teach Montana fund.

Historical Oil and Natural Gas Revenues Received by School Districts, All Funds, FY 1997 - FY 2010		
FY	Total Oil and Gas Revenues to School Districts	Ninety Percent of District Oil and Gas Revenues
1997	8,081,678	7,273,510
1998	8,581,361	7,723,225
1999	5,621,092	5,058,983
2000	7,089,591	6,380,632
2001	17,452,041	15,706,837
2002	13,457,837	12,112,053
2003	9,491,882	8,542,694
2004	16,944,595	15,250,135
2005	22,171,246	19,954,121
2006	34,744,530	31,270,077
2007	39,927,913	35,935,122
2008	47,242,301	42,518,071
2009	64,305,279	57,874,751
2010	33,593,529	30,234,176

However, revenue estimates for oil and gas revenues adopted by RTIC on November 19, 2010 imply that oil and gas revenues received by school districts under current law may be between $38 million and $40 million in FY 2011 through FY 2013. Ninety percent of these estimates would not fully fund the quality educator fund.

The executive's proposal begins the redistribution of oil and gas revenues beginning with revenue from production that takes place in the 2nd calendar quarter of 2011. Because of this, the additional oil and gas revenues received by the state will represent 5 quarters of receipts in FY 2012 and 4 quarters in fiscal years after that. The additional oil and gas revenue is estimated to be $45.4 million in FY 2012 and $35.6 million in FY 2013. This totals $81.0 million for the 2013 biennium, which would be enough to pay for the quality educator payment in the 2013 biennium. However, it is expected that in the 2015 biennium, oil and gas revenues would only total $61.5 million.

School Districts with Oil and Gas Revenue
FY 2010
Oil and Gas Revenue as a Percentage of Maximum General Fund Budget

O&G Revenue as Percent of Maximum Budget	Number of Districts	Percent of Total	Average Size of District	Average Ending Fund Balances per ANB
Less then 0.1 percent	14	11%	290	2,087
0.1 percent - 10 percent	76	58%	222	3,904
10.1 percent to 50 percent	23	18%	142	5,445
50.1 percent to 75 percent	3	2%	64	30,234
75.1 percent to 100 percent	4	3%	115	10,254
100.1 percent to 200 percent	6	5%	124	27,385
200.1 percent to 300 percent	1	1%	408	92,027
Greater than 300 percent	3	2%	31	170,997
Total and Average	130	100%	201	6,751

EFB is for all fund but excludes miscellaneous programs fund and impact aid fund

There are 130 school districts in 33 counties that received at least some oil and gas revenue in FY 2010. Most of the districts along the northern tier of counties produce predominantly natural gas and most of the districts in eastern Montana produce predominantly oil.

Most of the districts that receive oil and gas receive only a small amount of revenue. The chart above shows several categories measured as oil and gas revenues received in FY 2010 as a percent of a district's FY 2010 maximum general fund budget. Of the 130 school districts receiving oil and gas revenues, 90 districts, or 69%, report oil and gas revenues at or below 10% of their maximum budgets. An additional 26 districts report that oil and gas revenues are between 10% and 75% of their maximum budgets. Fourteen districts, or 11%, report oil and gas revenues in excess of 75% of maximum budgets. Three of these district report oil and gas revenues in excess of 300% of their maximum budgets. These three are all in Richland County and are small districts.

On average, all the districts receiving oil and gas revenues are small. The largest with substantial oil and gas revenues are Sidney high school (430 ANB) and Baker K-12 (408 ANB).

The chart also shows ending fund balances for each category of oil and gas revenues as a percent of maximum budget. Ending fund balances include all school district funds except those that receive primarily federal funds, the miscellaneous program fund and the impact aid fund. There appears to be a positive correlation between substantial receipts of oil and gas revenues and ending fund balances in district accounts.

The executive's proposal to fund the quality educator payment with redistributed oil and gas revenues puts the quality educator payment at risk should either oil and natural gas prices decrease and/or production declines. Regardless of which fund the quality educator payment is made from, current law requires it must be paid. If the oil and gas revenue from the districts is not sufficient, there will have to be a supplemental from the general fund in the 2013 session to pay for the shortfall.

Streambed Rent fund switch

HB 152 from the 2009 legislative session directed that streambed rents, rents owed to the state by the owners of dams for the property the dam and the reservoir behind it sit on, be deposited in the school facility and technology account beginning in FY 2012. Currently, streambed rents are deposited in the guarantee account and provide revenue for K-12 BASE aid.

The executive proposes to continue deposition of streambed rents into the guarantee account through FY 2013. The executive calls this a "transfer" of $20 million during the 2013 biennium. Currently only Avista and Pacificorp pay approximately $4.1 million per year (growing with inflation) into the school facilities and technology account. PPL, the other company with substantial dam property, has not paid the state because PPL has sued over the issue.

In PPL Montana, LLC v. State, 2010 MT 64, the Montana Supreme Court determined that title to the riverbeds of the Missouri, Clark Fork, and Madison Rivers passed to Montana when it became a state in 1889. As part of the decision, the Court upheld the District Court's methodology of calculating damages, and PPL was ordered to pay approximately $41 million (plus interest) in compensatory damages to the state for improper use of the streambed. PPL subsequently filed a petition with the US Supreme Court, asking it to hear the case. On November 1, 2010, the US Supreme Court referred the case for comment to the US Solicitor General. The case remains at the Office of the Solicitor General at this time.

If calculated in accordance with the way streambed rents are calculated for Avista and Pacificorp, the ongoing revenue due if PPL loses the case would amount to around $6.7 million per year, with an inflation adjustment each year.
The combined stream-bed rents would amount to around $10.9 million per year. If PPL loses and the executive's proposal passes, this money would be deposited in the guarantee account in FY 2012 and FY 2013 and be available to offset general fund in paying for K-12 BASE aid. It would then be deposited in the school facility and technology account in FY 2014 and beyond.

If PPL wins their case, it is likely that no streambed revenues will be forthcoming from Avista and Pacificorp.

Figure 2 summarizes the executive's tax and revenue proposals. As shown at the bottom of Figure 2, the executive is proposing $75.2 million of one-time transfers for the three-year period, FY 2011 through FY 2013. These transfers can be problematic for maintaining a structural balance.

The executive also proposes to permanently reduce revenue—beginning at a cost of $26.5 million in the 2013 biennium and growing to a cost of $46.8 million in the 2015 biennium. From a structural balance perspective, the difference ($20.3 million) will need to be budgeted for by the 2013 legislature.

Finally, the state special revenue changes proposed by the executive show that $28.1 million less revenue will be available to fund schools in the 2015 biennium. Between the tax proposals and the school funding proposal, there will be $48.4 million less revenue available to fund government services. This budgeting strategy exacerbates the structural balance issue for the 2013 legislature

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Figure 2

Executive Tax and Revenue Proposals
Figures in Millions

Proposal	2011 Biennium	2013 Biennium	2015 Biennium
Tax Proposals			
Tax cut for homeowners		($22.040)	($27.000)
Revise business equipment tax		(36.000)	(48.000)
Revise corporate tax audit advantage		5.800	5.800
Eliminate Nevada tax dodge		5.600	5.600
Eliminate foreign country tax shelter		5.300	5.300
Enhanced tax compliance package		5.000	6.000
Eliminate corporate net operating loss carryback		4.300	0.000
Technical fix to SB 407 (2003 Session)		4.000	4.000
Non-resident high-value real estate withholding		1.500	1.500
Net tax proposals		(26.540)	(46.800)
Transfers to the General Fund			
HB 5 - Long Range Building Program	$11.686	0.000	0.000
HB 10 - Long Range IT Program	10.737	0.000	0.000
HB 11 - TSEP	0.000	17.614	0.000
HB 11 - Regional Water	0.000	4.867	0.000
HB 140 - Big Sky Economic Development	0.000	2.890	0.000
HB 42 - Coal Bed Methane Account	0.000	6.000	0.000
HB 48 - Fire Supression Account	0.000	20.000	0.000
No Bill - Natural Resource Damage	1.300	0.000	0.000
No Bill - Health Care & Benefits	0.100	0.000	0.000
Transfers subtotal	23.823	51.371	0.000
State Special Revenue Changes			
HB 136 - Streambed rent reallocation*		8.560	
HB 136 - Local school district oil and gas redistribution		81.027	61.492
State special revenue subtotal		89.587	61.492
Total General Fund	23.823	24.831	(46.800)
On-going		(26.540)	(46.800)
One-time-only	23.823	51.371	0.000
Total State Special		89.587	61.492
Total	$23.823	$114.418	$14.692

*Does not include the additional revenues in the pending PPL court case. Potential revenue is $12.790 million in the 2013 biennium.

THE RTIC GENERAL FUND REVENUE OUTLOOK

RTIC FORECAST IS LOWER THAN THE EXECUTIVE BUDGET

A summary of the major revenue estimates that were adopted by RTIC (contained in HJ 2) is shown in Figure 3 below. The estimate for the 2013 biennium is $280.5 million more than the 2011 biennium estimate. All major sources and the remaining sources collectively are forecast to increase; however, most sources are growing only gradually and the risks to growth outlined in the previous chapter must be considered.

Figure 3

HJ 2 Revenue Estimate Recommendations - General Fund
Figures in Millions

	Actual FY 2010	Estimated FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium	Biennial $ Change	Biennial % Change
Individual Income Tax	$717.834	$738.761	$781.891	$825.590	$1,456.595	$1,607.481	$150.886	10.4%
Property Tax	222.510	229.084	237.809	242.859	451.594	480.668	29.074	6.4%
Corporation Income Tax	87.901	103.320	123.315	128.179	191.221	251.494	60.273	31.5%
Vehicle Tax and Fees	103.862	107.025	106.615	106.999	210.887	213.614	2.727	1.3%
Oil and Gas Production Tax	95.491	101.421	101.803	100.119	196.912	201.922	5.010	2.5%
Remaining Sources	399.547	392.522	402.334	422.217	792.069	824.551	32.482	4.1%
Total	**$1,627.145**	**$1,672.133**	**$1,753.767**	**$1,825.963**	**$3,299.278**	**$3,579.730**	**$280.452**	**8.5%**

As shown in Figure 4, the RTIC revenue estimates for the 2011 and 2013 biennia are $59.9 million and $104.3 million lower, respectively, than the revised executive estimates. This is due primarily to the executive's revision based on year-to-date collections. The RTIC estimates for individual income and corporation income taxes appear to have significant differences from the executive; however, nearly all of the difference can be attributed to the categorization of partnership income.

Figure 4

RTIC vs. Executive Revised Revenue Estimate Recommendations - General Fund
Figures in Millions

	Actual FY 2010	Estimated FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium
Individual Income Tax	($0.000)	($2.311)	$14.448	$6.231	($2.312)	$20.679
Property Tax	0.000	(2.380)	(0.628)	0.328	(2.380)	(0.300)
Corporation Income Tax	0.000	(8.334)	(2.516)	(4.500)	(8.334)	(7.016)
Vehicle Tax and Fees	0.000	(0.273)	(3.876)	(4.289)	(0.272)	(8.165)
Oil and Gas Production Tax	0.000	3.198	(3.107)	(10.178)	3.198	(13.286)
Remaining Sources	(0.000)	(11.872)	(7.659)	(7.773)	(11.872)	(15.432)
Exec. Upward Revision		(37.930)	(39.370)	(41.410)	(37.930)	(80.780)
Total	**$0.000**	**($59.902)**	**($42.708)**	**($61.591)**	**($59.902)**	**($104.299)**

RTIC FORECAST FOR MAJOR GENERAL FUND REVENUE SOURCES

This section presents the details on five of the major general fund revenue sources that comprise 75.5% of the total general fund revenue. Additional details of these and other revenue sources, including assumptions and analytical methods used to estimate each source, can be found in the LFD *Legislative Budget Analysis 2013 Biennium, Volume 2 – Revenue Estimates.*

Individual Income Tax

Background

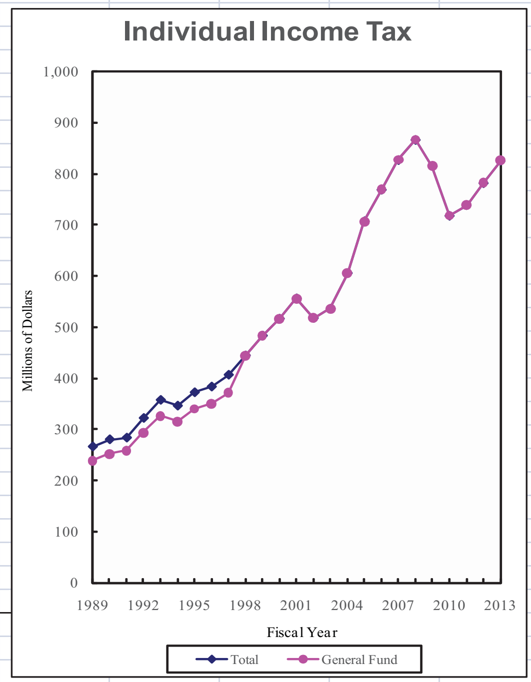
The tax is levied against taxable income, which is defined as Montana personal income adjusted for exemptions and deductions. Once tax liability is determined, the amount of tax due is computed by subtracting allowable credits. Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. Tax brackets, personal exemption amounts, and the standard deduction are adjusted by the rate of inflation in each year. SB 407, enacted by the 2003 legislature, created a new capital gains income tax credit. As a result, the tax rate on capital gains income is less than the tax rate on ordinary income by 1% in tax years 2005 and 2006, and by 2% in tax year 2007 and beyond.

Percent of total general fund revenue

FY 2004 – 43.82% FY 2007 – 45.04% FY 2010 – 44.12%
FY 2005 – 46.13% FY 2008 – 44.17%
FY 2006 – 45.01% FY 2009 – 45.09%

Revenue Forecast

	Fiscal Year	Total Collections Millions	General Fund Collections Millions	GF Percent Change
A	1989	265.539814	238.963596	Not App.
A	1990	279.642960	252.230465	5.55%
A	1991	282.960086	258.216424	2.37%
A	1992	321.538093	293.564151	13.69%
A	1993	356.986934	326.187735	11.11%
A	1994	345.643403	315.677433	-3.22%
A	1995	371.902909	339.939156	7.69%
A	1996	383.091612	350.161013	3.01%
A	1997	406.275740	371.275410	6.03%
A	1998	444.160729	444.160729	19.63%
A	1999	483.031571	483.031571	8.75%
A	2000	516.261912	516.261912	6.88%
A	2001	556.014554	556.014554	7.70%
A	2002	517.567691	517.567691	-6.91%
A	2003	535.830664	535.830664	3.53%
A	2004	605.582309	605.348420	12.97%
A	2005	707.343333	706.234579	16.67%
A	2006	768.922343	768.922343	8.88%
A	2007	827.145498	827.145498	7.57%
A	2008	866.658538	866.658538	4.78%
A	2009	815.138193	815.138193	-5.94%
A	2010	717.834371	717.834371	-11.94%
F	2011	738.761000	738.761000	2.92%
F	2012	781.891000	781.891000	5.84%
F	2013	825.590000	825.590000	5.59%



Forecast Factors

The income tax forecast for FY 2011 through 2013 began with obtaining actual calendar year 2009 income data from the tax returns. Calendar year growth factors were developed for each income and deduction component, applied to the base components in the 2009 income tax data, and run through the simulation model to produce a forecast of calendar year resident tax liability.

After accounting for non-resident liability and credits, the calendar year data was converted to fiscal year data and subsequently adjusted for audits, legislation and other special events.

In November 2010, the Revenue and Transportation Interim Committee met and developed the assumptions and the resulting revenue forecast for all state revenues. Many of the income tax growth factors were based on IHS October forecasts for wages disbursements, interest rates, corporate profits, S&P 500 stock index, oil prices, and other economic indicators.

The assumptions used in developing the income tax forecast can be found in the LFD *Legislative Budget Analysis 2013 Biennium, Volume 2 – Revenue Estimates*.

Property Tax

Background

Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A mill levy of 1.5 mills is also applied against all property in the five counties with a vocational technology (vo-tech) college. Taxable value is defined as the market value of statutorily defined property times a statutory tax rate. Property valued at market value includes personal property, utility property, railroad and airline property, and mineral net and gross proceeds. The assessed value of residential and commercial real estate is the market value phased in over the six-year reappraisal cycle. Agricultural land and timberland are valued on a productivity basis and their values are also phased in over the reappraisal cycle. The last reappraisal cycle took effect January 1, 2009.

The 2009 reappraisal showed that the market value of residential property rose 55.1%, commercial property values rose 34.5%, agricultural values rose 26.8%, and timberland values rose 51.7%. The legislature through combination of phased-in reductions in tax rates and phased-in increases in exemptions mitigated these increases over the six-year cycle, so that the only increases in the these tax bases will be the addition of new property, the destruction of existing property, or reclassification of property.

In addition to the tax on property, this revenue component includes collections from "non-levy" sources that are distributed on the basis of mills levied by taxing jurisdictions. These non-levy sources include the state share of coal gross proceeds taxes, federal forest revenues, and other smaller revenue sources.

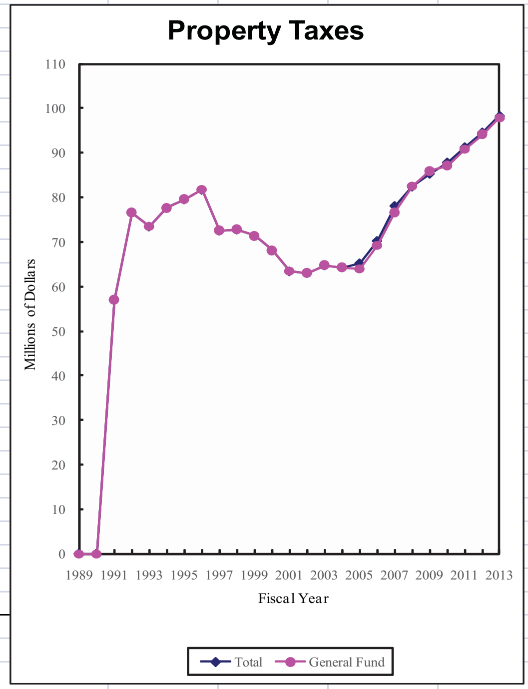
This source also includes the state's share of protested taxes paid by centrally assessed companies. Should the state fail in defense of the taxation of these companies, the protested taxes must be returned to the taxpayer.

Percent of total general fund revenue

FY 2004 – 12.27%	FY 2007 – 10.74%	FY 2010 – 13.68%
FY 2005 – 10.93%	FY 2008 – 11.53%	
FY 2006 – 10.40%	FY 2009 – 12.01%	

Revenue Forecast

	Fiscal Year	Total Collections Millions	General Fund Collections Millions	GF Percent Change
A	1989	114.444609	114.444609	Not App.
A	1990	133.619694	112.374543	-1.81%
A	1991	196.551532	176.154583	56.76%
A	1992	228.220531	206.138029	17.02%
A	1993	231.757476	207.646372	0.73%
A	1994	223.577122	202.381945	-2.54%
A	1995	226.944990	205.842671	1.71%
A	1996	226.234755	204.082588	-0.86%
A	1997	231.943080	209.284365	2.55%
A	1998	224.562154	202.350380	-3.31%
A	1999	225.681256	202.774979	0.21%
A	2000	215.866432	194.196158	-4.23%
A	2001	201.103545	180.050247	-7.28%
A	2002	181.923409	169.339388	-5.95%
A	2003	183.690786	171.679862	1.38%
A	2004	180.905286	169.530994	-1.25%
A	2005	182.587822	167.270350	-1.33%
A	2006	192.118042	177.639199	6.20%
A	2007	206.872427	190.981939	7.51%
A	2008	218.222981	205.043751	7.36%
A	2009	229.945033	217.042057	5.85%
A	2010	239.055986	222.509767	2.52%
F	2011	245.192891	229.084000	2.95%
F	2012	254.491498	237.809000	3.81%
F	2013	260.081757	242.859000	2.12%



Forecast Factors

The property tax forecast for FY 2011 through 2013 is comprised of five steps: 1) collect the latest base year data, in this case FY 2011 taxable values, 2) apply taxable value growth rates to the base data for FY 2012 and 2013 and sum across property classes, 3) forecast statewide tax increment financing values and abatement values and adjust the statewide taxable value forecast by these values, 4) for the general fund, apply the state 95 mills, to the net statewide taxable value and 5) subtract one-half of the forecast for protested taxes. The same procedure is applied for the 1.5 mill vo-tech levy which is also deposited in the general fund and the 6 mill university levy which is deposited in the university account. The 1.5 mill vo-tech levy is applied to the net taxable values in the five vo-tech counties.

Corporation Income Tax

Background

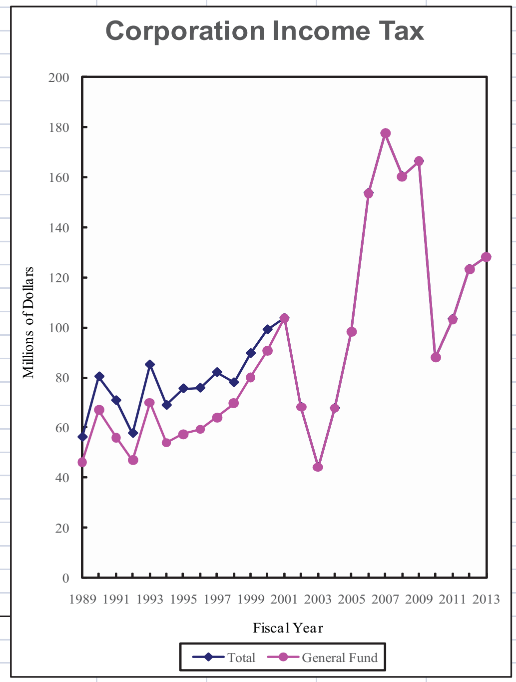
The corporation income tax is a license fee levied against a corporation's net income earned in Montana. The corporation income tax is imposed on corporations that, for reasons of jurisdiction, are not taxable under a license tax. Factors that affect corporation income tax receipts include tax credits and the audit efforts by the Department of Revenue. As with individual income tax, all tax liability is adjusted for allowable credits. The tax rate is 6.75%, except for corporations making a "water's edge" election (see 15-31-322, MCA), who pay a 7.0% tax on their net income.

Percent of total general fund revenue

FY 2004 – 4.90% FY 2007 – 9.67% FY 2010 – 5.40%
FY 2005 – 6.42% FY 2008 – 8.17%
FY 2006 – 9.00% FY 2009 – 9.20%

Revenue Forecast

	Fiscal Year	Total Collections Millions	General Fund Collections Millions	GF Percent Change
A	1989	56.139749	46.152627	Not App.
A	1990	80.315504	67.087905	45.36%
A	1991	70.784279	56.006784	-16.52%
A	1992	57.682672	47.027797	-16.03%
A	1993	85.054483	70.003987	48.86%
A	1994	68.871909	53.996713	-22.87%
A	1995	75.519940	57.425136	6.35%
A	1996	75.761891	59.336677	3.33%
A	1997	81.999138	64.078549	7.99%
A	1998	77.928498	69.724680	8.81%
A	1999	89.624560	80.142416	14.94%
A	2000	99.088867	90.682672	13.15%
A	2001	103.670487	103.670487	14.32%
A	2002	68.173253	68.173253	-34.24%
A	2003	44.137518	44.137518	-35.26%
A	2004	67.722940	67.722940	53.44%
A	2005	98.213716	98.213716	45.02%
A	2006	153.675068	153.675068	56.47%
A	2007	177.503707	177.503707	15.51%
A	2008	160.341786	160.341786	-9.67%
A	2009	166.354514	166.354514	3.75%
A	2010	87.900911	87.900911	-47.16%
F	2011	103.320000	103.320000	17.54%
F	2012	123.315000	123.315000	19.35%
F	2013	128.179000	128.179000	3.94%



Forecast Factors

The corporation tax is extremely reactive to national economic swings. Historic collection patterns demonstrate that in periods of national recession, Montana corporate tax revenues decline for two to three years. In FY 2010, with a national economy in the midst of "the great recession", corporation tax revenues experienced a significant decline of 47.2%. Although the economy is showing signs of recovery, many economists urge constraint, as this recovery is not anticipated to take the course of high and rapid growth experienced in past recoveries.

To estimate corporation tax collections, corporation tax payment data, provided by the Department of Revenue, is disaggregated based on corporate industrial sector, allowing analysis of specific components of the corporate landscape. Then, each sector can be analyzed, measured, and forecast individually. Through this methodology, the profitability changes inherent in highly volatile sectors can be captured. For example, the profitability of

Montana's large and volatile natural resource corporations is highly reactive to commodity prices, and the volatility affects the corporation tax payments of oil and gas, energy, mining, and timber corporations.

To develop the estimate for the corporation income tax, the sector growth rate is applied to the most recent tax year collections, 2008. The industrial sectors are then summed to provide an estimate for the tax year corporation tax liabilities. Because the industrial sector estimates are based on a tax year analysis, but are paid in a state fiscal year, payment timing must be taken into consideration. The estimated tax year payments of three years are distributed between two fiscal years, 5:53:42, to obtain the fiscal year liability ($0.05\times TY1 + 0.53\times TY2 + 0.42\times TY3 = FY3$).

Vehicle Tax

Background

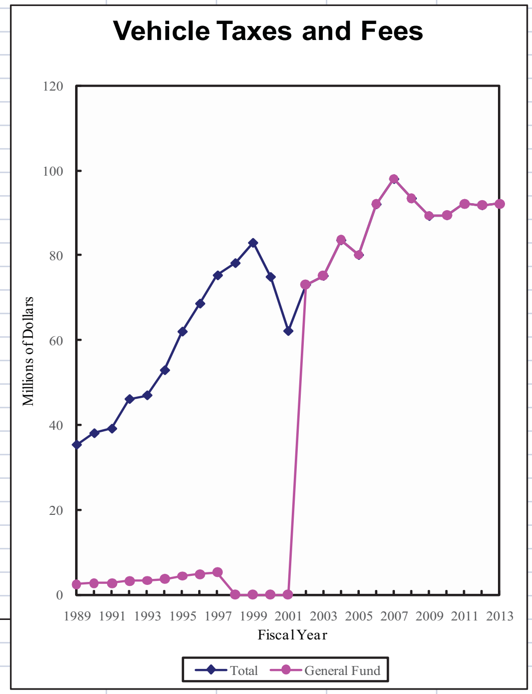
Light vehicles, motorcycles and quadricycles, snowmobiles, buses, trucks, and truck tractors having a manufacturer's rated capacity of more than 1 ton, motor homes, and certain trailers and travel trailers are taxed under a fee schedule that varies by age and weight. The fee for light vehicles is $195 for ages between zero and four years, $65 for vehicles between five and ten years of age, and $6 for vehicles over ten years old. Owners of vehicles greater than ten years old may pay $87.50 (plus other applicable fees) for a permanent registration. The fee schedule for trucks varies by age and weight capacity. The fees-in-lieu-of-tax on motorcycles and quadricycles, trailers and travel trailers, snowmobiles, watercraft, off-highway vehicles are one-time payments, except upon change of ownership.

Percent of total general fund revenue

FY 2004 – 8.27%	FY 2007 – 6.54%	FY 2010 – 6.38%
FY 2005 – 7.23%	FY 2008 – 6.33%	
FY 2006 – 6.63%	FY 2009 – 5.79%	

Revenue Forecast

	Fiscal Year	Total Collections Millions	General Fund Collections Millions	GF Percent Change
A	1989	40.139702	2.471472	Not App.
A	1990	44.232002	8.869602	258.88%
A	1991	46.947105	10.582218	19.31%
A	1992	56.247735	13.378654	26.43%
A	1993	56.358436	12.670105	-5.30%
A	1994	62.629657	13.424539	5.95%
A	1995	71.925382	14.238226	6.06%
A	1996	78.442141	14.605759	2.58%
A	1997	85.645500	15.588374	6.73%
A	1998	88.988649	10.778306	-30.86%
A	1999	94.058206	11.053035	2.55%
A	2000	86.666587	11.715716	6.00%
A	2001	74.720471	12.548251	7.11%
A	2002	100.548823	100.398624	700.10%
A	2003	104.092316	103.537563	3.13%
A	2004	115.208780	114.330455	10.42%
A	2005	111.494279	110.771948	-3.11%
A	2006	114.000647	113.292384	2.28%
A	2007	117.211161	116.471506	2.81%
A	2008	113.108912	112.487931	-3.42%
A	2009	105.240081	104.679977	-6.94%
A	2010	104.401578	103.861549	-0.78%
F	2011	107.587000	107.025000	3.05%
F	2012	107.175000	106.615000	-0.38%
F	2013	107.561000	106.999000	0.36%



Forecast Factors

With constant tax rates, the future change in vehicle tax revenue results from change in the vehicle stock in Montana. Because tax payments are directly connected to the number of vehicles in the state, estimates for the revenues are made by applying estimated growth rates to the previous year revenue. Growth rates for the stock of Montana vehicles are derived by obtaining IHS estimates for the national vehicle stock, and new car sales nationwide and for Montana. A ratio is then developed to project the stock of Montana vehicles. An average of the Montana stock in the current and previous years is used in this estimate from which growth between two years is calculated. For the estimated period, revenue is expected to increase in FY 2011, decline slightly in FY 2012, and increase slightly in FY 2013. The growth rate is applied to the base year (FY 2010) revenues of each tax category and projected for all estimated fiscal years based on the stock ratio for Montana.

Oil and Natural Gas Production Tax

Backgound

The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state. Gross taxable value of oil and natural gas production is based on the type of well and type of production.

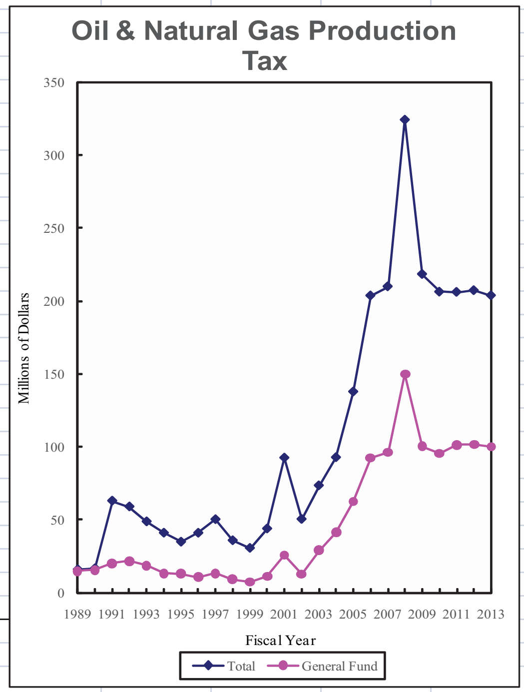
The oil and natural gas production tax has numerous tax rates depending on several factors. These factors include whether the oil or gas is produced from a stripper well, a stripper incentive well, from a well initially drilled before 1999 or after, from a well newly drilled within the last year or 18 months, and whether the interest being taxed is the working interest or the royalty interest. The Board of Oil and Gas Conservation imposes an additional privilege and license (P & L) tax on all oil and natural gas tax rates. Starting October 2006 as set by the Board, the P&L tax rate is 0.09%. Based on this rate, HB 758 enacted by the 2005 legislature allows an additional tax rate of 0.17% to generate revenue for local impacts for local governments. The two taxes may not exceed 0.3%.

Percent of total general fund revenue

FY 2004 – 2.99%	FY 2007 – 5.25%	FY 2010 – 5.87%
FY 2005 – 4.09%	FY 2008 – 7.64%	
FY 2006 – 5.42%	FY 2009 – 5.56%	

Revenue Forecast

	Fiscal Year	Total Collections Millions	General Fund Collections Millions	GF Percent Change
A	1989	15.748241	14.959251	Not App.
A	1990	16.486405	15.567426	4.07%
A	1991	62.879742	20.163269	29.52%
A	1992	58.892324	21.822893	8.23%
A	1993	48.650604	18.676586	-14.42%
A	1994	40.871318	13.403408	-28.23%
A	1995	34.704332	12.963887	-3.28%
A	1996	40.826475	10.665986	-17.73%
A	1997	50.150068	13.283093	24.54%
A	1998	35.709042	9.120152	-31.34%
A	1999	30.446634	7.505617	-17.70%
A	2000	43.772950	11.362741	51.39%
A	2001	92.395790	25.791723	126.99%
A	2002	50.303610	12.902439	-49.97%
A	2003	73.389376	29.086038	125.43%
A	2004	92.676050	41.323718	42.07%
A	2005	137.754331	62.625939	51.55%
A	2006	203.681078	92.562800	47.80%
A	2007	209.946350	96.334992	4.08%
A	2008	324.311270	149.993826	55.70%
A	2009	218.425215	100.490971	-33.00%
A	2010	206.286267	95.490812	-4.98%
F	2011	206.132000	101.421247	6.21%
F	2012	207.277000	101.803362	0.38%
F	2013	203.815000	100.119249	-1.65%



Forecast Factors – Oil

Data from the Board of Oil and Gas Conservation are used extensively to isolate monthly historical production of oil and natural gas by field and by individual well. IHS provides future estimates of West Texas Intermediate oil and national well head natural gas prices. Production, price, value, and revenue collections, by oil type, are provided on a quarterly basis by the Department of Revenue.

The significance of the Elm Coulee oil field to Montana's revenue has decline considerably since 2006. Declining production and the increase in the type of production no longer subject to the tax holiday has put this field more on par with most other fields in Montana. Accordingly, the revenue estimate methodology for this revenue source has been changed from previous years. Historical production from nine of the greatest producing fields, including Elm Coulee, was estimated separately and either a production decline or growth curve developed for each one. Production from all other fields was combined into a single "field" and a production curve developed. For each of the 10 fields, future production was projected based on the production curve for each one. Forecast production from each field was summed to obtain total forecast production. An applied tax rate was developed to capture the effects of the various tax rates from various production types and applied to total production to derive the forecast revenue.

The price for each quarter is estimated by adjusting the IHS West Texas Intermediate oil price for that quarter by the ratio of the previous three-year average Montana price to the three-year average of the IHS price.

Forecast Factors – Natural Gas

The revenue estimate methodology for natural gas is similar to that of oil. Accordingly, the revenue estimate methodology for this revenue source has been changed from previous years. Historical production from 17 of the greatest producing fields, including Elm Coulee, was estimated separately and either a production decline or growth curve developed for each one. Production from all other fields was combined into a single "field" and a production curve developed. For each of the 18 fields, future production was projected based on the production curve for each one. Forecast produce from each field was summed to obtain total forecast production. An applied tax rate was developed to capture the effects of the various tax rates from various production types and applied to total production to derive the forecast revenue.

The price for each quarter is estimated by adjusting the IHS national well head price for that quarter by the ratio of the previous three-year average Montana price to the three-year average of the IHS price.

All Remaining General Fund Revenue

The remaining general fund revenue sources in the 2013 biennium constitute 24.5% of the total. For detailed information on all the remaining general fund and selected state special revenue sources, see the LFD *Legislative Budget Analysis 2013 Biennium, Volume 2 – Revenue Estimates.*