

REVENUE STABILIZATION FUND

**CALCULATIONS
FOR THE YEAR ENDED
JUNE 30, 2008**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 30, 2008

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> |
|--|--|
| 2006 | \$13,162,050 |
| 2007 | \$13,941,647 |
| 2008 | \$14,227,165 |
| Average for three years | \$13,776,954 |
| Maximum fund allowed (10% of average) | \$ 1,377,695 |

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, beginning with fiscal year 2005 and continuing through fiscal year 2010, we will perform 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. For fiscal year 2008, neither calculation method requires a deposit to the fund.

For fiscal years 2005 and 2006, the calculation resulting in the lower deposit excluded the effect of the tax increases and exemption repeals. In fiscal year 2007, the calculation resulting in the lower deposit included 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.

In fiscal year 2008 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. We expect for the remaining 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. Therefore, in this report we identify the mandatory deposit calculation as including tax increases and exemption repeals and the alternative calculation as excluding tax increases and exemption repeals.

Minimum Mandatory Deposit Calculation: Including Tax Increases and Exemption Repeals

Including the effect of tax increases and exemption repeals, certified tax revenues increased by 2.05 percent between fiscal years 2007 and 2008, and the average revenue growth for the preceding six years was 6.14 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is a *negative* 4.09 percent.

Since the average growth resulting from the minimum mandatory deposit calculation is negative, there is no requirement to make a deposit to the fund. Exhibit 1 provides the certified tax revenue amounts used in the minimum mandatory deposit calculation, which includes the effect of the tax increases and exemption repeals.

Alternative Deposit Calculation: Excluding Tax Increases and Exemption Repeals

Excluding the effect of tax increases and exemption repeals, under the alternative calculation, certified tax revenues increased by 2.01 percent between fiscal years 2007 and 2008, and the average growth for the preceding six years was 5.33 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is a *negative* 3.32 percent.

Since the average growth resulting from the alternative deposit calculation is negative, there is no requirement to make a deposit to the fund. Exhibit 1 provides the certified tax revenue amounts used in the alternative deposit calculation, which excludes the effect of the 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 2008. 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.

**FISCAL YEAR 2008 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 | \$ 453,307* |
| Income adjusted age deduction | Individual and fiduciary income | 55,600 |
| Public service corporation exemption | State sales and use | 38,600 |
| Delaware holding companies deduction | Corporate income | 30,500 |
| Pass-through entities tax base | Individual and fiduciary income | 31,000 |

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

Fiscal Year 2008 Activity and Pending Deposit

In June 2008, in accordance with Item 260.10 A.3 of Chapter 847 of the 2008 Acts of Assembly, there was a deposit of \$114,845,430 to the Revenue Stabilization Fund. Immediately following this deposit, in accordance with Item 260.10 B.1 of Chapter 847 of the 2008 Acts of Assembly, there was a withdrawal of \$351,500,000 from the Fund.

In Chapter 879 of the 2008 Acts of Assembly, the General Assembly has appropriated \$21,320,527 for deposit into the Fund during fiscal year 2009. This amount represents the minimum mandatory deposit for fiscal year 2009 related to actual tax collections during fiscal year 2007. Exhibit 2 provides the funding progress of the Fund through June 30, 2008, and the anticipated balance following the appropriated deposit for fiscal year 2009.

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 both calculation methodologies, as shown in Exhibit 3, the growth of certified tax revenues does not meet any of the required conditions. Therefore, the Governor does not need 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 9, 2008, the Governor officially indicated that he plans to request that the General Assembly consider a \$400 million 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 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. In addition, a withdrawal from the Fund can 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. Finally, a withdrawal from the Fund cannot exceed more than one-half the balance of the Fund.

In October 2008, the Governor released revised revenue collections for fiscal year 2009. The general fund revenues appropriated in Chapter 879 exceed the revised general fund forecast by \$950,876,000, which exceeds the two percent threshold of \$284,543,000. Therefore, the Governor could request a withdrawal of up to \$475,438,000, which is one half of the calculated difference between the general fund revenues appropriated and the revised general fund forecast for fiscal year 2009 and below one half of the balance of the Fund at June 30, 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 2009.

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)**

| 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 |
| 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% |
| 2008 ^b | 10,117,132 | 807,852 | 3,302,181 | 14,227,165 | 2.05% | 6.14% |

^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.

**CALCULATIONS USED FOR THE REVENUE STABILIZATION FUND
ALTERNATIVE DEPOSIT
(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 |
| 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% |
| 2008 ^b | 10,030,532 | 777,352 | 2,810,274 | 13,618,158 | 2.01% | 5.33% |

^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.

Exhibit 2

SCHEDULE OF FUNDING PROGRESS

| | <u>Amounts</u> <u>(In Thousands)</u> |
|--|---|
| Balance at June 30, 2007 | \$1,189,834 |
| June 2008 mandatory deposit | 114,845 |
| June 2008 withdrawal | (351,500) |
| Interest earned during fiscal year 2008 | <u>61,691</u> |
| Total in fund at June 30, 2008 | <u>1,014,870</u> |
| Percentage of maximum fund allowed | 74% |
| Required future deposits*: | |
| Fiscal year 2009 minimum mandatory deposit | <u>21,321</u> |
| Total fund including required deposits | <u>\$1,036,191</u> |

*A fiscal year 2010 deposit is not required based on fiscal year 2008 calculations including and excluding the effect of tax increases and exemption repeals.

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 | 2.01% | 2.05% |
| Average revenue growth for the preceding six years multiplied by 1.5 | 8.00% | 9.21% |
| 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* | (4.02)% | (4.02)% |

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

*Calculated based on revised general fund revenue estimate released by the Governor in October 2008.

Exhibit 4

CALCULATIONS FOR WITHDRAWALS

Calculation of 2 Percent Threshold

| | <u>Threshold Amounts (in thousands)</u> |
|--|---|
| Certified tax revenues collected in most recently ended fiscal year (2008) | \$ 14,227,165 |
| 2 percent of certified tax revenues (threshold established by Virginia Constitution) | \$ 284,543 |

Calculation of Total Revised General Fund Forecast

| | <u>Revised Forecast Amounts (in thousands)</u> |
|-------------------------------------|--|
| General fund revenue estimate* | \$15,133,498 |
| General fund transfers* | 367,586 |
| General fund balance forward* | <u>518,417</u> |
| Total revised general fund forecast | <u>\$16,019,501</u> |

* Provided by the Office of the Secretary of Finance on October 6, 2008.

Calculation of Variance

| | <u>Variance Amounts (in thousands)</u> |
|--|--|
| General fund revenues appropriated (per Chapter 879) | \$16,970,377 |
| Revised general fund forecast | <u>16,019,501</u> |
| Calculated variance | <u>\$ 950,876</u> |
| One half of calculated variance | <u>\$ 475,438</u> |

Calculation of One Half the Balance of the Fund

| | <u>Balance Amounts (in thousands)</u> |
|---|---|
| Revenue Stabilization Fund Balance at June 30, 2008 | \$1,014,870 |
| 50 percent of the balance of the Fund | \$ 507,435 |

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 2008 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.

