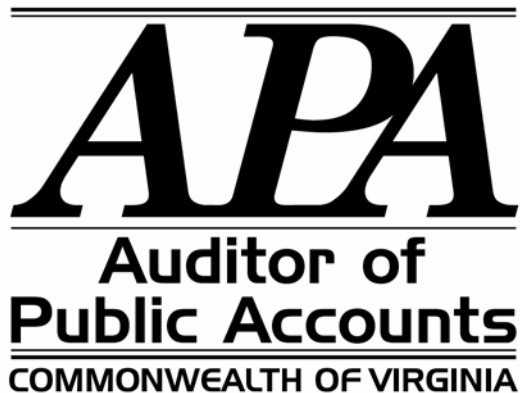


REVENUE STABILIZATION FUND

**CALCULATIONS
FOR THE YEAR ENDED
JUNE 30, 2006**





Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

October 26, 2006

Dear General Assembly Member:

REVENUE STABILIZATION FUND

This Office is providing a report of the required calculations for the Revenue Stabilization Fund. Appendix A provides historical information concerning the establishment of the Revenue Stabilization Fund and the requirements surrounding it.

CALCULATION OF MAXIMUM FUND ALLOWED

<u>Years</u>	<u>Tax Revenues (In Thousands)</u>
2004	10,448,160
2005	12,036,699
2006	13,210,174
Average for three years	\$11,898,344
Maximum fund allowed (10% of average)	\$ 1,189,834

CALCULATION OF CONSTITUTIONAL DEPOSIT

As a result of changes in the tax structure enacted by the 2004 General Assembly, there have been both increases and decreases in the taxes used to perform the calculation of the mandatory deposit into the Revenue Stabilization Fund. The Virginia Constitution permits the exclusion, in whole or in part, of the growth in tax revenues resulting from increases in tax rates or the repeal of exemptions from the computation of the mandatory deposit for a period up to six years after the effective year of the change. Therefore, for fiscal year 2006 we calculated the mandatory deposit and have shown an alternative calculation, which includes the tax increases and exemption repeals.

Mandatory Deposit: Excluding Tax Increases and Exemption Repeals

Excluding the effect of tax increases and exemption repeals, certified tax revenues increased by 8.77 percent between fiscal years 2005 and 2006, and the average growth for the preceding six years was 5.40

percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 3.37 percent.

As a result, the General Assembly must make a mandatory deposit of at least \$213,380,695 related to fiscal year 2006 tax collections excluding tax increases and exemption repeals, as required by the Virginia Constitution. Exhibit 1 provides the certified tax revenue amounts used in the mandatory deposit calculation and the funding progress of the Revenue Stabilization Fund based on the required mandatory deposit.

To perform this calculation, we used estimates provided by the Department of Taxation (Taxation) related to the effect of tax increases and exemption repeals on certified tax revenues for fiscal year 2006. We reviewed the methodology and data Taxation used to arrive at the estimated amounts to ensure the amounts were reasonable. Taxation could not establish a methodology to estimate the additional tax revenue associated with the elimination of the common carrier sales and use tax exemption; therefore, we could not eliminate the effect of this tax change from the mandatory deposit calculation. The amounts provided by Taxation related to the effect of tax increases and exemption repeals are included in the schedule below.

**EFFECT OF TAX INCREASES AND EXEMPTION REPEALS
(IN THOUSANDS)**

<u>Tax Source</u>	<u>Tax Category Effected</u>	<u>Amount</u>
State sales and use tax rate	State sales and use	\$ 434,400*
Income adjusted age deduction	Individual and fiduciary income	51,380
Public service corporation exemption	State sales and use	37,220
Delaware holding companies deduction	Corporate income	25,000
Pass-through entities tax base	Individual and fiduciary income	11,639

*Amount based on actual collections as recorded in the Commonwealth Accounting and Reporting System.

Alternative Deposit: Including Tax Increases and Exemption Repeals

Since the Virginia Constitution allows the Governor and General Assembly to include the effect of tax increases and exemption repeals, in whole or in part, under the alternative calculation certified tax revenues increased by 9.75 percent between fiscal years 2005 and 2006, and the average revenue growth for the preceding six years was 6.05 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 3.70 percent.

Based on fiscal year 2006 certified tax revenues including tax increases and exemption repeals, the General Assembly may make a deposit, in addition to making the mandatory deposit calculated above, of up to \$31,046,730, or a total deposit of \$244,427,425, which includes the mandatory deposit. Exhibit 2 provides the certified tax revenue amounts used in the alternative deposit calculation and the funding progress of the Revenue Stabilization Fund based on the alternative deposit, which includes the effect of tax increases and exemption repeals.

Fiscal Year 2006 Deposits and Transfer to General Fund

Item 280 of Chapter 2 of the Special Session 1, 2006 Acts of Assembly, appropriated a total of \$584,160,131 for deposit into the Revenue Stabilization Fund during fiscal year 2006. This amount consists of the June 2006 mandatory deposit, as well as an advance payment in the amount of \$402,224,018. Item 280 stipulated that the advance payment would first apply to the June 2007 mandatory deposit (for actual certified revenues for fiscal year 2005). The remaining excess less any transfer to the General Fund if the additional

deposit caused the balance to exceed the maximum fund allowed, would then apply to the June 2008 mandatory deposit (for actual certified revenues for fiscal year 2006). At June 30, 2006, the Revenue Stabilization Fund included the 2006 mandatory deposit, all interest earnings, and the advance payment.

Consequently at June 30th, the balance exceeded the maximum fund allowed and there was a transfer from the Revenue Stabilization Fund to the General Fund in accordance with section 2.2-1829 of the Code of Virginia in the amount of \$19,103,708. The net effect of the prepayment reduces the June 2007 mandatory deposit to zero and reduces the June 2008 mandatory and alternative deposits calculated above by \$29,063,066 as illustrated in Exhibits 1 and 2.

In the Comptroller's General Fund Preliminary Annual Report for the fiscal year ended June 30, 2006, the Governor has indicated that it is his intention to make a deposit of \$187,510,000 during fiscal year 2008 related to fiscal year 2006 tax revenues, which takes into consideration the advance payment indicated above. Taxation revised its estimate for the pass-through entities tax base subsequent to release of the General Fund Preliminary Annual Report. We reviewed the methodology Taxation used for the revised estimate and have performed our calculation using the new estimate, which resulted in a lower required mandatory deposit than calculated by the Department of Accounts.

CALCULATION OF STATUTORY DEPOSIT

Section 2.2-1829 of the Code of Virginia, as discussed in Appendix A, requires the Governor to include an additional deposit to the Revenue Stabilization Fund in his budget recommendations if certain conditions occur. Under each funding alternative, as shown in Exhibit 3, the growth of certified tax revenues meets the requirements of two of the three conditions. However, estimated general fund revenues for fiscal year 2007 are not 5 percent greater than actual general fund revenues for fiscal year 2006 as required by the third condition; therefore, there is no need for an additional deposit. Should the Governor revise the revenue forecast above 5 percent after the date of this letter, this change could lead to the need for an additional deposit.

Should you have any questions concerning this information, please contact me.

AUDITOR OF PUBLIC ACCOUNTS

WJK:aom
Enclosure

Exhibit 1 – MANDATORY DEPOSIT

**CALCULATIONS USED FOR THE REVENUE STABILIZATION FUND
(IN THOUSANDS)**

Tax Revenue Required for Computation						
Years	Individual and Fiduciary Income Taxes	Corporate Income Tax	State Sales and Use Taxes	Totals	Average Annual Percentage Change	Preceding Six Year Annual Average
2000	6,829,587	565,909	2,201,533	9,597,029	11.94%	8.04%
2001	7,226,407	363,757	2,272,954	9,863,118	2.77%	9.21%
2002	6,710,857	290,215	2,429,845	9,430,917	(4.38)%	8.50%
2003	6,775,799	343,319	2,335,959	9,455,077	0.26%	6.77%
2004	7,430,870	434,493	2,582,797	10,448,160	10.50%	5.36%
2005 ^a	8,303,557	584,108	2,742,495	11,630,160	11.31%	5.22%
2006 ^a	9,245,652	846,554	2,558,328	12,650,534	8.77%	5.40%

^a Amounts and percentages **exclude** the effect of tax increases and exemption repeals.

FISCAL YEAR 2006 FUNDING

	Amounts (In Thousands)
Balance at June 30, 2005	\$ 482,259
Interest earned during fiscal year 2006	17,349
June 2006 mandatory deposit	181,936
Prepayment of 2007 mandatory deposit	354,057
Partial prepayment of 2008 mandatory deposit	48,167
Less amount in excess of maximum fund allowed transferred to the General Fund	<u>(19,103)</u>
Total in fund at June 30, 2006	\$ 1,064,665
Percentage of maximum fund at June 30, 2006	100%

PROJECTED FUTURE FUNDING

Fiscal year 2007:	
No additional deposit required	
Fiscal year 2008:	
June 2008 mandatory deposit	213,381
Less net June 2006 prepayment*	<u>(29,063)</u>
Projected 2008 mandatory deposit**	<u>\$ 184,318</u>

*Net prepayment equals prepayment of 2008 mandatory deposit less amount in excess of maximum fund allowed transferred to the General Fund.

**The amount of the mandatory deposit may be less if the deposit amount would cause the fund to exceed the maximum fund allowed. There will be a new maximum fund calculation in fiscal year 2008 when the actual deposit will occur using the certified tax revenue collected in fiscal years 2005, 2006 and 2007.

Exhibit 2 – ALTERNATIVE DEPOSIT

**CALCULATIONS USED FOR THE REVENUE STABILIZATION FUND
(IN THOUSANDS)**

Tax Revenue Required for Computation						
Years	Individual and Fiduciary Income Taxes	Corporate Income Tax	State Sales and Use Taxes	Totals	Average Annual Percentage Change	Preceding Six Year Annual Average
2000	6,829,587	565,909	2,201,533	9,597,029	11.94%	8.04%
2001	7,226,407	363,757	2,272,954	9,863,118	2.77%	9.21%
2002	6,710,857	290,215	2,429,845	9,430,917	(4.38)%	8.50%
2003	6,775,799	343,319	2,335,959	9,455,077	0.26%	6.77%
2004	7,430,870	434,493	2,582,797	10,448,160	10.50%	5.36%
2005 ^a	8,352,488	616,690	3,067,521	12,036,699	15.20%	5.22%
2006 ^a	9,308,671	871,554	3,029,949	13,210,174	9.75%	6.05%

^a Amounts and percentages **include** the effect of tax increases and exemption repeals.

FISCAL YEAR 2006 FUNDING

	Amounts (In Thousands)
Balance at June 30, 2005	\$ 482,259
Interest earned during fiscal year 2006	17,349
June 2006 mandatory deposit	181,936
Prepayment of 2007 mandatory deposit	354,057
Partial prepayment of 2008 mandatory deposit	48,167
Less amount in excess of maximum fund allowed transferred to the General Fund	<u>(19,103)</u>
 Total in fund at June 30, 2006	 \$1,064,665
 Percentage of maximum fund at June 30, 2006	 100%

PROJECTED FUTURE FUNDING

Fiscal year 2007:	
No additional deposit required	
Fiscal year 2008:	
Required June 2008 mandatory deposit	213,381
Alternative June 2008 maximum deposit	31,046
Less June 2006 prepayment*	<u>(29,063)</u>
 Total potential deposits**	 <u>\$ 215,364</u>

*Net prepayment equals prepayment of 2008 mandatory deposit less amount in excess of maximum fund allowed transferred to the General Fund.

**The amount of the mandatory deposit may be less if the deposit amount would cause the fund to exceed the maximum fund allowed. There will be a new maximum fund calculation in fiscal year 2008 when the actual deposit will occur using the certified tax revenue collected in fiscal years 2005, 2006 and 2007.

Exhibit 3

CALCULATIONS FOR STATUTORY DEPOSIT

	<u>Excluding Effect of Tax Increases and Exemption Repeals</u>	<u>Including Effect of Tax Increases and Exemption Repeals</u>
Growth of certified tax revenues collected in most recently ended fiscal year.	8.77%	9.75%
Average revenue growth for the preceding six years multiplied by 1.5.	8.10%	9.07%
Estimate of general fund revenues for the fiscal year in which the deposit is to be made as a percentage of actual general fund revenues for the immediately preceding fiscal year.	4.17%	4.17%

APPENDIX A HISTORICAL INFORMATION

Mandatory Deposit

Article X, Section 8 of the Virginia Constitution and the enabling legislation established the Revenue Stabilization Fund and require this Office to report to the General Assembly the following:

1. certified tax revenues for the calculation of the Revenue Stabilization Fund;
2. the maximum size allowed of the Revenue Stabilization Fund; and
3. the amount of the mandatory deposit to the fund.

The amount in the Revenue Stabilization Fund is not to exceed 10 percent of the Commonwealth's average annual tax revenues derived from taxes on income and retail sales as certified by our Office for the three fiscal years immediately preceding. The General Assembly is required to make deposits to the Revenue Stabilization Fund to equal at least 50 percent of the total of: certified tax revenues for the most recently ended fiscal year times the difference between the annual percentage increase in certified tax revenues collected for the most recently ended fiscal year and the average annual percentage increase in certified tax revenues collected for the six fiscal years immediately preceding the most recently ended fiscal year.

Item 280 of Chapter 2 of the Special Session 1, 2006 Acts of Assembly requires this Office to report to the General Assembly on or before November 1st of each year.

Statutory Deposit

Legislation passed during the 2003 General Assembly Session added a requirement for an additional deposit to the Revenue Stabilization Fund under certain conditions. The provisions of this change were effective July 1, 2003. The conditions are as follows:

1. a growth of the certified tax revenues collected in the most recently ended fiscal year of 8 percent or greater than the certified tax revenues collected for the immediately preceding fiscal year;
2. a growth of the certified tax revenues for the most recently ended fiscal year greater than 1.5 times the average percentage increase in the certified tax revenues collected in the six fiscal years immediately preceding the most recently ended fiscal year; and
3. the estimate of general fund revenues prepared in accordance with Section 2.2-1503 of the Code of Virginia for the fiscal year in which the deposit is to be made is at least 5 percent greater than the actual general fund revenues for the immediately preceding fiscal year.

If the above conditions exist, the Governor must include in his budget recommendations, submitted to the General Assembly in the subsequent session, an amount equal to at least 25 percent of the product of the certified tax revenues collected in the most recently ended fiscal year multiplied by the difference between the annual percentage increase in the certified tax revenues collected for the most recently ended fiscal year and the average annual increase in the certified tax revenues collected in the six fiscal years immediately preceding the most recently ended fiscal year.