

REVENUE STABILIZATION FUND

**CALCULATIONS
FOR THE YEAR ENDED
JUNE 30, 2007**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA



Commonwealth of Virginia

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

November 1, 2007

Dear General Assembly Member:

REVENUE STABILIZATION FUND

This Office is providing a report of the required calculations for the Revenue Stabilization Fund. On October 31, 2007, the Tax Commissioner noted that an application change affected the distribution between tax revenue and interest and penalties, which we discuss later in this report. The change does affect the amount of tax revenues previously reported by this Office and the State Comptroller.

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>
2005	\$ 12,036,699
2006	\$ 13,162,050
2007	\$ 13,941,647
Average for three years	\$ 13,046,799
Maximum fund allowed (10% of average)	\$ 1,304,680

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 2007, we performed two calculations: one including the effect of the tax increases and exemption repeals and the other excluding the effect of the tax increases and exemption repeals.

The amount we report as the mandatory deposit represents the calculation resulting in the lower required deposit. For fiscal years 2005 and 2006, the calculation resulting in the lower deposit excluded the effect of the tax increases and exemption repeals. For fiscal year 2007, the calculation resulting in the lower deposit includes the effect of the tax increases and exemption repeals. The primary reason for this change is it took two years to fully realize the impact of the tax rate increase and exemption repeals since the changes took place during fiscal year 2005.

For fiscal year 2007 and in future years, there should be minimal differences in the average annual percentage increase we calculate under each calculation method. However, there will continue to be differences in the six year average annual increase we calculate under each calculation method due to the impact of the 2005 and 2006 calculations. Therefore, we expect for the remaining three years in which we perform two calculations that the one resulting in the lower required deposit will include the effect of the tax increases and exemption repeals.

Minimum Mandatory Deposit: Including Tax Increases and Exemption Repeals

Including the effect of tax increases and exemption repeals, certified tax revenues increased by 5.92 percent between fiscal years 2006 and 2007, and the average revenue growth for the preceding six years was 5.62 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 0.30 percent.

As a result, the General Assembly must make a minimum mandatory deposit of at least \$21,320,527 for fiscal year 2007, as required by the Virginia Constitution. Exhibit 1 provides the certified tax revenue amounts used in the minimum mandatory deposit calculation and the funding progress of the Revenue Stabilization Fund based on the minimum mandatory deposit, which includes the effect of the tax increases and exemption repeals.

Alternative Deposit: Excluding Tax Increases and Exemption Repeals

Excluding the effect of tax increases and exemption repeals, under the alternative calculation, certified tax revenues increased by 5.93 percent between fiscal years 2006 and 2007, and the average growth for the preceding six years was 4.80 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 1.13 percent.

Based on fiscal year 2007 certified tax revenues excluding tax increases and exemption repeals, the General Assembly may make a deposit, in addition to making the mandatory deposit calculated above, of up to \$53,910,028, or a total deposit of \$75,230,555. 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 excludes the effect of tax increases and exemption repeals.

To perform this calculation, we used estimates provided by the Department of Taxation (Taxation) for the effect of tax increases and exemption repeals on certified tax revenues for fiscal year 2007. We reviewed Taxation's methodology and data 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. Below is Taxation's estimate of the effect of tax increases and exemption repeals.

**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	\$ 450,307*
Income adjusted age deduction	Individual and fiduciary income	52,900
Public service corporation exemption	State sales and use	45,200
Delaware holding companies deduction	Corporate income	25,000
Pass-through entities tax base	Individual and fiduciary income	18,400

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

Effect of Application Change

As reported by the Tax Commissioner on October 31, 2007, an application change affected the distribution between tax revenue and interest and penalties in the interface between the Department of Taxation's revenue system and the Commonwealth Accounting and Reporting System. The Tax Commissioner has recommended the Comptroller reclassify \$48,124,043 in tax revenues for fiscal year 2006 and \$79,799,222 in tax revenues for fiscal year 2007 as interest and penalties. This change does not affect the total General Fund revenues, but affects the Revenue Stabilization Fund calculation as discussed later.

We performed our calculations using the corrected revenue amounts. Therefore, the deposit and maximum fund allowed amounts we report in this letter differ from the amounts the Comptroller included in the General Fund Preliminary Annual Report.

Fiscal Year 2007 Deposits and Transfer to General Fund

In accordance with Section 2.2-1829 of the Code of Virginia, the Governor must include an additional deposit to the Revenue Stabilization Fund in his budget recommendations if certain conditions occur. The changes in the revenue estimates for fiscal year 2007 caused the Governor to include in Item 260.10 of Chapter 847 of the 2007 Acts of Assembly, \$106,690,348 for deposit into the Revenue Stabilization fund during fiscal year 2007. This amount represents a statutory deposit triggered by the Governor's revision of the revenue forecast subsequent to our October 26, 2006, letter. We reviewed the calculation of the statutory deposit and determined the Governor's revision of the revenue forecast did trigger the requirement.

At June 30, 2007, the balance in the Revenue Stabilization Fund exceeded the maximum fund allowed, and there was a transfer of \$34,186,251 from the Revenue Stabilization Fund to the General Fund in accordance with section 2.2-1829 of the Code of Virginia. This amount represents a portion of the interest earned during fiscal year 2007.

Fiscal Year 2008 Pending Deposits

The General Assembly must make a deposit in fiscal year 2008 related to actual collections during fiscal year 2006. We calculated a mandatory deposit of \$186,495,460 for fiscal year 2008. However, the Governor made a \$29,063,066 prepayment in June 2006, which reduced the fiscal year 2008 payment to \$157,432,364.

In the Comptroller's General Fund Preliminary Annual Report for the fiscal year ended June 30, 2007, the Governor indicated that it is his intention to make a deposit of \$119,109,539. The amount is the difference between the balance in the Revenue Stabilization Fund at June 30, 2007, and the maximum

fund allowed for fiscal year 2008, which used the revenues reported in the General Fund Preliminary Annual Report.

The difference between the balance in the Revenue Stabilization Fund at June 30, 2007, and the maximum fund allowed presented in this report is \$114,845,430. This is the maximum deposit the Governor can make since the Virginia Constitution does not allow deposits to the Revenue Stabilization Fund to result in a balance in excess of the maximum fund allowed.

CALCULATION OF STATUTORY DEPOSIT

As discussed above, 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 calculation methodology, as shown in Exhibit 3, the growth of certified tax revenues meets the requirements of only one of the three conditions. Therefore, the Governor is not required to include an additional deposit in his budget recommendations.

CALCULATION OF WITHDRAWAL

Article X, Section 8 of the Virginia Constitution, as discussed in Appendix A, establishes the requirements for making a withdrawal from the Revenue Stabilization Fund. On October 1, 2007, the Governor officially indicated that he may request that the General Assembly consider a withdrawal from the Fund for the fiscal year ended June 30, 2008.

To assist the General Assembly in its consideration of this request, we are providing the following information. A withdrawal from the fund can occur to compensate for no more than one-half of the difference between the total general fund revenues appropriated and a revised general fund revenue forecast during a subsequent regular or special legislative session. In addition, the withdrawal can occur only if general fund revenues appropriated exceed the revised general fund forecast by more than two percent of certified tax revenues collected in the most recently ended fiscal year.

On August 20, 2007, the Governor released revised estimates of revenue collections for fiscal year 2008. The general fund revenues appropriated in Chapter 847 exceed the revised general fund forecast by \$606,985,000, which exceeds the two percent threshold of \$278,833,000. Therefore, the Governor could request a withdrawal of up to \$303,492,500, which is one-half of the calculated difference between the general fund revenues appropriated and the revised general fund forecast for fiscal year 2008. This amount is subject to change based on the general fund forecast the Governor includes in his official budget recommendations for the remainder of fiscal year 2008.

All actions withdrawing funds from Revenue Stabilization Fund are subject to review and approval by the General Assembly. Exhibit 4 contains detailed information showing the calculations of the amounts above.

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

AUDITOR OF PUBLIC ACCOUNTS

Enclosure
SAH:wdh

Exhibit 1

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

Years	Tax Revenue Required for Computation				Average Annual Percentage Change	Preceding Six Year Annual Average
	Individual and Fiduciary Income Taxes	Corporate Income Tax	State Sales and Use Taxes	Totals		
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	9,201,966	842,116	2,558,328	12,602,410	8.36%	5.40%
2007 ^b	9,787,786	879,575	3,274,286	13,941,647	5.92%	5.62%

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

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

**SCHEDULE OF FUNDING PROGRESS
MINIMUM MANDATORY DEPOSIT**

	Amounts (In Thousands)
Balance at June 30, 2006	\$ 1,064,665
Interest earned during fiscal year 2007	52,665
June 2007 statutory deposit	106,690
Less amount in excess of maximum fund allowed transferred to the General Fund (interest)	<u>(34,186)</u>
Total in fund at June 30, 2007	<u>1,189,834</u>
Percentage of maximum fund allowed	91%
Required future deposits:	
Fiscal year 2008 required deposit	114,845
Fiscal year 2009 minimum mandatory deposit	<u>21,321</u>
Total fund including required deposits	<u>\$ 1,326,000*</u>

*While the total fund including future deposits exceeds the current maximum fund calculation, there will be a new maximum fund calculation in fiscal year 2009 when the actual deposit will occur which will use certified tax revenue collected in fiscal years 2006, 2007 and 2008.

Exhibit 2

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

Years	Tax Revenue Required for Computation				Average Annual Percentage Change	Preceding Six Year Annual Average
	Individual and Fiduciary Income Taxes	Corporate Income Tax	State Sales and Use Taxes	Totals		
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	9,264,985	867,116	3,029,949	13,162,050	9.35%	6.05%
2007 ^b	9,716,486	854,575	2,778,779	13,349,840	5.93%	4.80%

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

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

**SCHEDULE OF FUNDING PROGRESS
ALTERNATIVE DEPOSIT**

	Amounts (In Thousands)
Balance at June 30, 2006	\$ 1,064,665
Interest earned during fiscal year 2007	52,665
June 2007 statutory deposit	106,690
Less amount in excess of maximum fund allowed transferred to the General Fund (interest)	<u>(34,186)</u>
Total in fund at June 30, 2007	<u>1,189,834</u>
Percentage of maximum fund allowed	91%
Required future deposits:	
Fiscal year 2008 required deposit	114,845
Fiscal year 2009 minimum mandatory deposit	21,321
Alternative fiscal year maximum deposit	<u>53,910</u>
Total potential deposits	<u>190,076</u>
Total fund including mandatory and alternative deposits	<u>\$ 1,379,910*</u>

*While the total fund including mandatory and alternative deposits exceeds the current maximum fund calculation, there will be a new maximum fund calculation in fiscal year 2009 when the actual deposit will occur which will use certified tax revenue collected in fiscal years 2006, 2007 and 2008.

Exhibit 3

CALCULATIONS FOR STATUTORY DEPOSIT

(As required by Section 2.2-1829 of the Code Of Virginia)

	<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	5.93%	5.92%
Average revenue growth for the preceding six years multiplied by 1.5	7.20%	8.43%
Increase of estimated general fund revenues for the fiscal year in which the deposit is to be made over general fund revenues for the immediately preceding fiscal year	5.57%	5.57%

See the Statutory Deposit Section in Appendix A for conditions triggering a deposit.

Exhibit 4

CALCULATIONS FOR WITHDRAWALS

Calculation of 2 Percent Threshold

	Threshold Amounts (in thousands)
Certified tax revenues collected in most recently ended fiscal year (2007)	\$ 13,941,647
2% of certified tax revenues (threshold established by Virginia Constitution)	\$278,833

Calculation of Total Revised General Fund Forecast

	Revised Forecast Amounts (in thousands)
General fund revenues (per August 2007 forecast)	\$ 16,025,700
General fund transfers (per August 2007 forecast)	890,800
General fund balance forward*	<u>117,800</u>
Total Revised General Fund Forecast	<u>\$ 17,034,300</u>

* Equals difference between planned carry forward of \$326,300 included in Chapter 847 and fiscal year 2007 forecast variance of \$208,500 per the August 2007 report.

Calculation of Variance

	Variance Amounts (in thousands)
General fund revenues appropriated (per Chapter 847)	\$ 17,641,285
Revised general fund forecast	<u>17,034,300</u>
Calculated Variance	<u>\$ 606,985</u>

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 multiplied by 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 260.10 of Chapter 847 of the 2007 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 five 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.

Withdrawals

Per Article X, Section 8 of the Virginia Constitution, the General Assembly may appropriate an amount for transfer from the Fund to compensate for no more than one-half of the difference between the total general fund revenues appropriated and a revised general fund revenue forecast presented to the General Assembly prior to or during a subsequent regular or special legislative session. However, no transfer shall be made unless the general fund revenues appropriated exceed such revised general fund revenue forecast by more than two percent of certified tax revenues collected in the most recently ended fiscal year. Furthermore, no appropriation or transfer from such fund in any fiscal year shall exceed more than one-half of the balance of the Revenue Stabilization Fund.