

GENERAL FUND REVENUE

FY 2004

FY 2004 General Fund total resources are projected to be \$6.65 billion. This amount consists of \$6.46 billion of FY 2004 revenue plus a \$192.2 million balance forward from FY 2003. As indicated in *Table 1* below, the revised FY 2004 revenue estimate is \$240.0 million higher than the estimate from the FY 2004 budget enacted in the spring of 2003.

Table 1	
FY 2004 Revenue Forecast	
(\$ in Millions)	
Adopted FY 2004 Revenue Estimate	\$6,218.5
Revised Revenue Forecast	240.0
Revised FY 2004 Revenue Estimate	\$6,458.5

The revised FY 2004 estimate assumes an increase of 6.5% in on-going revenues (excluding Urban Revenue Sharing and federal disproportionate share payments) compared to the prior year. Based on preliminary December numbers, year-to-date on-going revenues are \$121 million above the original budget forecast.

As described below in the FY 2005 section, the JLBC Staff has used a consensus forecasting process to develop its FY 2005 General Fund revenue estimates. The JLBC Staff used the forecast consensus as a guide in its FY 2004 revenue projection, but did not adhere strictly to these rates. With six months of the fiscal year completed as of this writing, the FY 2004 estimates rely as heavily on year-to-date actual data as it does on a forecast projection. The JLBC Staff forecast incorporates the latest year to date information, while the other forecast components have one to two months less of actual data. *Table 2* below provides the FY 2004 consensus estimates and the rates used by the JLBC Staff in its forecast.

The individual revenue detail for FY 2004 is found in *Table 4* at the end of this section.

The FY 2004 General Fund revenue estimate of \$6.46 billion includes one-time revenues of \$187.4 million. FY 2004 one-time revenues include:

- Fund transfers of \$54.5 million – This amount represents the one-time transfer of balances from several funds into the General Fund in FY 2004.
- Tax amnesty revenues of \$43.0 million – The Department of Revenue (DOR) estimates that the tax amnesty program will generate a total of \$73.0 million in FY 2004. DOR indicates that about \$4.0 million

will be distributed to local jurisdictions, and about \$22.0 million represents audit activity that would have been collected in FY 2004 without the tax amnesty program. This leaves approximately \$47.0 million for the General Fund resulting from the amnesty program. This amount is \$22.0 million greater than the \$25.0 million estimate that was included in the enacted budget. The enacted budget included \$18.0 million in ongoing revenues resulting from the tax amnesty program, and an additional estimated \$7.0 million of one-time revenues. Based on actual amnesty returns, the level of ongoing revenues appears closer to \$4 million.

- Federal cash assistance of \$87.3 million – A provision of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 was an assistance grant to states. The first half of Arizona’s portion (\$87.2 million) was received in June. The second half of the \$174.5 million grant was received in October, and is included in the revenue estimate.
- Judicial collection plan revenue of \$2.6 million – The enacted budget includes a plan that requires 75% of excess FY 2004 court collections over FY 2003 collections be deposited into the General Fund (up to a maximum of \$45 million). Later in the fiscal year, these monies will be distributed to state agencies to defray the employer cost of state employee health insurance and retirement. The revenue estimate includes the year-to-date collections through November of \$2.6 million.

FY 2005

Projected FY 2005 General Fund total resources are \$6.93 billion. This amount includes \$6.75 of FY 2005 revenues plus a balance forward amount of \$178.7 million from FY 2004. On-going revenues are expected to increase 7.6% over FY 2004 collections excluding Urban Revenue Sharing and Federal disproportionate share revenues.

The FY 2005 estimates for the “Big 3” revenue categories (sales tax, individual income tax and corporate income tax) were developed by averaging the results of the following four forecasts:

- Finance Advisory Committee panel forecast of December 16, 2003. This independent panel consists of 18 public and private sector economists that meets three times a year to provide the Legislature with guidance on the status of the Arizona economy.
- The University of Arizona Economic and Business Research (EBR) General Fund baseline model.
- EBR’s conservative forecast model, and
- JLBC Staff projections.

The growth rates from each sector of the forecast are detailed in *Table 3* below. The FY 2005 forecast for the remaining revenue categories, which constitute about 6% of the total, was based on JLBC Staff estimates.

Table 2
FY 2004 Quartile Forecast Percentages

	<u>FAC</u>	UA <u>Low</u>	UA <u>Base</u>	<u>JLBC</u> ^{1/}	<u>Avg.</u>
Sales Tax	6.0%	6.0%	6.5%	6.3%	6.2%
Individual Income Tax ^{2/}	4.3%	6.4%	7.5%	7.6%	6.4%
Corporate Income Tax	10.5%	20.1%	20.1%	18.8%	17.3%

^{1/} JLBC estimate used in FY 2004 revenue estimate.
^{2/} Percentages did not include the shift of income tax liability from FY 2004 to FY 2005 due to underwithholding. The revenue forecast has been adjusted down to 3.9% to reflect this shift of collections into FY 2005.

Table 3
FY 2005 Quartile Forecast Percentages

	<u>FAC</u>	UA <u>Low</u>	UA <u>Base</u>	<u>JLBC</u>	<u>Avg.</u> ^{1/}
Sales Tax	6.1%	4.1%	7.5%	6.0%	5.9%
Individual Income Tax ^{2/}	7.4%	5.6%	9.9%	5.8%	7.2%
Corporate Income Tax	11.0%	6.4%	11.7%	8.0%	9.3%

^{1/} Consensus average used in FY 2005 revenue estimate.
^{2/} Percentages did not include the shift of income tax liability from FY 2004 to FY 2005 due to underwithholding. The revenue forecast has been adjusted to 11.0% to reflect these additional FY 2005 collections.

The individual income tax estimates for FY 2005 have been adjusted upward from the 4-sector consensus to reflect a technical increase in collections. The federal government enacted a tax reduction package in the summer of 2003, including a decrease in federal income tax withholding rates. Since state income tax withholding is a percentage of federal withholding, state income tax collections have temporarily declined. State withholding throughout the year is ultimately recouped when taxpayers file their income tax returns in April of each year. The state attempted to adjust its withholding rates to compensate for the decline in federal rates. This adjustment was insufficient.

In summary, state income tax liability has not changed, but the timing of collections has. The ultimate impact is that \$76 million of income tax collections that would have been collected in FY 2004 are now scheduled to be received in FY 2005. The consensus rates were adjusted accordingly. The Governor has proposed a statutory adjustment in state withholding rates to eliminate the underwithholding. This adjustment would generate another \$76 million in FY 2005 above the JLBC revenue estimates.

The individual revenue detail for FY 2005 is found in *Table 4* at the end of this section.

Ladewig Reserve – Based on the 2001 Arizona Supreme Court decision in the Ladewig v. State of Arizona case, the state is required to refund individual income taxes paid on non-Arizona dividends earned for the years 1986 through 1989. Payments and related costs associated with this case were originally estimated to total approximately \$348 million over 5 years.

Laws 2002, Chapter 321 provided a \$75 million “set-aside” for FY 2003 costs associated with the Ladewig case. Laws 2003, 1st Special Session, Chapter 2 reduced this allocation to \$15 million. This amount was to pay FY 2003 administrative costs associated with the settlement.

Laws 2003, Chapter 263 as transmitted to the Governor allocated \$75 million for Ladewig for FY 2004. Of this amount, \$7.3 million was for administrative costs, and the remainder was to be set aside for future taxpayer refunds. The Governor line-item vetoed the FY 2004 set-aside, in order to provide an additional \$75 million in the General Fund balance. As a result of the veto, there was no new funding available for administrative costs.

Most of the FY 2005 expenses reflect taxpayer refunds. Of the total refund, 50% is to be paid in FY 2005 and 25% in both FY 2006 and FY 2007. The FY 2005 cost was originally estimated to be \$161 million. Recent reports suggest that the FY 2005 payments will not be as high as expected. As a result, \$120 million has been set aside in the FY 2005 JLBC budget estimate.

Table 4

GENERAL FUND REVENUE FORECAST FY 2004 - FY 2005

ADJUSTED REVENUE GROWTH ^{1/}							
(\$ in Thousands)							
	ACTUAL FY 2003	FY 2004 FORECAST	% CHANGE ABOVE FY 2003	\$ CHANGE ABOVE FY 2003	FY 2005 FORECAST	% CHANGE ABOVE FY 2004	\$ CHANGE ABOVE FY 2004
Taxes:							
Sales and Use	3,033,877.7	3,224,279.9	6.3%	190,402.1	3,414,512.4	5.9%	190,232.5
Income -Individual	2,097,754.9	2,180,358.9	3.9%	82,604.0	2,420,198.4	11.0%	239,839.5
-Corporate	389,406.3	462,650.3	18.8%	73,244.0	505,676.8	9.3%	43,026.5
Tax Amnesty Program	0.0	4,000.0	N/A	4,000.0	4,000.0	0.0%	0.0
Property	25,689.8	37,600.0	46.4%	11,910.2	30,500.0	-18.9%	(7,100.0)
Luxury	64,587.0	60,000.0	-7.1%	(4,587.0)	60,000.0	0.0%	0.0
Insurance Premium	226,648.8	297,384.3	31.2%	70,735.5	343,711.0	15.6%	46,326.7
Estate	94,217.9	40,000.0	-57.5%	(54,217.9)	30,000.0	-25.0%	(10,000.0)
Other Taxes	8,689.4	4,762.8	-45.2%	(3,926.6)	4,762.8	0.0%	0.0
Sub-Total - Taxes	5,940,871.8	6,311,036.2	6.2%	370,164.3	6,813,361.4	8.0%	502,325.2
Other Non-Tax Revenues:							
Lottery	31,000.0	31,000.0	0.0%	0.0	31,000.0	0.0%	0.0
Licenses, Fees and Permits	97,520.4	105,528.6	8.2%	8,008.2	105,728.6	0.2%	200.0
Interest	12,855.3	25,000.0	94.5%	12,144.7	15,000.0	-40.0%	(10,000.0)
Transfers and Reimbursements	24,259.9	33,732.1	39.0%	9,472.2	36,419.1	8.0%	2,687.0
Sub-Total - Non-Tax	165,635.6	195,260.7	17.9%	29,625.1	188,147.7	-3.6%	(7,113.0)
Subtotal Adjusted Revenue	6,106,507.4	6,506,296.9	6.5%	399,789.4	7,001,509.1	7.6%	495,212.2
Urban Revenue Sharing (URS)	(430,559.1)	(365,065.1)	-15.2%	65,494.0	(373,074.2)	2.2%	(8,009.1)
Disproportionate Share Revenue	120,613.5	129,830.2	7.6%	9,216.7	111,447.4	-14.2%	(18,382.8)
Litigation/Other Set-Aside	(15,000.0)	0.0	-100.0%	15,000.0	0.0	N/A	0.0
Adjusted Revenue w/URS/Litigation	5,781,561.8	6,271,062.0	8.5%	489,500.1	6,739,882.3	7.5%	468,820.3
One-Time Financing Sources:							
FY 2003 Prison Funding	3,800.0	0.0	-100.0%	(3,800.0)	0.0	N/A	0.0
FY 2003 Transfers - 2nd RS/6th SS/1st SS	344,863.2	0.0	-100.0%	(344,863.2)	0.0	N/A	0.0
FY 2004 Judicial Enhancement	0.0	2,644.1	N/A	2,644.1	0.0	-100.0%	(2,644.1)
FY 2004/FY 2005 Transfers In	0.0	54,500.0	N/A	54,500.0	11,700.0	-78.5%	(42,800.0)
FY 2004 Tax Amnesty - 1st RS	0.0	43,000.0	N/A	43,000.0	0.0	-100.0%	(43,000.0)
FY 2004 Federal Cash Assistance	87,234.1	87,265.9	0.0%	31.8	0.0	-100.0%	(87,265.9)
Sub-Total - One-Time Financing Sources	435,897.3	187,410.0	-57.0%	(248,487.3)	11,700.0	-93.8%	(175,710.0)
Total Adjusted Revenue	6,217,459.1	6,458,472.0	3.9%	241,012.8	6,751,582.3	4.5%	293,110.3

^{1/} The adjusted revenue forecast includes tax law and other one-time changes and represents a "bottom line" revenue growth estimate.