Joint Legislative Budget Committee
Staff Memorandum

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DATE: September 1, 1999

TO: Members of the Legislature

FROM: Richard Stavneak, Director

SUBJECT: FY 1999 EXCESS GENERAL FUND REVENUE/ FORECAST PERFORMANCE

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Attached you will find the JLBC Staff analysis of excess FY 1999 revenues and the status of the "triggers."

If you need further information, please contact our office at 542-5491.

RS:lm
Attachment

FY 1999 Year End Review

The Joint Legislative Budget Committee Staff and the Governor's Office of Strategic Planning and Budgeting are statutorily required to jointly report by September 1, 1999 on the level of FY 1999 General Fund revenue. If actual FY 1999 revenue exceeds the budget forecast, certain conditional enactments, or "triggers" become effective. The JLBC Staff and OSPB have determined that FY 1999 revenue was $5,635,343,000, or $99,398,000 above the forecast.

This level of excess revenue will "trigger" $19.7 million in tax reductions, $29.3 million in spending increases, and a $50.4 million addition to the ending balance in FY 2000. Due to the delayed implementation of several tax triggers, however, the impact of the tax reductions will grow to $77.5 million in FY 2001. The elimination of one-time spending will reduce the permanent increase in spending in FY 2001 to $20.0 million (all set aside for K-12). The table below displays the triggered tax cuts and spending increases.

The revenue underestimate of $99.4 million represents a 1.8% forecast error. The majority of the error occurred in two volatile revenue sources: corporate income tax and estate tax collections. The forecast error for our two largest revenue sources, sales and individual income, was less than 1%.

STATUS OF TRIGGERS
WITH FINAL FY 1999 REVENUE

	$ in Millions	
	FY 2000	FY 2001 [1/]
Reduce Mining Severance Tax	$4.7	$8.0
One-Time Expenditures:		
Vehicle Emission Inspection	1.5	0.0
Dept. of Administration Building Renewal Fu nding	3.4	0.0
Land Department Growing Smarter	1.0	0.0
Lottery Advertising	1.5	0.0
Project Challenge Facilities	1.9	0.0
Reduce Corporate Income Tax Rate from 8.0% to 7.0%	0.0	32.0
Eliminate the R & D Tax Credit Cap	0.0	5.0
Phase Down Personal Property Minimum Value	0.0	2.5
Reduce Vehicle License Tax by 17 cents	15.0	30.0
Increase K-12 Support Level	20.0	20.0
Increase Balance Forward	50.4	1.9
TOTAL - FY 1999 EXCESS REVENUES	$99.4	$99.4

1/ Represents annualized impact of FY 2000 adjustments, and does not include additional triggers that may become effective if FY 2000 excess revenues exceed the FY 2000 statutory revenue amount.

Trigger Summary

At the level of $99.4 million in excess revenue, $77.5 million in tax reductions will be implemented by FY 2001. These reductions include $32 million in corporate income tax rate reductions, $30 million in vehicle license tax rate reductions, $8 million in mining severance cuts and $7.5 million in other reductions. Of this total tax package, only $19.7 million will become effective in FY 2000.

The excess revenue will also increase spending by $29.3 million in FY 2000. The Department of Education will receive $20.0 million of this amount as a permanent increase in the K-12 Basic State Aid support level to school districts. Another $9.3 million of the spending increases are one-time adjustments for FY 2000 only, including funding for vehicle emission inspections, state building repair, the Growing Smarter initiative, Lottery advertising, and the Project Challenge facility.

Forecast Evaluation Summary

In general, the revenue forecast faired well with only a 1.8% error. The majority of the error was in the corporate income tax ($44.2 million), and in the estate tax ($21.8 million). Both taxes are very volatile and difficult to predict. Although the sales tax experienced the third largest error in terms of dollar amount ($21.7 million), the percent error was very small (0.8%). The individual income tax forecast was our most impressive, realizing only a 0.2% error.

The forecast error for each tax category in terms of dollar value and percentage is provided in the following table. The category titled "Other" captures the forecast error of minor taxes, as well as miscellaneous revenues.

Summary of FY 1999 Forecast Error by Tax

($ in Millions)

	$ Error	% Error
Sales	21.7	0.8
Individual Income	3.7	0.2
Corporate Income	44.2	8.8
Property	(1.3)	(2.9)
Vehicle License	5.2	6.1
Estate	21.8	33.2
Luxury	(0.4)	(0.7)
Other	4.5	6.0
Overall	**$ 99.4**	**1.8%**

Corporate Income Tax collections in FY 1999 were $44.2 million, or 8.8% above forecast. This forecast was too pessimistic because corporate collections lagged during the first 7 months of the year. At the time of our forecast revision in February, corporate income tax collections were (6.0)% below the prior year, and we did not expect the rest of the year to deviate from this trend. The remaining months of the fiscal year, however, were very strong and we ended the year an unexpected 3.3% higher than FY 1998.

The corporate income tax is by far the most volatile of the major tax categories. In FY 1997, net corporate collections increased from $448.0 million to $600.9 million. The following year collections dropped to $528.1 million, only to recover with $545.4 million in net collections in FY 1999. Because corporate income tax collections do not strictly follow any common economic variables, and because limited information is available concerning individual company returns, this tax will continue to be one of the most volatile.

Estate Tax collections were $21.8 million, or 33.2% above our forecast. According to the Department of Revenue, this past year's exceptionally high collections were the result of a 55% increase in the number of estate tax returns. This surge in tax returns is believed to be primarily caused by the deaths of some of the elderly and wealthy individuals who moved to Arizona in the last decade or so. To a lesser extent, the increased collections are also the result of more audits and the finalized processing of a few extremely large estates.

Sales Tax collections in FY 1999 were $21.7 million, or 0.8% above our forecast. We underforecasted this tax because consumer spending showed surprising strength in comparison to the last several years. Sales tax revenue actually grew by 8.8% compared to growth rates of 7.1% in FY 1998 and 5.1% in FY 1997.

The sales tax categories that exhibited noteworthy strength were contracting, which grew by 17.0%, and retail, which grew by 8.2%.

Individual Income Tax collections were $3.7 million, or 0.2% above the forecast. We were fortunate to be so close to our forecast as individual income tax collections continue to display surprising strength. Withholding grew by 10.8% compared to 10.4% the previous year. Estimated and final payments grew by 15.7% in FY 1999 versus 10.1% in the prior year. These 2 components of income tax receipts have grown dramatically in the last 3 years. This reflects both the growth of independent businesses in Arizona, which often make quarterly estimated payments, and the growth of capital gains income for many taxpayers during the year. The volatility of these capital gains has made this tax increasingly difficult to forecast.