



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
Amy Carlson

DATE: April 13, 2011

TO: Senator Jim Peterson, Senate President
Rep. Mike Milburn, House Speaker
Senator Bruce Tutvedt, Chair, Senate Taxation Committee
Rep. Mark Blasdel, Chair, House Taxation Committee
Senator Jeff Essmann, Senate Majority Leader
Rep. Tom McGillvray, House Majority Leader
Senator Carol Williams, Senate Minority Leader
Rep. Jon Sesso, House Minority Leader

FROM: Terry W. Johnson, Principal Fiscal Analyst

RE: General Fund Revenue Update Number 3

PURPOSE OF REPORT

This is the third revenue update report designed to brief the legislature on recent economic trends and the corresponding outlook for FY 2011, 2012, and 2013 general fund revenue estimates. This analysis is based on collection data received through the end of March 2011 and includes economic forecasts by IHS Global Insight (IHS) for both the national and state economies

It is critical for the legislature to be apprised of current economic conditions and the potential general fund revenue impacts in order to craft a state budget that is balanced as required by the Montana Constitution. This report shows revised LFD estimates that are recommended to be incorporated into HJ2, the revenue estimating resolution.

THE BOTTOM LINE

This analysis shows that general fund revenue collections have improved as compared to the revised HJ2 revenue estimates approved in March 2011. It should be noted that the following recommendations are in context to the new HJ2 estimates adopted by the House in March 2011. The LFD is now recommending the HJ2 estimates be increased by an additional \$26.8 million

for the three year period FY 2011, FY 2012, and FY 2013. The impacts of higher oil prices and an improved outlook for wage and salary income accounts for a majority of this change.

Figure 1 shows the total general fund recommended adjustments to the HJ2 revenue estimates.

Figure 1
Recommended Adjustments to HJ2
Figures in Millions

Revenue Category	Revision FY 2011	Revision FY 2012	Revision FY 2013	Biennium 2012-13
Individual Income Tax	5.298	5.599	5.294	10.893
Corporation Income Tax	0.219	1.296	1.537	2.833
Oil & Gas Production Tax	0.489	4.544	4.281	8.825
Us Mineral Royalty	0.459	0.671	0.711	1.382
Cigarette Tax	(0.587)	(0.926)	(0.927)	(1.853)
All Other Categories	<u>(0.145)</u>	<u>(0.353)</u>	<u>(0.635)</u>	<u>(0.988)</u>
Total General Fund	\$5.734	\$10.831	\$10.261	\$21.092

The LFD recommends the HJ2 general fund revenue estimates be increased by \$5.7 million for FY 2011 and \$21.1 million for the 2013 biennium. The revenue improvement for FY 2011 will increase the beginning general fund balance for the 2013 biennium. Because the 2013 biennium revenue improvement is expected to be on-going, the \$21.1 million could be incorporated into the 2013 biennium budget plan on an on-going basis. The next section of the report summarizes the results of our analysis.

NEW INFORMATION

Each month, the LFD receives a revised national economic outlook from IHS. This is the economic forecasting company that Montana has a contract with to provide national and regional economic forecasting services. This service includes written material as well as a variety of economic forecasts for hundreds of economic variables. The information received from IHS in early April reflects their forecasts as of March 2011 for the national economy. The updated economic data for Montana has not been received at this time.

The statewide budgeting and accounting system (SABHRS) produces a snapshot of accounting transactions on the last day of each month. The LFD has internal computer processes to download this data and produce a variety of reports and spreadsheets. While this data is critical in monitoring year to date collection trends, this system does not contain any tax return or economic information such as individual and corporate income components, oil and gas production, or prevailing interest rates. This type of detailed data must be extracted from other sources provided the information is available. The accounting transaction detail that is available to the LFD reflects revenue collections through March 2011. Historical collection data by month are available back to FY 2000.

The LFD, in cooperation with the DOR, developed a process whereby the DOR sends the LFD tax return data for fifty different tax types at the beginning of each month. This data are extremely helpful in analyzing various trends that may be occurring within a given tax type. For example, the DOR data show oil production by calendar quarter as reported by the taxpayer. These data are invaluable in tracking production trends throughout the year. It should be noted, however, that since oil production taxes are payable sixty days after the end of each quarter, there is a considerable lag time before the LFD can analyze the data. Nonetheless, these new data were received April 1 and included return information captured in the DOR system as of March 31, 2011.

During each month, there are numerous articles and economic reports that are produced by newspapers, economic websites, and federal entities. To the extent possible, this information is reviewed for relevancy to Montana's economy and the impact it may have on state revenues. Usually this information is for reference and does not have a quantifiable impact on our revenue outlook. This type of information is received and reviewed daily throughout the month.

Based on this new information, the following section of the report highlights our analysis of the new data and summarizes the total LFD recommended changes to the general fund revenue estimates for FY 2011, 2012, and 2013.

RESULTS OF LFD ANALYSIS

The primary components of total general fund revenues are individual and corporate income taxes, property taxes, motor vehicle fees/taxes, and natural resource taxes. If all of these components are added together, over 78% of total general fund revenues are produced from these sources. The analysis discussed in this report focuses on individual income tax, corporation income tax, and oil and gas production tax.

This general fund revenue update report focuses on key economic assumptions and the potential impacts on general fund revenue estimates for FY 2011, 2012, and 2013. This report is prepared in a format that compares collection data through March 2011 with collections through March 2010. This type of comparison can provide insight to the strengths or weaknesses of year to date collections and can help identify trends that may be indicative of collections for the remainder of FY 2011. This information can then be used to research the economic conditions that have changed to impact the collection patterns. Economic conditions determine revenue trends - collections do not produce economic activity.

YEAR TO DATE COLLECTIONS

Figure 2 shows general fund revenue collections by individual revenue source. This table is produced monthly based on the revenue transactions recorded on SABHRS. The information shown in Figure 2 represents revenue collections for the first nine months of FY 2010 compared to the first nine months of FY 2011. As shown at the bottom of Figure 2, total general fund collections are \$83.0 million (8.0%) above last year. The HJ2 total general fund revenue estimate as adopted by the House in March, 2011, expected revenues to be 4.0% above FY 2010 collections.

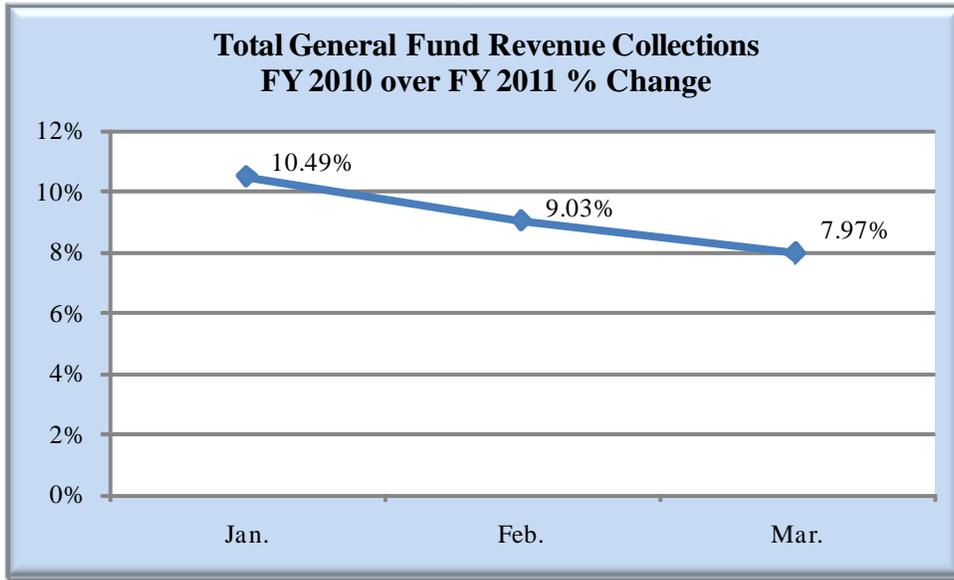
This information seems to indicate that overall, general fund revenue collections are on pace to exceed the HJ2 estimate. However, other than individual income tax, several accounting and timing issues lead the reader to believe that revenue collections are exceeding expectations.

Figure 2

Legislative Fiscal Division							
General Fund Revenue Monitoring Report							
Revenue Source	Actual Fiscal 2010	HJ2 Estimate Fiscal 2011	Through 3/31/10	Through 3/31/11	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	4,156,003	3,567,000	2,857,406.58	2,818,953.68	(38,452.90)	-1.35%	-14.17%
GF0200 Insurance Tax	54,892,354	55,445,000	26,540,243.46	26,096,834.15	(443,409.31)	-1.67%	1.01%
GF0300 Investment Licenses	6,224,662	6,375,000	5,557,498.11	6,258,312.21	700,814.10	12.61%	2.42%
GF0400 Vehicle License Fee	89,484,621	92,192,000	51,462,105.70	56,763,489.92	5,301,384.22	10.30%	3.03%
GF0500 Vehicle Registration Fee	14,376,928	14,812,000	7,530,389.98	9,140,042.21	1,609,652.23	21.38%	3.03%
GF0600 Nursing Facilities Fee	5,300,229	4,984,000	2,674,438.72	2,632,975.95	(41,462.77)	-1.55%	-5.97%
GF0700 Beer Tax	3,031,854	3,157,000	2,022,115.32	1,967,585.04	(54,530.28)	-2.70%	4.13%
GF0800 Cigarette Tax	32,217,914	31,554,000	23,504,518.26	22,362,755.59	(1,141,762.67)	-4.86%	-2.06%
GF0900 Coal Severance Tax	10,321,853	12,494,000	6,078,100.86	6,667,259.94	589,159.08	9.69%	21.04%
GF1000 Corporation Tax	87,900,911	97,360,000	46,423,126.38	65,006,785.26	18,583,658.88	40.03%	10.76%
GF1100 Electrical Energy Tax	4,713,429	4,452,000	2,107,117.39	2,507,248.52	400,131.13	18.99%	-5.55%
GF1150 Wholesale Energy Trans Tax	3,556,056	3,657,000	1,784,837.41	2,024,000.13	239,162.72	13.40%	2.84%
GF1200 Railroad Car Tax	2,579,263	2,031,000	1,977,856.00	1,674,825.79	(303,030.21)	-15.32%	-21.26%
GF1300 Individual Income Tax	717,834,371	762,396,000	562,970,214.39	612,941,685.87	49,971,471.48	8.88%	6.21%
GF1400 Inheritance Tax	90,544	5,000	70,564.95	43,164.57	(27,400.38)	-38.83%	-94.48%
GF1500 Metal Mines Tax	6,541,391	8,931,000	3,456,374.78	2,095,001.72	(1,361,373.06)	-39.39%	36.53%
GF1700 Oil Severance Tax	95,490,812	104,514,000	21,314,801.54	23,061,185.87	1,746,384.33	8.19%	9.45%
GF1800 Public Contractor's Tax	6,969,395	7,262,000	5,869,004.67	6,034,701.75	165,697.08	2.82%	4.20%
GF1850 Rental Car Sales Tax	2,807,415	3,118,000	1,701,344.83	1,874,822.89	173,478.06	10.20%	11.06%
GFxxxx Property Tax	222,509,767	229,084,000	130,417,966.95	133,804,705.67	3,386,738.72	2.60%	2.95%
GF2150 Lodging Facilities Sales Tax	12,330,846	13,209,000	7,131,816.26	8,119,173.06	987,356.80	13.84%	7.12%
GF2200 Telephone Tax	-	-	-	-	-	-	-
GF2250 Retail Telecom Excise Tax	23,523,474	21,772,000	12,883,972.90	10,936,851.51	(1,947,121.39)	-15.11%	-7.45%
GF2300 Tobacco Tax	5,334,499	5,680,000	3,595,814.44	3,638,574.70	42,760.26	1.19%	6.48%
GF2400 Video Gaming Tax	52,395,999	49,333,000	27,618,431.41	24,672,302.13	(2,946,129.28)	-10.67%	-5.85%
GF2500 Wine Tax	1,932,669	2,058,000	1,309,217.78	1,331,273.17	22,055.39	1.68%	6.48%
GF2600 Institution Reimbursements	22,000,354	17,555,000	12,830,446.10	12,923,328.38	92,882.28	0.72%	-20.21%
GF2650 Highway Patrol Fines	4,646,462	4,666,000	2,859,610.23	2,844,422.20	(15,188.03)	-0.53%	0.42%
GF2700 TCA Interest Earnings	2,692,285	2,215,000	1,907,799.72	1,727,980.61	(179,819.11)	-9.43%	-17.73%
GF2900 Liquor Excise Tax	15,626,091	16,151,000	7,420,579.74	10,589,621.54	3,169,041.80	42.71%	3.36%
GF3000 Liquor Profits	9,000,000	9,499,000	-	-	-	-	5.54%
GF3100 Coal Trust Interest Earnings	26,914,102	26,514,000	15,799,094.22	16,053,078.82	253,984.60	1.61%	-1.49%
GF3300 Lottery Profits	10,631,304	11,036,000	5,558,657.00	5,332,464.00	(226,193.00)	-4.07%	3.81%
GF3450 Tobacco Settlement	3,468,623	3,565,000	-	-	-	-	2.78%
GF3500 U.S. Mineral Leasing	30,287,794	31,136,000	17,293,517.71	18,789,627.73	1,496,110.02	8.65%	2.80%
GF3600 All Other Revenue	35,360,264	29,848,000	18,187,955.85	20,932,228.19	2,744,272.34	15.09%	-15.59%
Grand Total	1,627,144,538	1,691,627,000	1,040,716,939.64	1,123,667,262.77	82,950,323.13	7.97%	3.96%

As discussed in previous revenue updates, revenue collections during FY 2010 were depressed during the first six months and improved significantly during the second six months. This unique revenue flow creates a skewed view when comparing FY 2011 collections to the first six months of FY 2010. Figure 3 shows the downward trend in the computed growth%age as compared to FY 2010 for January, February, and March. As discussed in earlier reports, this was expected because of the significant improvement in collections observed in the second six months of FY 2010. This downward trend is expected for the remainder of FY 2011 as future comparisons are calculated using the second six months of FY 2010.

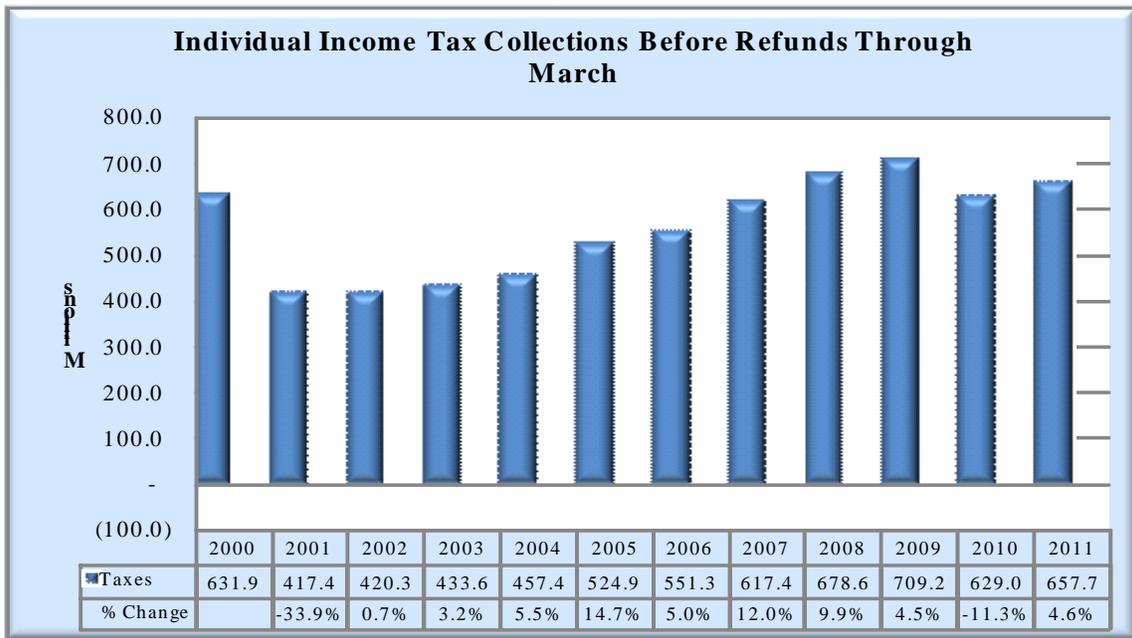
Figure 3



Individual Income Tax

Figure 4 shows individual income tax collection data (less refunds) for the first nine months of FY 2011 compared to the same period of FY 2010. Other fiscal years are shown for reference. As shown in the figure, total individual income tax collections less refunds are 4.6% (\$28.7 million) above last year.

Figure 4



The increase in FY 2011 suggests that individual income tax collections less refunds are improving and that economic conditions are recovering from the “Great Recession”. Because of this improvement, the withholding tax growth versus the wage and salary income growth

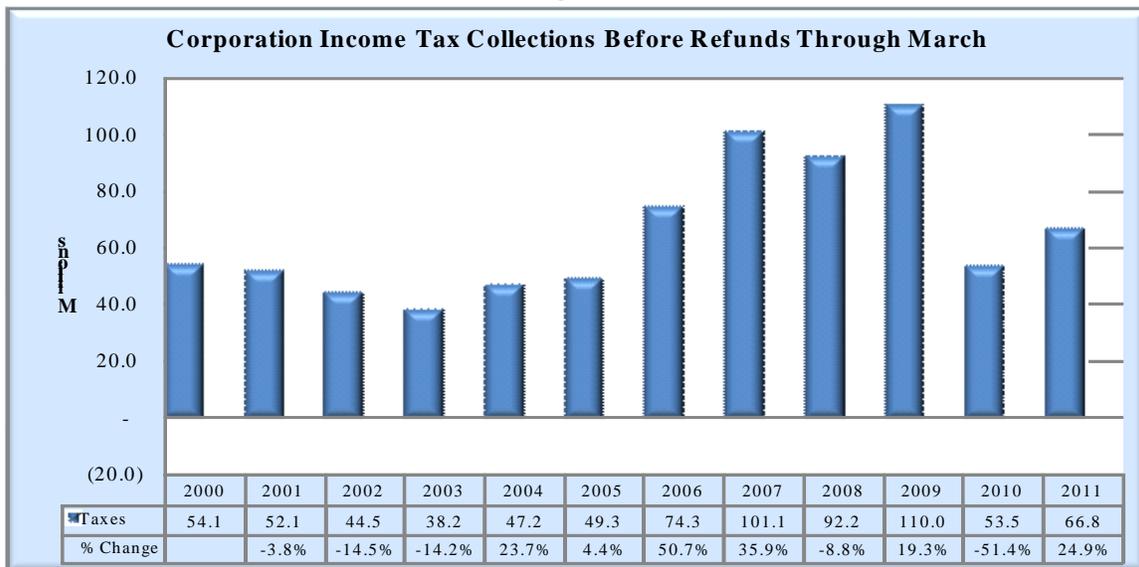
forecast by IHS was re-analyzed. This analysis showed that an upward adjustment was warranted for the wage and salary growth assumption for calendar 2010. This change was the primary reason for the upward revision in individual income tax collections.

Corporation Income Tax

Figure 5 shows more detailed corporation income tax collection data (less refunds) for the first nine months of FY 2011 compared to the same period of FY 2010. Other years are shown for reference. As shown in the figure, total corporation income tax collections less refunds are 24.9% (\$13.3 million) above last year. The current growth rate is well above the assumed growth rate in HJ2 but is expected to decline when corporate taxpayers take advantage of H.R. 4853. Federal legislation (H.R. 4853) allows corporate taxpayers to expense depreciable assets placed in service between September 9, 2010 and the end of 2011 and also allows a 50% bonus depreciation for depreciable assets placed in service in 2012. Because corporate taxpayers are expected to take full advantage of this legislation, the anticipated revenue reduction is not expected to occur until late FY 2011. The corporation tax estimate recommended in March was adjusted for the impacts of this federal legislation. The estimated impact on state revenues is \$16.4 million for the three year period, 2011 through 2013.

The recommended revision to the corporation tax estimates is primarily due to higher oil prices as forecast by IHS.

Figure 5

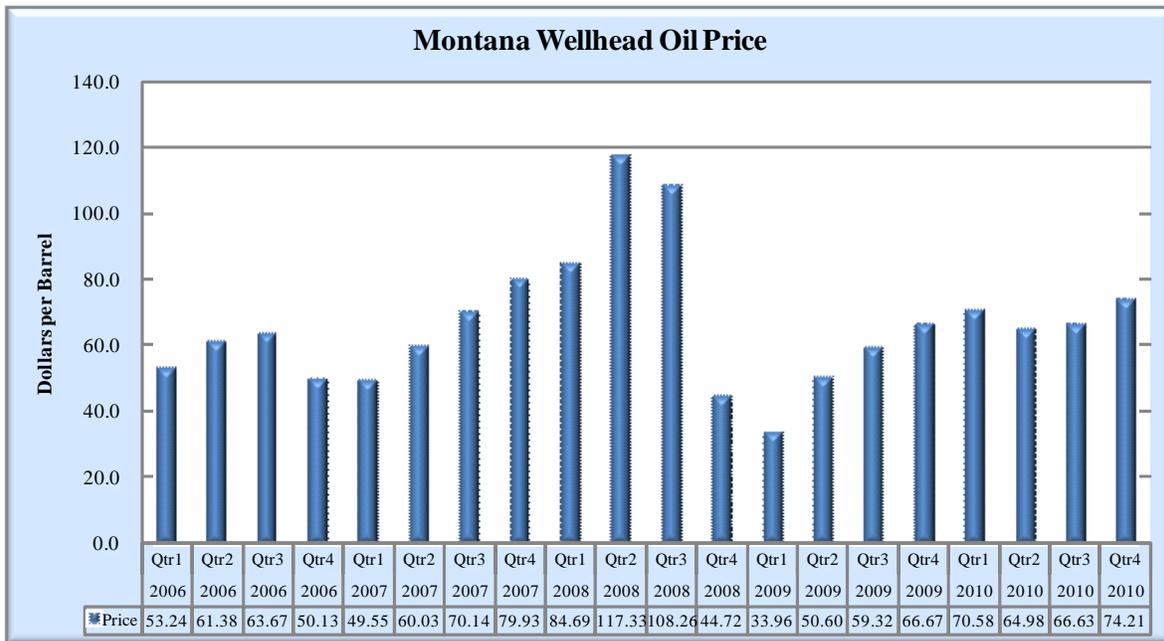


Oil and Gas Production Tax

Total oil and gas production tax collections are \$1.7 million (8.2%) above last year as of the end of March. These collections represent economic conditions through the 3rd quarter of calendar 2010 as compared to the 3rd quarter of calendar 2009. This increase was not unexpected since Montana oil prices averaged \$66.63 per barrel for the 3rd quarter of calendar 2010 versus \$59.32 per barrel for the 3rd quarter of calendar 2009. Preliminary fourth quarter calendar 2010 collections have increased as Montana oil prices averaged \$74.21 per barrel during the quarter,

well above the \$66.67 per barrel average during the 4th quarter of calendar 2009. The next tax payment of oil and gas production taxes will be processed by late April.

Figure 6

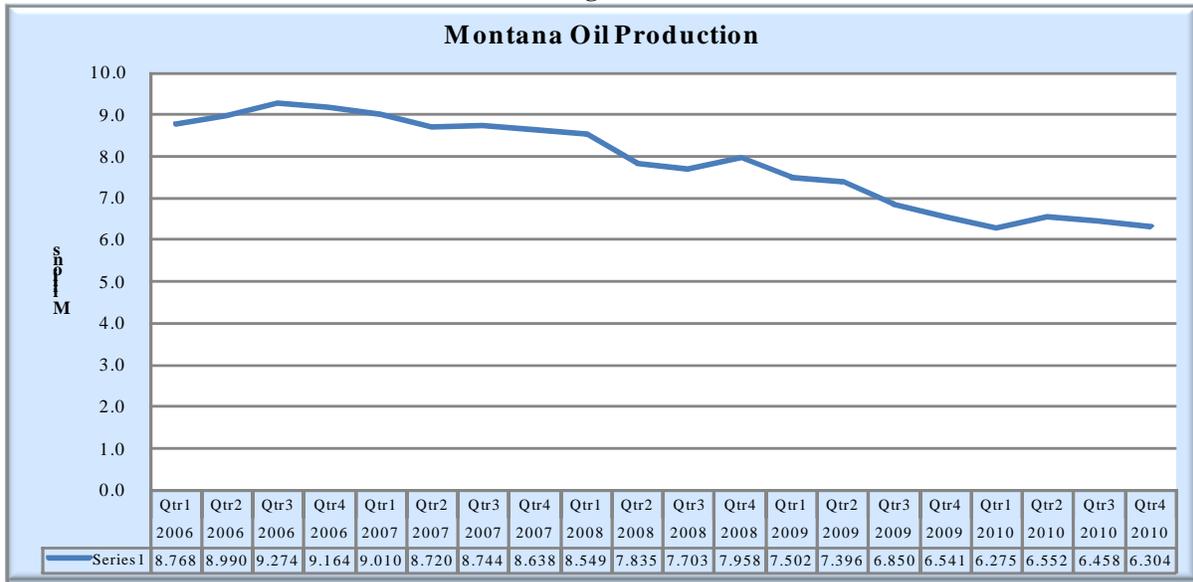


Although the average wellhead price is at high levels, total production in Montana continues to decline as shown in Figure 7. Production was 28.3 million barrels for calendar 2009 compared to 25.6 million barrels in calendar 2010. This is a decline of 2.7 million barrels or 9.5%.

There appears to be some slowing in the production decline rate during the last four quarters of calendar 2010. First quarter of calendar 2009 to first quarter of calendar 2010 showed a decline of 16.4%. Comparable data for the fourth quarter showed this decline rate slowed to 3.6%. Further data will be necessary to identify whether a new production pattern is occurring.

Based on the turmoil in Libya and the apparent world oil supply shortage, IHS has increased their forecasts for West Texas Intermediate (WTI) prices throughout the forecast period. IHS revised forecasts expect WTI prices to average \$100.59 in calendar 2011, \$104.16 in calendar 2012, and \$108.07 for calendar 2013. These adjustments result in increased revenue estimates for oil production tax, corporation income tax, and US mineral royalty revenue.

Figure 7



SUMMARY OF LFD ANALYSIS

Based on our analysis of new data received from the sources mentioned previously, the information indicates that total general fund revenue estimates could be understated by \$5.7 million in FY 2011 and \$21.1 million in the 2013 biennium as compared to the revenue estimates contained in HJ2. A majority of these amounts is due to changes in the underlying assumptions for wage and salary income and oil prices.

Other adjustments are recommended for several other minor sources because of the interrelationship with the various economic assumptions provided by IHS. In total, these changes are small and do not change the revenue outlook significantly.

The total recommended adjustments in general fund revenue estimates are shown in Figure 8. The estimated change amounts are calculated by comparing the HJ2 estimate as adopted by the House in March with the April LFD analysis. A positive number means the LFD estimate is above the amount contained in HJ2.

Figure 8

Recommended Adjustments to HJ2				
Figures in Millions				
Revenue Category	Revision FY 2011	Revision FY 2012	Revision FY 2013	Biennium 2012-13
Individual Income Tax	5.298	5.599	5.294	10.893
Corporation Income Tax	0.219	1.296	1.537	2.833
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All Other Categories	<u>(0.145)</u>	<u>(0.353)</u>	<u>(0.635)</u>	<u>(0.988)</u>
Total General Fund	\$5.734	\$10.831	\$10.261	\$21.092

The legislature is faced with an extremely difficult task of developing a 2013 biennium budget in light of current economic conditions and how these conditions will affect future revenue collections. The duration and intensity of the “Great Recession” was not anticipated and had a profound impact on state general fund revenues. Even with these revised upward recommendations, it will take several years before revenues return to the peak level observed in FY 2008. As the new data were reviewed and analyzed by staff, two key points were noted.

First, with receipt of year to date collections and revised economic data, anticipated revenues are performing as expected except for the change in wage and salary income and oil prices. Without these adjustments, revenue collections would be close to being on target with the HJ2 estimates. Computer system issues, accounting changes, and collection timing patterns explain why other sources are showing improvement over FY 2010 collections and do not reflect changing economic conditions.

Second, the immediate task for the legislature is to adopt a balanced 2013 biennium budget. The major issue the legislature faces is the risk associated with the revised LFD recommendations.

There is a distinct possibility that refunds issued may be higher than anticipated when the peak refund season occurs in April and May. However, there is also the possibility that refunds will subside and that less refunds will be issued between now and June 30. Refunds issued from January 1 to March 31 are up about 2.0% from last year.

As the economy recovers, there is a good chance that individual and corporate taxpayers may adjust their estimated payments upward to reflect the improvement in their non-wage income levels. This adjustment could show up in estimated payments received in April and June. However, if taxpayers do not adjust their estimated payments (no penalty assessed), there is a high probability that refunds issued a year from now will be reduced reflecting the higher incomes for tax year 2011. Currently, there is no evidence that non-wage income will be up significantly.

Regardless, there are risks that could impact the revenue estimates negatively or positively. The LFD recommends the legislature discuss and debate revenue estimates to ensure the best possible numbers are used to balance the 2013 biennium budget.