GENERAL FUND
UPDATED REVENUE TRENDS

A Report Prepared for the

Revenue & Transportation Interim Committee

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MONTANA LEGISLATIVE FISCAL DIVISION

INTRODUCTION

This report highlights the year-to-date revenue collections through the end of November FY 2014, and provides an overview by revenue source of the impact of new data and revised modeling on revenue trends.

SUMMARY OF UPDATED TREND REVENUES

Although the updated revenue trends will not be incorporated into the official revenue, the changes could have a small positive impact on the ending fund balance. The chart below takes the updated trend totals and subtracts the potential fire fund transfer due to the increased corporation tax trend. The difference between the net updated trend and SJ 2 is summed over the biennium to produce a potential increase in the ending fund balance of $3.9 million.

Potential Fund Balance Impact of Updated Trend

(in Millions)

	FY 2014	FY 2015	FY 2016	Total Impact
Updated Trend	$2,064.4	$2,138.2		
Less Potential Corp Transfer to Fire Fund	-	1.7	4.1	
Net Updated Trend	$2,064.4	$2,136.6	($4.1)	
Less SJ 2	2,056.4	2,136.6	-	
Potential Change to Fund Balance	$8.0	($0.0)	($4.1)	
Potential Change Total				$3.9

FY 2014 YEAR-TO-DATE REVENUE

FY 2014 general fund revenues through the end of November are $10.3 million or 1.5% ahead of FY 2013 revenues through the same period; this increase is above the anticipated growth of -1.0%. The income level for FY 2014 forecast in SJ 2 is lower than the actual collections received in FY 2013, which is why anticipated growth is negative.

About half of the increase can be attributed to the top seven sources. Individual income tax continues to increase over FY 2013; strong growth may continue through January 2014, as CY 2013 quarterly estimated payments are likely to be based on elevated CY 2012 income. The increase in individual income tax is offset by a sharp decrease in corporate income tax. Year-to-date differences for all major revenue sources are discussed in further detail in the next section.

General Fund Revenue Monitoring Report (in Millions)							
Revenue Source	Actual FY 2013	SJ2 Estimate* FY 2014	SJ2 Estimate % Change	11/30/2012 FY 2013	11/30/2013 FY 2014	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	$1,047.790	$1,039.082	-0.8%	$467.876	$494.723	$26.848	5.7%
Property Tax	244.607	245.287	0.3%	11.955	11.452	(0.502)	-4.2%
Corporation Tax	177.497	154.096	-13.2%	63.906	42.926	(20.980)	-32.8%
Vehicle Taxes & Fees	99.352	102.659	3.3%	33.152	35.590	2.438	7.4%
Oil Severance Tax	98.683	99.336	0.7%	-	-	-	
Insurance Tax	61.678	52.021	-15.7%	12.757	10.645	(2.112)	-16.6%
Video Gaming Tax	57.261	59.929	4.7%	14.104	14.049	(0.055)	-0.4%
Other Business Taxes							
Drivers License Fee	4.527	4.435	-2.0%	1.729	1.461	(0.268)	-15.5%
Investment Licenses	6.951	7.457	7.3%	0.832	0.945	0.112	13.5%
Lodging Facilities Sales Tax	16.720	18.365	9.8%	6.689	6.767	0.078	1.2%
Public Contractor's Tax	(0.138)	3.259	-2468.7%	(0.820)	1.927	2.747	-335.1%
Railroad Car Tax	2.179	2.320	6.5%	1.586	1.602	0.016	1.0%
Rental Car Sales Tax	3.523	3.632	3.1%	1.489	1.440	(0.049)	-3.3%
Retail Telecom Excise Tax	20.652	23.236	12.5%	4.162	4.120	(0.042)	-1.0%
Other Natural Resource Taxes							
Coal Severance Tax	13.265	14.857	12.0%	4.358	3.763	(0.595)	-13.6%
Electrical Energy Tax	5.067	4.521	-10.8%	1.085	0.909	(0.176)	-16.2%
Metal Mines Tax	10.049	10.595	5.4%	0.005	0.008	0.003	64.9%
U.S. Mineral Royalties	29.205	30.953	6.0%	8.576	8.674	0.099	1.2%
Wholesale Energy Trans Tax	3.558	4.140	16.4%	0.863	0.795	(0.068)	-7.9%
Other Interest Earnings							
Coal Trust Interest Earnings	24.153	24.354	0.8%	6.395	5.443	(0.952)	-14.9%
TCA Interest Earnings	2.465	2.346	-4.8%	0.993	0.707	(0.285)	-28.7%
Other Consumption Taxes							
Beer Tax	3.033	3.067	1.1%	1.143	1.149	0.006	0.5%
Cigarette Tax	31.011	30.433	-1.9%	13.100	12.654	(0.446)	-3.4%
Liquor Excise Tax	17.724	19.284	8.8%	6.232	6.440	0.208	3.3%
Liquor Profits	10.500	11.080	5.5%	-	-	-	
Lottery Profits	13.084	14.342	9.6%	-	-	-	
Tobacco Tax	5.853	6.005	2.6%	2.114	2.240	0.126	5.9%
Wine Tax	2.195	2.218	1.0%	0.767	0.789	0.022	2.8%
Other Sources							
All Other Revenue	36.578	32.548	-11.0%	13.613	16.164	2.551	18.7%
Highway Patrol Fines	4.140	4.467	7.9%	1.379	1.355	(0.024)	-1.8%
Nursing Facilities Fee	4.928	4.740	-3.8%	1.246	1.223	(0.023)	-1.9%
Public Institution Reimbursements	16.212	17.802	9.8%	1.827	3.416	1.589	87.0%
Tobacco Settlement	3.321	3.519	6.0%	-	-	-	
Largest Seven Subtotal	$1,786.868	$1,752.411	-1.9%	$603.749	$609.387	$5.637	0.9%
Remaining Sources Subtotal	290.754	303.974	4.5%	79.363	83.991	4.628	5.8%
Grand Total	$2,077.622	$2,056.385	-1.0%	$683.112	$693.378	$10.265	1.5%

* SJ 2, Adjusted for Legislative Impacts

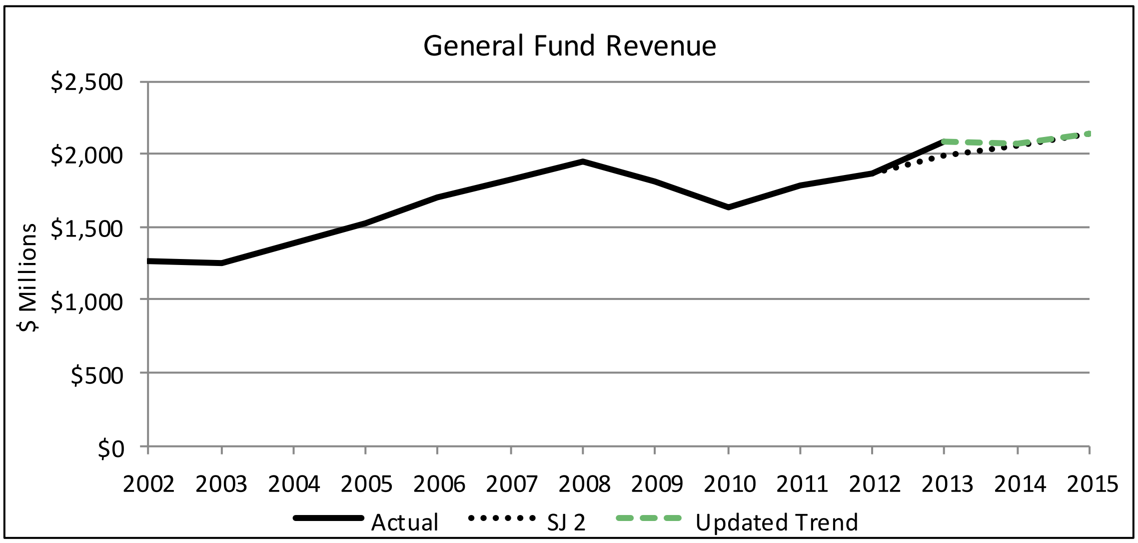
UPDATED REVENUE TRENDS

The updated revenue trends for each source reflect a combination of changes in base year data, revised assumptions, modeling adjustments, and new IHS forecasts. While it is instructive to see the impact of the new data on expected revenue trends, it is important to note that no changes have been made to the official estimate contained in SJ 2. The updated revenue trends in this report are informational only.

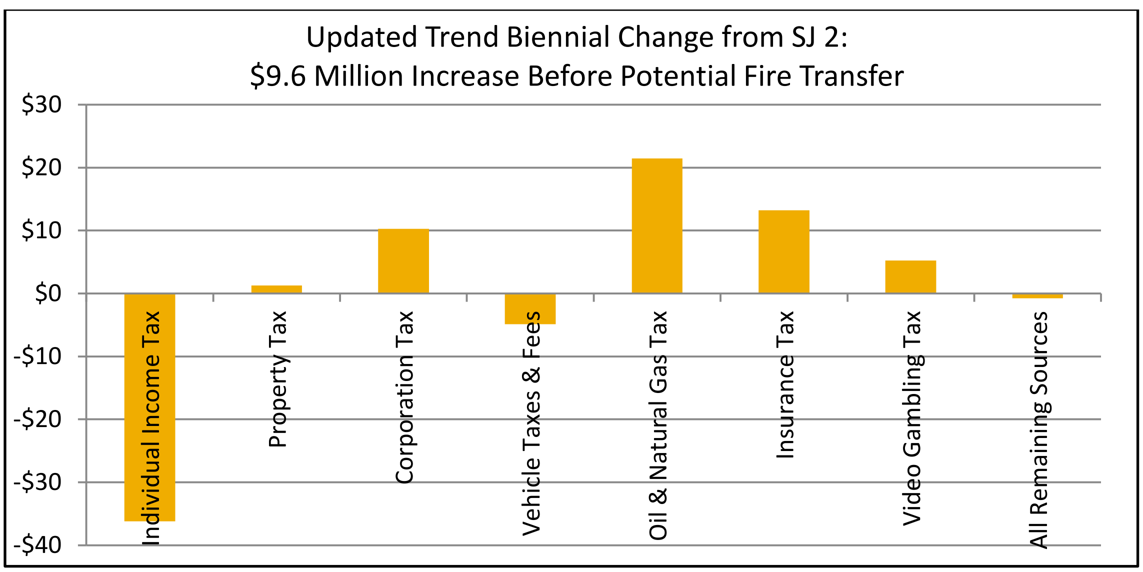
The new data available since the adoption of SJ 2 includes the following sources:

- FY 2013 revenue collections
- New individual and corporate tax return data, and property valuation data
- New oil and natural gas production data
- Revised coal, metal mine, and wholesale and electrical production estimates from surveys
- Updated IHS forecasts

All revenue trend graphs show actual collections from FY 2002 to FY 2013, the SJ 2 estimate for FY 2013 through FY 2015, and the updated trend for FY 2014 and FY 2015. The aggregate of the individual updated trends compared to the total SJ 2 general fund estimate is shown in the chart below. FY 2013 collections were higher than anticipated, but the SJ 2 estimate for FY2014 and FY 2015 appears consistent with the updated trend.

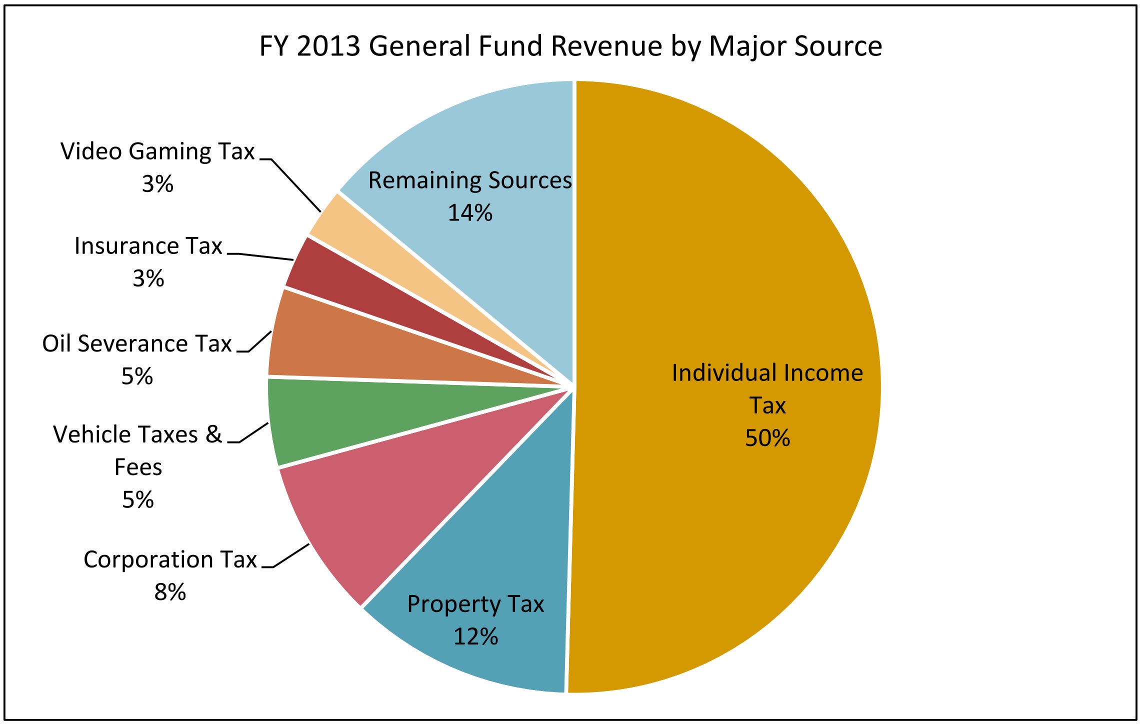


Total biennium impacts of the updated trends by source are shown below:



Large Revenue Sources

In FY 2013, the largest seven revenue sources accounted for 86% of total general fund revenue. This section will highlight the updated trends with each source and further revenue detail if applicable.



Individual Income Tax

Individual income tax collections through the end of November are $26.8 million or 5.7% above the year-to-date collections in FY 2013. All accounts are contributing to the increase, as shown in the following table:

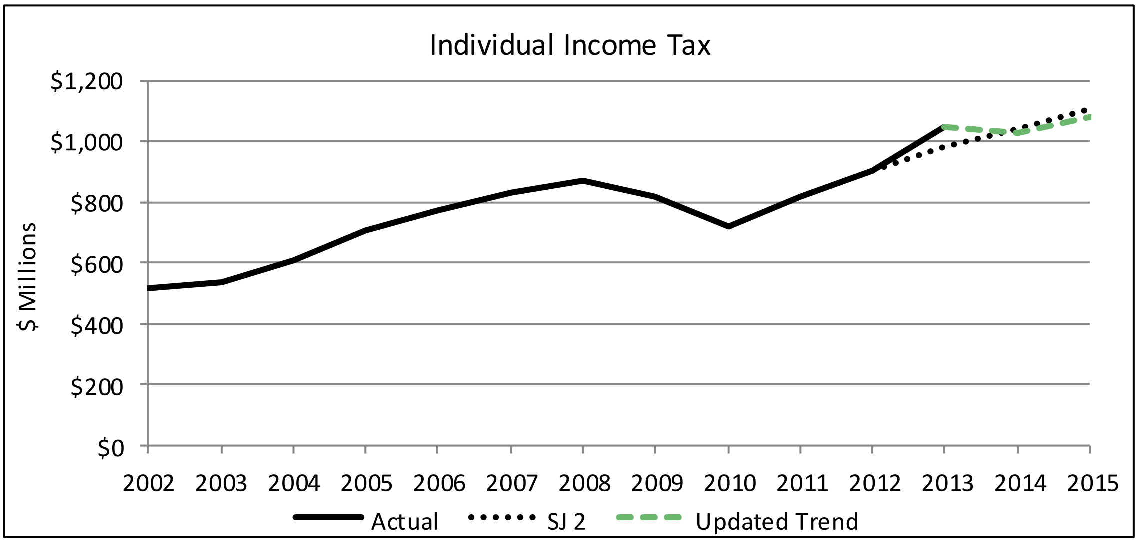
Year-to-Date Individual Income Tax *($ Millions)*				
	FY 2014	FY 2013	Difference	% Difference
Withholding	$298.4	$290.8	$7.5	2.6%
Estimated Payments	81.5	77.8	3.6	4.7%
Current Year Payments	20.0	15.8	4.1	25.9%
Audit, P&I, Amended	9.2	8.6	0.6	6.9%
Refunds	(51.8)	(55.4)	3.6	-6.5%
Refund Accrual Reversal	129.1	124.8	4.3	3.4%
Partnership Income Tax	2.7	1.6	1.1	71.8%
Mineral Royalties	5.8	3.8	2.0	51.6%
Total	$494.7	$467.9	$26.8	5.7%

Individual income tax collections were $63.8 million above the FY 2013 estimate contained in SJ 2. The updated trend includes the FY 2013 actual collections, as well as CY 2012 tax data and data from the most recent IHS forecast.

There has been significant speculation regarding the impact of the federal tax uncertainty and the end of CY 2012:

- Did the potential for higher tax rates result in taxpayers accelerating capital gain realization?
- Did the potential for higher tax rates result in corporations paying increased dividends?
- Did the increased level of estimated and current year tax payments reflect growth in non-wage income?
- How might income acceleration into 2012 be accounted for in subsequent years?

The remainder of this section summarizes the known estimate errors and corresponding explanations, as well as adjustments included in model. The updated trend based on the new data and revised modeling is just slightly below the estimate contained in SJ 2.



<u>Error Analysis</u>

Error can be generated four main ways in the individual income tax estimate:

- Estimated growth rates for income and deduction items
- IHS forecast
- Tax simulation model
- Fiscal year conversion

The CY 2012 error impact in FY 2013 estimated collections is summarized in following table and explained in greater detail in subsections below.

Summary of CY 2012 Error on FY 2013 Collections *($ Millions)*	
Source	Amount
Underestimate of two major growth rates	$10
Underestimate of all other growth rates	6
IHS forecast error	7
Model error	12
Total	$35

Growth Rates

Growth rates for each type of income, addition, reduction and itemized deduction are developed using the historical return data and various economic indicators. Estimate error can result from unusual historical data, use of incorrect economic indicators, and the inaccurate forecast growth of economic indicators. Note that the release date of the IHS forecast is important, and impacts accuracy of the forecast. The IHS data used in SJ 2 contained only a rough estimate of the impact of the "Fiscal Cliff" and no indication of the government shutdown, while the data used to produce the updated trend includes a much better measure of the "Fiscal Cliff" impacts and also makes an estimate of the government shutdown impact.

Growth estimates can be compared to actual growth from the tax return data. The following table compares the income levels forecast in SJ 2 with actual CY 2012 data:

Income Levels
($ Millions)

	Actual	SJ 2	$ Diff	% Diff
Wage Income	$14,686.2	$14,605.3	$80.9	0.6%
Interest Income	313.1	372.6	(59.5)	-16.0%
Dividend Income	627.6	472.9	154.7	32.7%
Taxable Refunds	90.1	93.4	(3.3)	-3.5%
Alimony Received	13.2	14.5	(1.3)	-9.0%
Net Business	740.9	735.5	5.4	0.7%
Cap. Gains	1,491.2	1,309.2	182.0	13.9%
Sup. Gains	53.1	48.7	4.4	9.0%
Rents & Royalties	2,340.9	2,140.6	200.4	9.4%
IRA Income	619.0	651.3	(32.3)	-5.0%
Taxable Pensions	1,841.0	1,841.8	(0.8)	0.0%
Taxable Soc. Sec.	721.7	671.5	50.2	7.5%
Farm Income	(135.9)	(108.5)	(27.4)	25.2%
Other Income	(552.9)	(511.3)	(41.6)	8.1%
Total	$22,849.3	$22,337.4	$511.9	2.3%

The underestimate of three sources—dividend income, capital gains income, and rent, royalties & partnership income—accounted for the majority of the overall income error. Dividend and capital gains income may have been impacted by the tax uncertainty at the end of CY 2012, although the increase in either of the sources was not unusual by historical standards.

Using all actual CY 2012 growth rates in the SJ 2 income tax model suggests that the underestimate of these growth rates produced a $16 million underestimate of FY 2013 collections, with about two-thirds of the difference attributable to the dividend and capital gains income growth rates.

IHS Forecast

IHS data is used to model each of the income types, and several of the additions, reductions and itemized deductions. Changes in the data—whether historical revisions or updated estimates—automatically result in changes to the forecast income. In addition, the federal and state income tax brackets are forecast based on changes in CPI. Even small changes in the CPI can impact the overall revenue estimate.

Using the most recent IHS data in the SJ 2 income tax model suggests that the January 2013 IHS forecast was slightly low for its CY 2012 estimate; this difference produced a $7 million underestimate of FY 2013 collections.

Tax Simulation Model

The tax simulation model forecasts calendar year full year resident tax liability by applying the growth rates discussed above to each resident taxpayer's income and deduction items. The model makes various determinations on income type, income level and filing status. These assumptions are used to assign tax rates and applicable deductions, and ultimately the amount of tax liability. The model aggregates all the individual taxpayer information for each income line to produce an estimate of full year resident calendar year tax liability.

Combining the most recent IHS forecast with the known CY 2012 growth rates in the SJ 2 income tax model seems to suggest that the simulation model is responsible for an underestimate of about $12 million.

Fiscal Year Conversion

The fiscal year conversion takes the calendar year full-year resident liability output of the tax simulation model and adjusts for non-full-year resident liability to produce a total calendar year liability.

Old Conversion Method:
Previous forecasts have then adjusted the total calendar year liability by subtracting all credits other than the capital gains credit, and calculated fiscal year growth rates based on an assumption of equally-spaced timing. These rates were applied to the last fiscal year total collections, excluding audit and penalty and interest collections, and including any base year adjustments, to produce estimated fiscal year collections before audits and other adjustments. Finally, estimated audit, penalty, and interest collections, as well as any other adjustment are added to produce the final estimate.

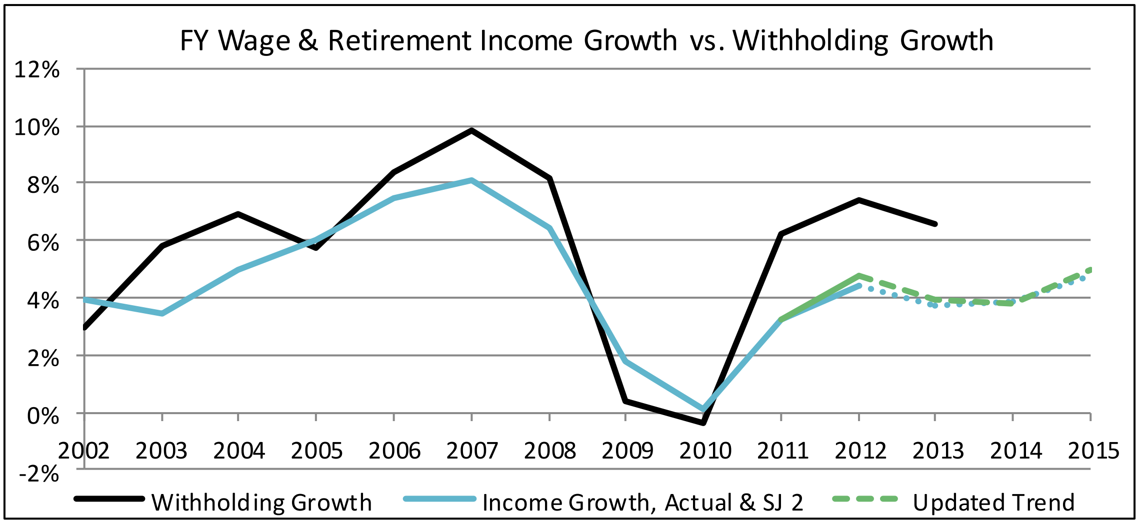
Because calculated fiscal growth rates were applied to the last known fiscal year collections, any unusual collection activity was propagated throughout the forecast years. Even if all growth rates were accurate, whether they were applied to an unusually high base year or an unusually low base year, the likely result would be over or underestimating future fiscal year collections. In a past report on FY 2012 FYE collections, it was estimated that a low base fiscal year account for nearly two-thirds of the estimate error. Base year adjustments can be made, but there is typically only scant evidence for making these types of adjustments; furthermore, if the changes are wrong, the method extends the error for all three years of the forecast period.

New Conversion Method:
The revised conversion method models total fiscal year collections less audit, penalty and interest collections on a one-year lag of total calendar year liability mentioned above. The historical relationship between twenty-one years of fiscal year collections and lagged calendar year liabilities is applied to forecast calendar year liabilities to produce estimated fiscal year collections before audit, penalty and interest revenue. Aggregated audit, penalty and interest collections are forecast based on an average ratio to prior years' liability, and added to the fiscal collection to produce a total estimate.

The advantage of using a historical relationship applied to forecast total calendar year liability, rather than applying calculated fiscal year growth rates to the last known fiscal year is the estimate become much less dependent on any particular year. In years where collections are unusually high or low, reducing this dependence should produce a better estimate.

<u>Wage and Retirement Income Growth vs. Withholding Growth</u>

There is a correlation between withholding growth and wage income growth; however, the correlation is not particularly strong, as shown in the graph below:

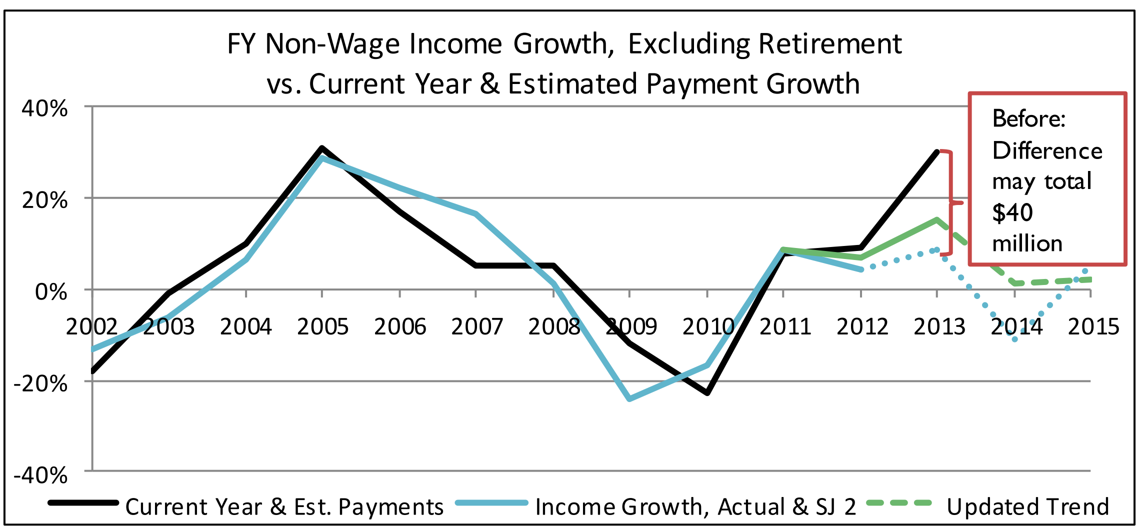


Earlier revenue reports noted that the strong withholding growth could suggest that wage income growth was stronger than estimated in SJ 2. There was a small percentage increase over the estimate, but withholding growth continues to be significantly higher than wage growth.

Non-Wage Growth vs. Current Year & Estimated Payments

High estimated and current year payments were significant contributors to the FY 2013 increase; as noted in previous reports, both of these revenue streams were likely impacted by taxpayers' response to the federal tax uncertainty at the end of calendar year 2012

Prior reports hypothesized that underestimate of growth in non-wage income in FY 2013 could explain about $40 million of additional income tax collections. However, with the availability of actual CY 2012 tax return data, only about a third of the difference is explained by stronger-than-anticipated non-wage income growth.

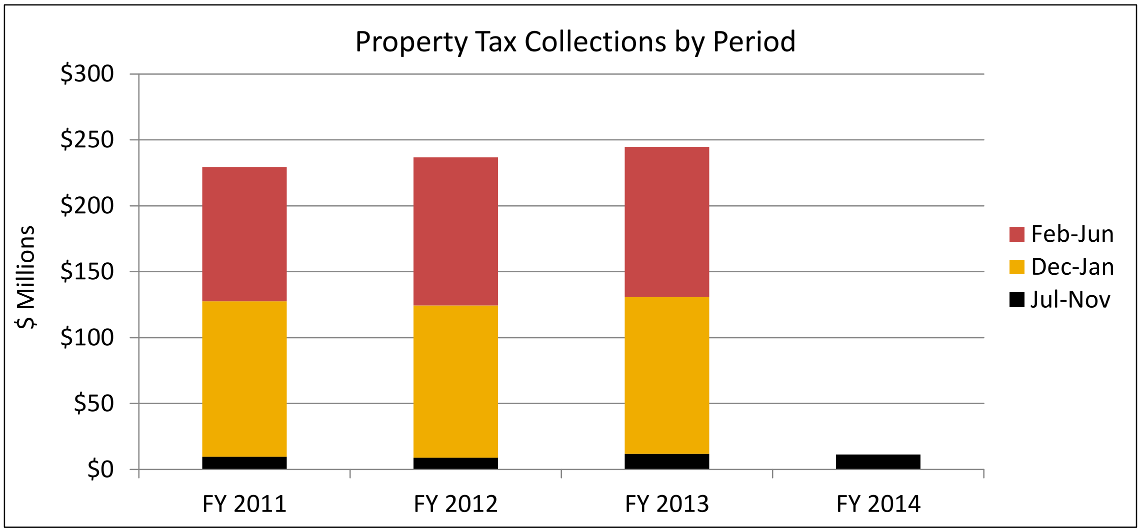


The updated trend for capital gains income includes a leading indicator of changes to the highest marginal tax rate for capital gains income. The addition of the variable improves the historical accuracy of the capital gains income model, and suggests that capital gains income will decrease somewhat in CY 2013.

In summary, of the $64 million tax revenue increase in FY 2013, only $35 million can be attributed to known error sources. The remaining nearly $30 million is primarily due to the growth in current year and quarterly estimated payments. A portion of the increase may reflect larger estimated payments based on the increased CY 2012 income.

Property Tax

Property tax collections through the end of November are $0.5 million or 4.2% below collections through the same period in FY 2013. Fluctuations through the first half of the fiscal year are common; due to the timing of property tax payments, accurate year-to-date comparisons cannot be made until after January. Property tax collections by period are shown in the graph below:

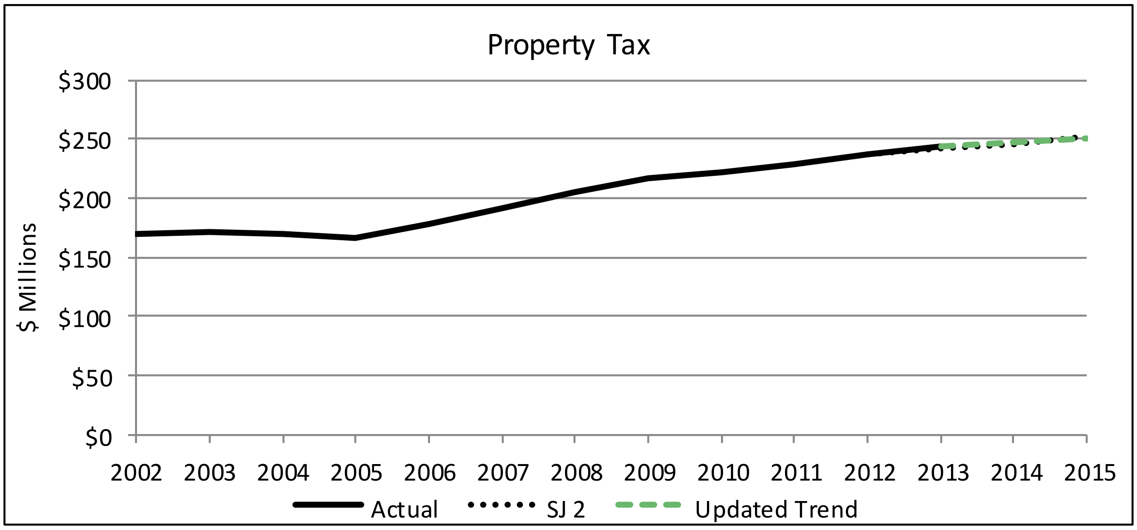


Property tax collections came in $2.9 million above the FY 2013 estimate in SJ 2. The updated revenue trend includes a reduction in taxable property value for metal mines due to decreased production and a reduction in class 13 property due to a settlement with a major energy producer.

Large Property Tax Differences from SJ 2
(in Millions)

Reason for Difference	FY 2014	FY 2015
Class 1 & 2 reductions due to metal mines	-$1.1	-$1.6
Class 13 reduction due to settlement	-1.3	-1.5
Federal forest extension payments	3.1	
Total	$0.7	-$3.1

Despite the net decreases in expected taxable value, the updated trend is slightly above SJ 2 in FY 2014 due to federal forest receipts that were expected to fall to $0.5 million in FY 2014, but due to a one-year federal extension payments are expected to be $3.5 million. This extension is not continued into FY 2015, so the decreases in taxable property value result in lower FY 2015 revenue.

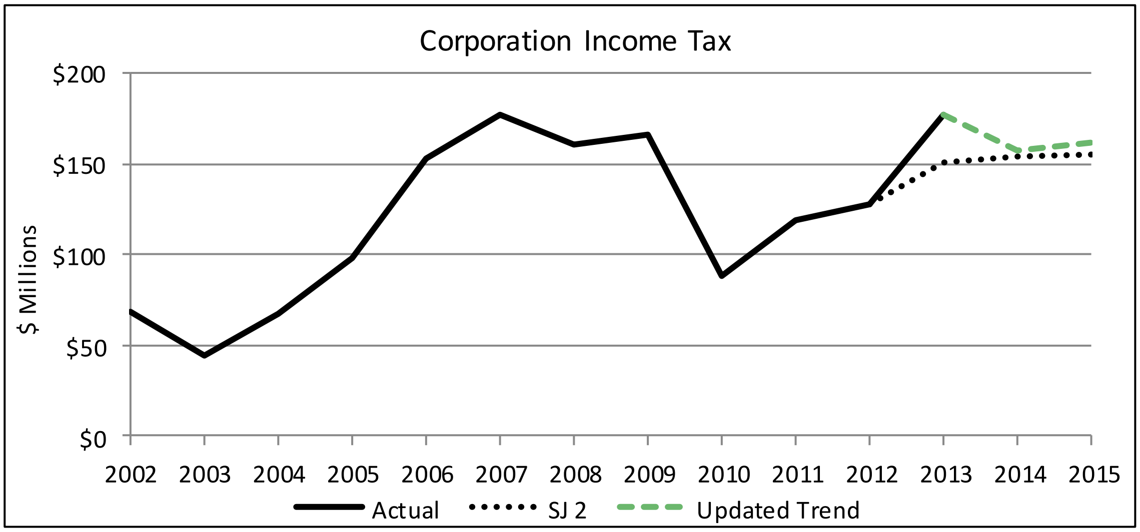


Corporation Income Tax

Corporation income tax collections through the end of November are $21.0 million or 32.8% below the year-to-date collections in FY 2013. All accounts are contributing to the reduction, as shown in the following table:

Year-to-Date Corporation Income Tax (*$ Millions*)				
Account	FY 2014	FY 2013	Difference	% Difference
Corporation Tax	$3.4	$10.7	($7.2)	-67.8%
Estimated Payments	36.7	39.0	(2.3)	-5.9%
Refunds	(6.5)	(4.1)	(2.5)	60.5%
Refund Accrual Reversal	5.6	12.8	(7.2)	-56.0%
Audit, P&I, Amended	3.7	5.5	(1.8)	-33.3%
Total	$42.9	$63.9	($21.0)	-32.8%

Corporation income tax collections were $26.8 million above the official estimate for FY 2013. The updated trend includes the FY 2013 actual collections, as well as CY 2011 corporate tax data and data from the most recent IHS forecast. Much of the increase in FY 2013 was due a large one-time payment and unusually low refunds; these items are not expected to continue, and total tax collections are anticipated to resume levels near those estimated in SJ 2. Note that any revenue in excess of $156.2 million in FY 2014 and $157.5 million in FY 2015 will be transferred to the wildfire suppression fund in the subsequent fiscal year.



No significant modeling changes were made to produce the updated corporation tax trend. Research is just beginning on developing rigorous standard errors for revenue estimates, and results from this research will be used to adjust the growth rate modeling prior to the 2015 session.

<u>Error Analysis</u>

Error can be grouped by three main sources in the corporation income tax estimate:

- Growth rates of tax liability by industry sector
- IHS forecast
- Refund & audit estimates

The impact on the FY 2013 estimate by these errors is summarized in the table below:

FY 2013 Error Sources *($ Millions)*	
Source	Amount
Underestimate of CY 2011 sector growth rates	$11
IHS forecast error	9
Net FY 2013 refund & audit error	8
Total	$28

Compounding the estimating error is the 18-month lag in actual data. The estimate contained in SJ 2 was based on data for CY 2010, which was still strongly affected by the recession. Data is just now available for CY 2011.

Growth Rates

The CY 2011 tax liability growth rate estimates included in SJ 2 were 12.2% below actual growth. The underestimate of the wholesale and retail trade sector accounts for nearly half of the discrepancy and is likely due to being based on recession-level tax liability. Information sector growth was impacted by the sale of a large technology firm in 2011. Information regarding the sale was available at the time of the SJ 2 estimate; however, the impact on tax revenues was not clear, and no adjustment was made at that time.

CY 2011 Tax Liability ($ Millions)				
Sector	Actual	SJ 2	$ Diff	% Diff
Agriculture	$4.4	$2.7	$1.7	64.3%
Mining	16.3	14.7	1.6	10.7%
Utilities	0.7	1.0	(0.3)	-27.0%
Construction	2.1	1.1	0.9	84.9%
Manufacturing	38.5	37.4	1.1	2.8%
Wholesale & Retail Trade	19.6	13.8	5.7	41.4%
Transportation	2.4	8.7	(6.3)	-72.2%
Information	4.6	2.0	2.6	132.0%
Professional	7.5	7.1	0.4	5.6%
Large Banks & Holding Companies	25.7	20.0	5.7	28.4%
Social	2.4	2.0	0.5	23.8%
Unknown	0.0	0.2	(0.1)	-97.4%
Total	$124.2	$110.7	$13.5	12.2%

One of the primary goals of developing standard errors for the revenue estimates is to have a tool for measuring the effectiveness of various economic indicators in modeling sector tax liability, and ultimately increasing the accuracy of forecast growth rates. The corporation tax estimate will be one of the first sources to implement this analysis.

IHS Forecast

IHS data is used to model the tax liability of each sector. Changes in the data—whether historical revisions or updated estimates—automatically result in changes to the forecast tax liability. Using the most recent IHS data in the SJ 2 corporation tax model suggests that the January 2013 IHS forecast was low for its CY 2012 estimate; this difference produced a $9 million underestimate of FY 2013 collections.

Refunds

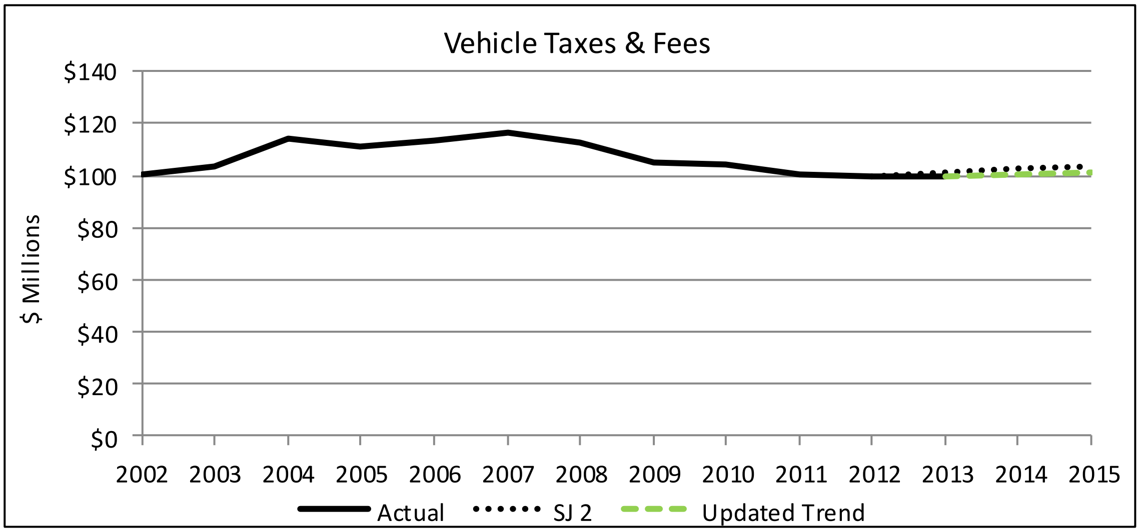
Total refunds, including the FY 2012 accrual reversal in October and the accrual made in June, in the state accounting system (SABHRS) were unusually low in FY 2013. Refunds net of the accounting adjustment were close to the level anticipated in SJ 2. The large negative accrual at the end of FY 2012 and the subsequent positive reversal of the same amount in October FY 2013, coupled with the much smaller negative accrual at the end FY 2013 resulted in the low total refund amount as recorded in SABHRS in FY 2013.

As in the SJ 2 estimate, refunds in the updated trend are calculated based on an average ratio of refunds to prior year tax liability. Further modeling updates may attempt to include an adjustment for forecast accruals.

Vehicle Taxes & Fees

Revenue collections from vehicle fees and taxes through the end of November were $2.4 million or 7.4% above collections through the same period in FY 2013. This growth represents the first increase in year-to-date revenue since FY 2008, and is in line with vehicle sales trends.

Combined revenue collections from vehicle fees and taxes were $1.5 million less than anticipated in SJ 2 for FY 2013. Revenue from this source is forecast based on IHS estimates for new and used Montana car sales. Using these estimates, a growth rate in Montana’s vehicle stock is developed to apply to forecast years.

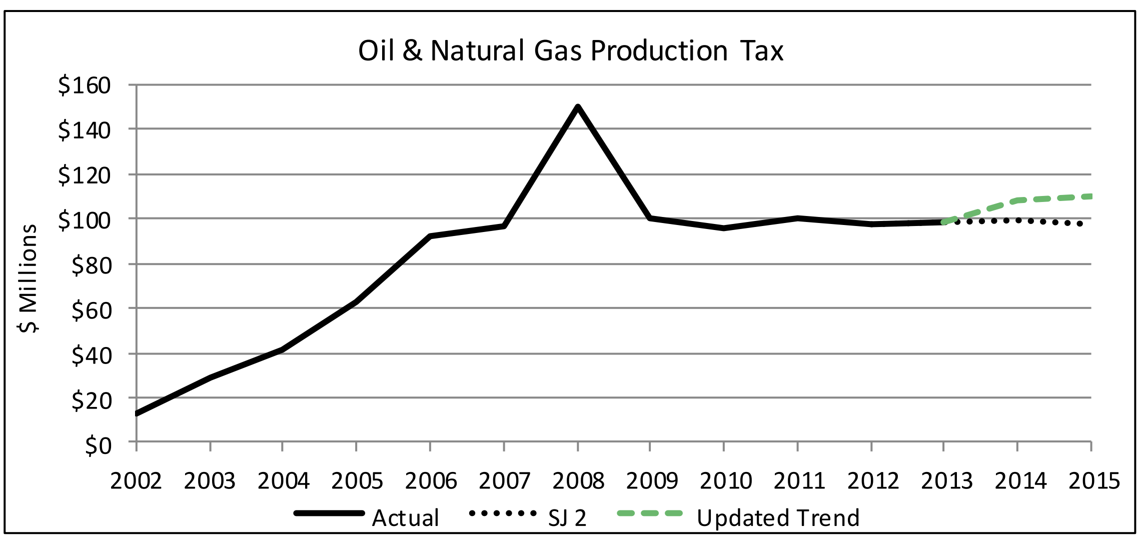


Modeling for this revenue source has not changed. The decline in the updated trend compared to SJ 2 estimates results from revised estimates regarding Montana's vehicle stock and the smaller-than-expected revenue in FY 2013. Modeling will be updated before the 2015 session to include detailed registration data available from the Department of Justice.

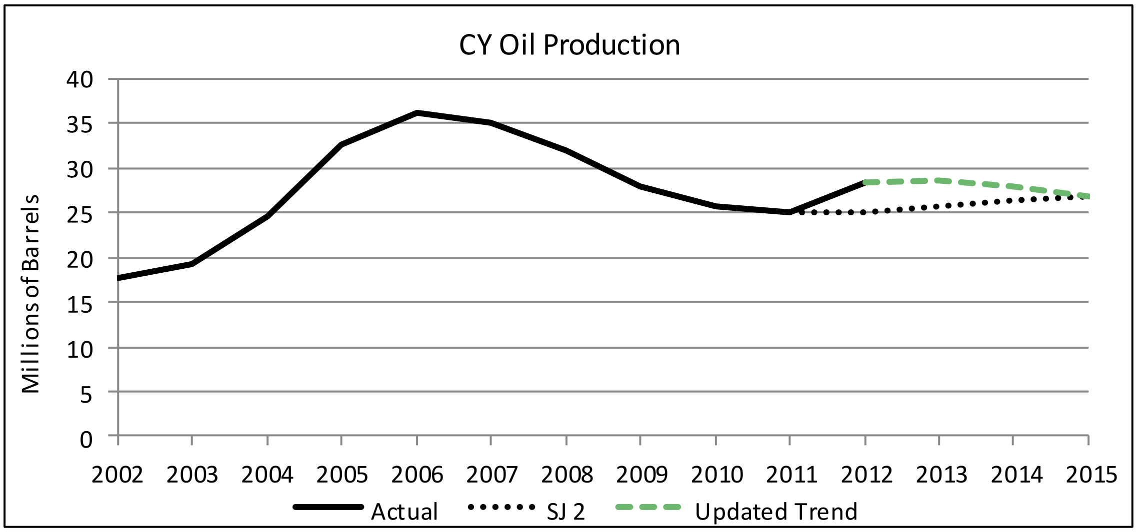
Oil & Natural Gas Severance Tax

Oil and natural gas production tax collections are zero through November. This is expected due to the statutory requirement of when taxes are due and the time allowed for the Department of Revenue to determine the distribution of taxes to local governments.

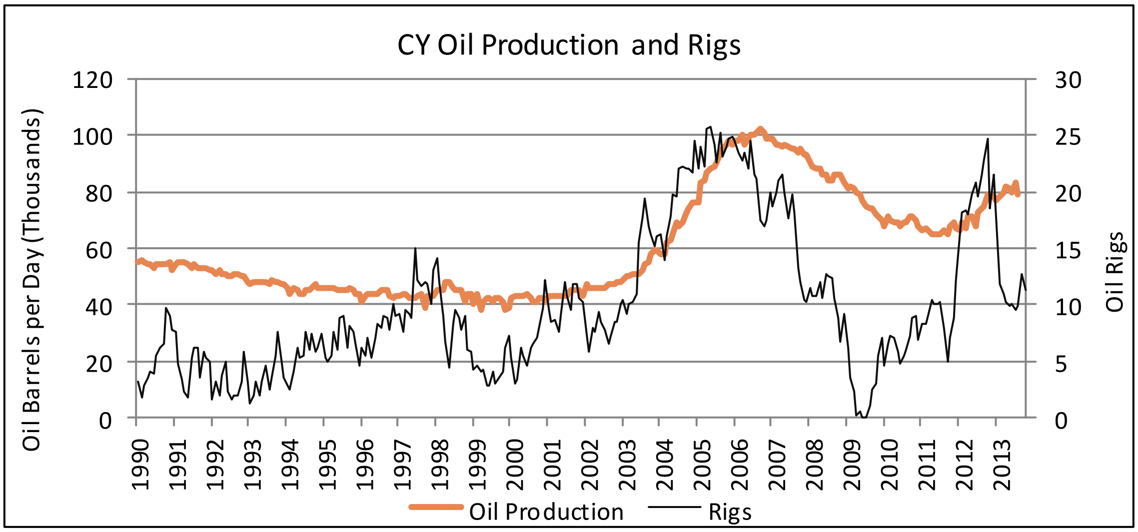
Oil and natural gas production tax collections were $0.1 million below the SJ 2estimate in FY 2013. The consistency of the revenue to the general fund mask changes that are happening in the state as production declines in natural gas have offset the increasing production of oil. The updated revenue trend includes production data through July 2013, as well as higher price forecasts from IHS. These changes, coupled with the relative stability of natural gas value, result in an increase of approximately $10 million per year over SJ 2.



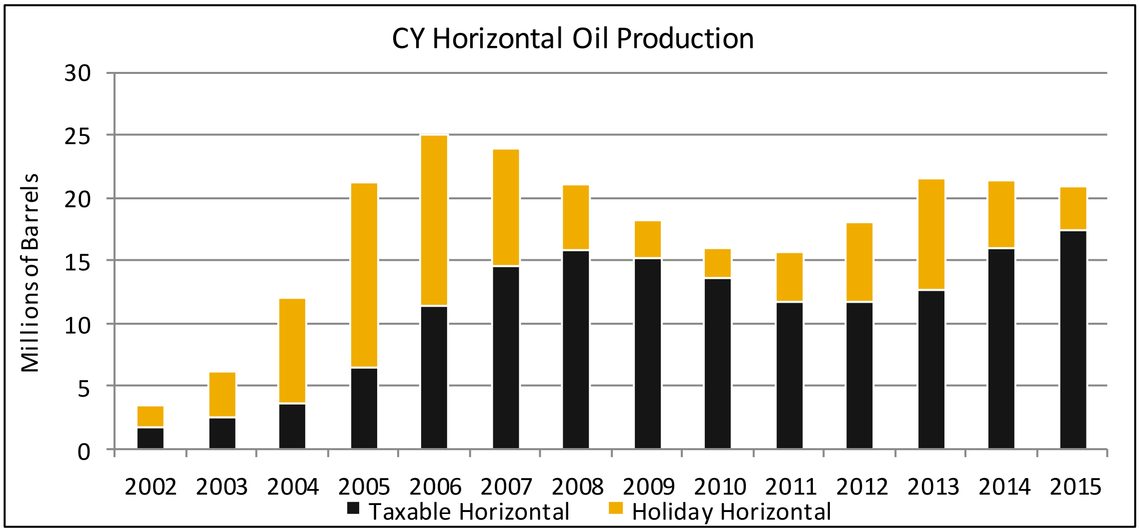
The two factors driving this increased trend are production and price. As shown in the chart below, actual CY 2012 production was above the forecast in SJ 2. Production modeling based the actual values through July 2013 continues the increase with a gradual decline, leading to a convergence of the production line with SJ 2 estimates in FY 2015.



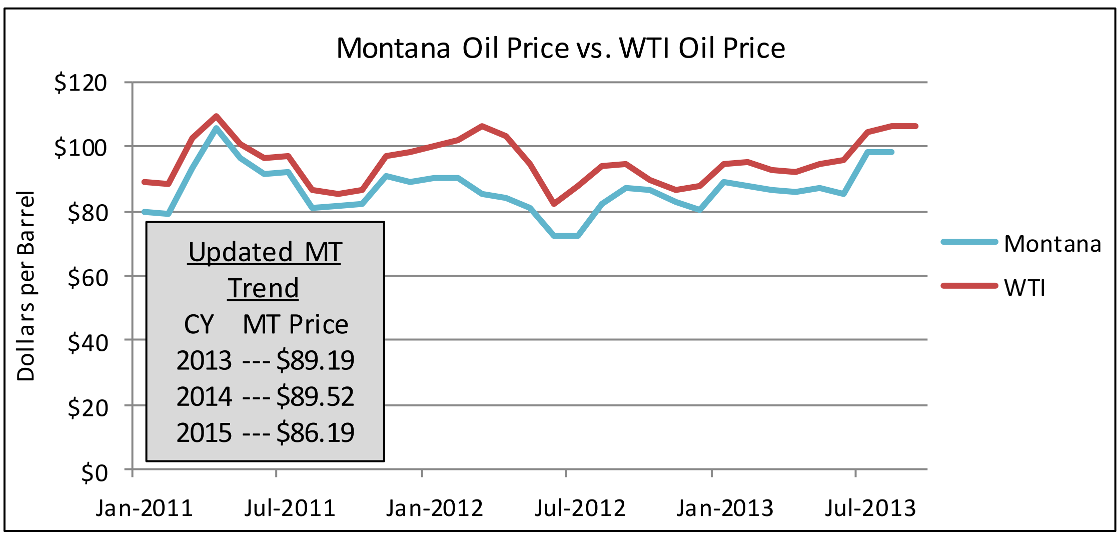
In line with historical patterns, the production increase follows the increased average number of oil rigs in 2012, as shown below:



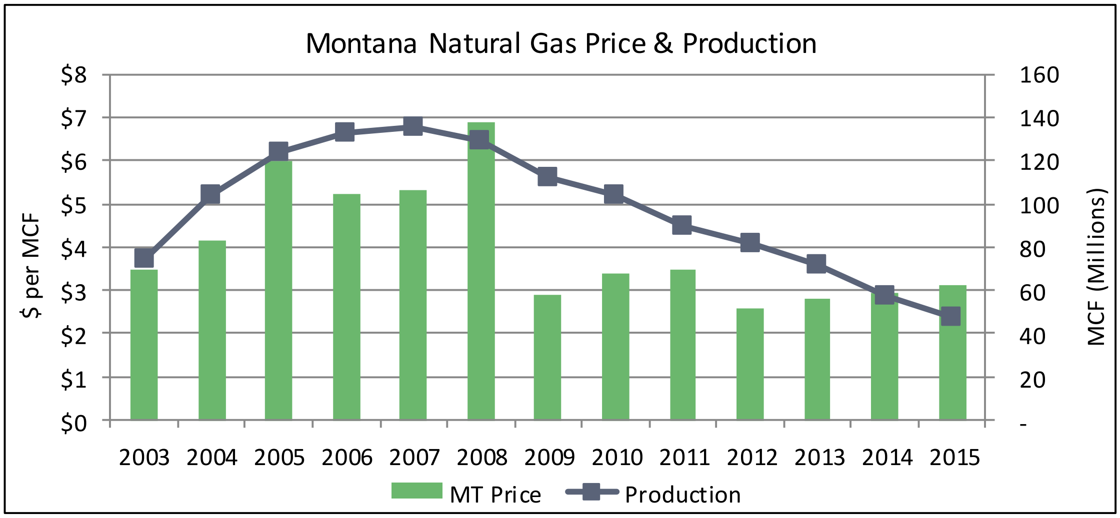
The increase in production is entirely attributable to increased horizontal drilling. The low point in production occurred in CY 2011. Since then, production has been increasing; however, with the 18 month tax holiday, the new production did not contribute significantly to state revenue. The chart below illustrates the new production moving from Holiday Horizontal to Taxable Horizontal, and it is the change that affects FY 2014 and FY 2015 revenue.



Along with increases in production, new data from IHS on West Texas Intermediate (WTI) oil prices per barrel have increased the forecasted Montana average oil price. SJ 2 estimated oil prices declining below the $80 per barrel by FY 2015, however, the update data suggests that the decline in oil prices will be more modest, declining from around $89 in CY 2013 and CY 2014 to $86 in CY 2015. The most recent price data for Montana is from August 2013, and the year-to-date average CY 2013 price per barrel is $89.8, with the current August price at $98.3.



Gas continues its production decline and relative price stability, similar to SJ 2.



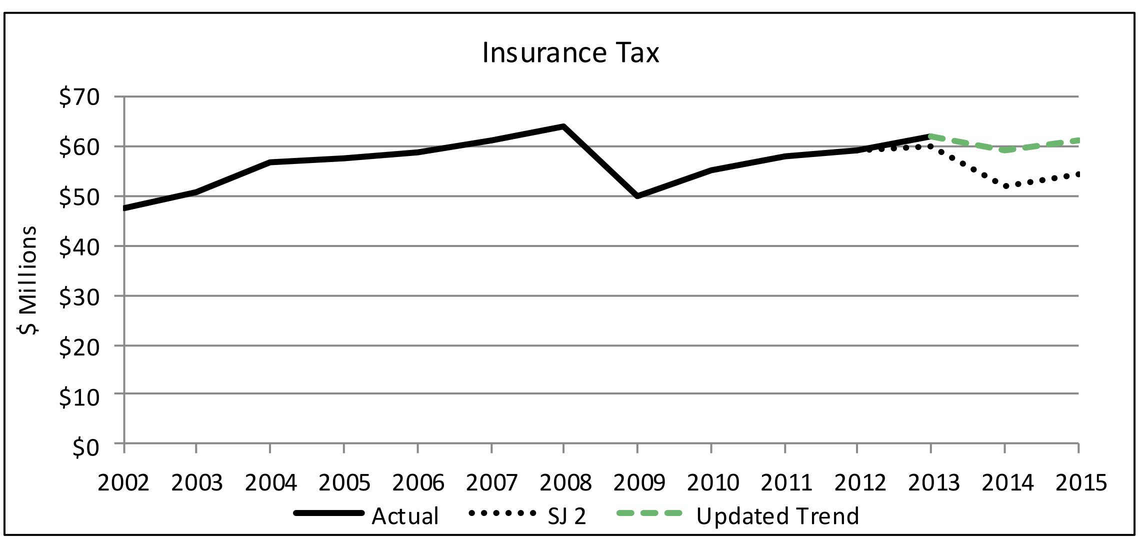
To summarize, the updated trend is above SJ 2, with much of change based on production increases that have happened and higher forecast WTI prices from IHS. Current modeling suggests a return to the production levels forecast in SJ 2.

Insurance Tax

Revenue collections from insurance taxes through the end of November were $2.1 million or 16.6% below collections through the same period in FY 2013. This decline is likely explained by timing issues: the increased allocation to CHIP began in July, while higher payments due to the Blue Cross Blue Shield sale began in September.

There are a number of changes that will impact future general fund insurance tax revenue:

- The reversion of the share of the tax deposited into the state special revenue fund for the Children's Health Insurance Program (CHIP) back to its original 33% (up from 16.67%) in FY 2014
- The merger of Blue Cross Blue Shield of Montana (BCBS) with Health Care Service Corporation (HCSC); as part of the deal HCSC will pay tax from which BCBS was exempt
- The implementation of the Affordable Care Act (ACA)
- The eventual elimination of Montana Comprehensive Health Association (MCHA) offset

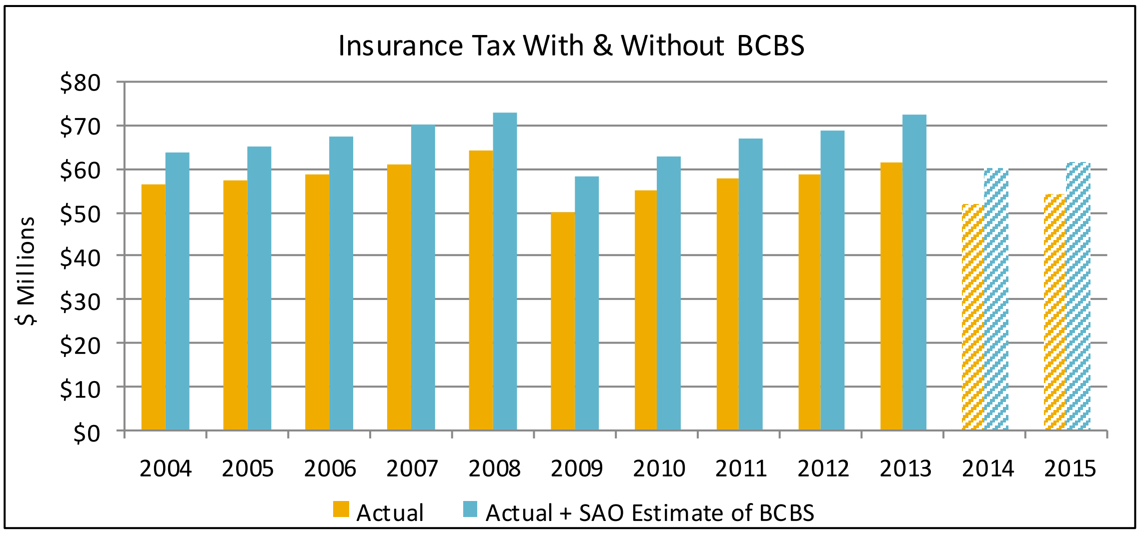


CHIP

This is the only major change that was known at the time of the SJ 2 revenue estimate. Doubling the proportion of insurance tax revenue allocated to CHIP was the primary driver of the decrease forecast in SJ 2.

BCBS Merger

In August 2013, BCBS merged with Health Care Service Corporation (HCSC). As a non-profit, BCBS has historically been tax exempt. While that non-profit status continues post-merger, part of the deal as negotiated by Monica Lindeen is that the company will no longer be tax exempt. Steve Matthews, the Chief Financial Examiner at the State Auditor's Office (SAO), has examined BCBS premiums since FY 2004 to calculate the tax the company would have paid had it not been exempt. The updated trend is based on the SAO calculation of what insurance tax revenues would have been if those taxes had been collected. The trended point for FY 2014 takes into account that BCBS will only be contributing for 11 of the 12 months of the fiscal year.



Affordable Care Act

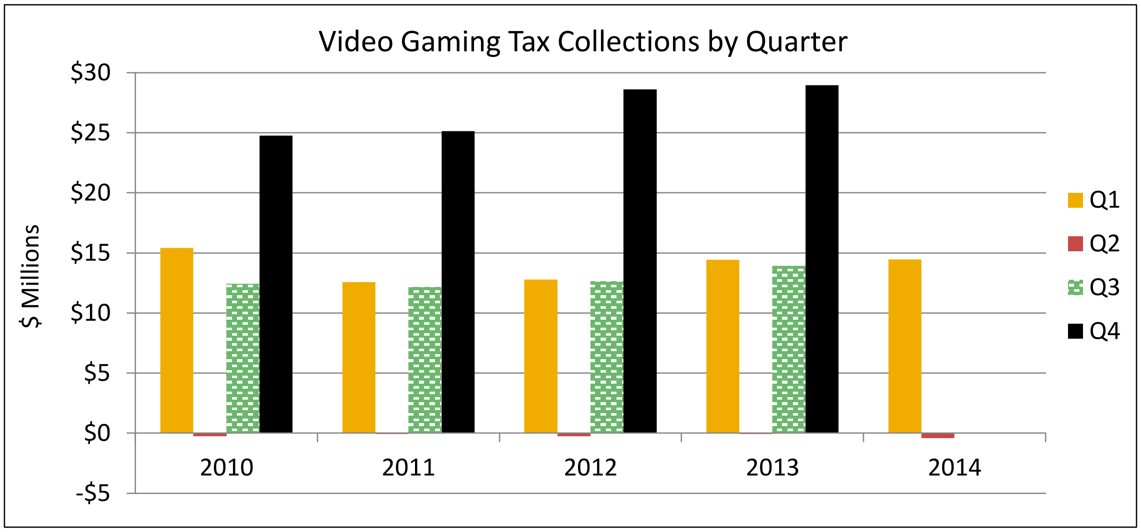
Two of the three companies on Montana's health exchange are tax exempt, including the company with the least expensive coverage plans. While it is impossible to say which plans individuals will choose, the SAO does not anticipate much of an impact on insurance tax revenue as a result of this legislation.

MCHA Offset

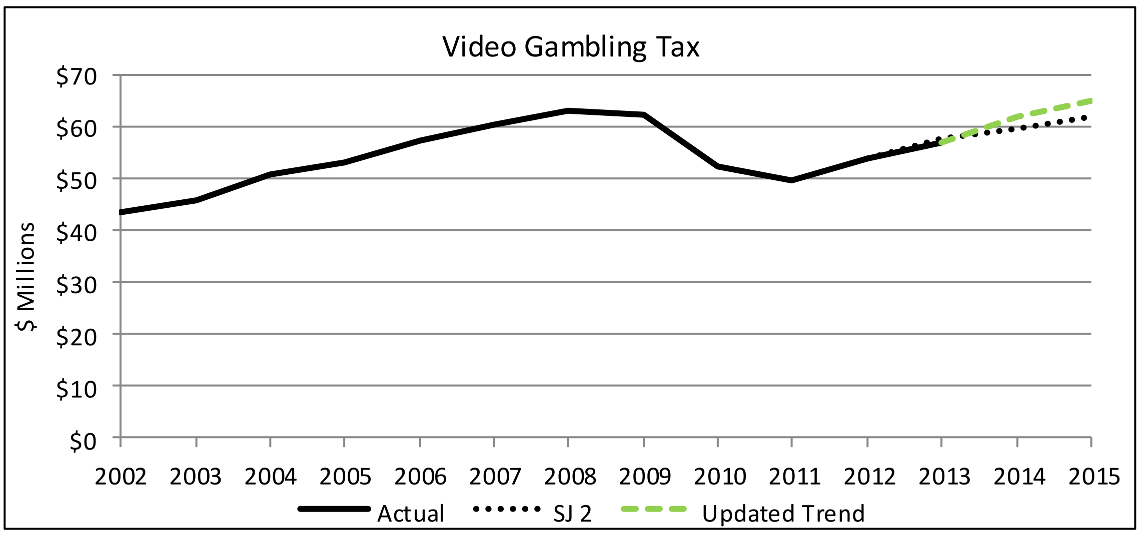
The MCHA offers policies to people who have historically been denied coverage by other insurers. This group will be ceasing business at the end of CY 2013 when people may no longer be denied due to the ACA. Historically, insurance companies have paid part of their tax directly to the MCHA—usually a total amount between $1.5 and $2.5 million annually—that will now go into the general fund.

Video Gambling Tax

Video gambling tax revenue collections through the end of November were $0.1 million or 0.4% below collections through the same period in FY 2013. There was a slight growth through the first quarter; the decline can be attributed to small reductions so far in the second quarter.



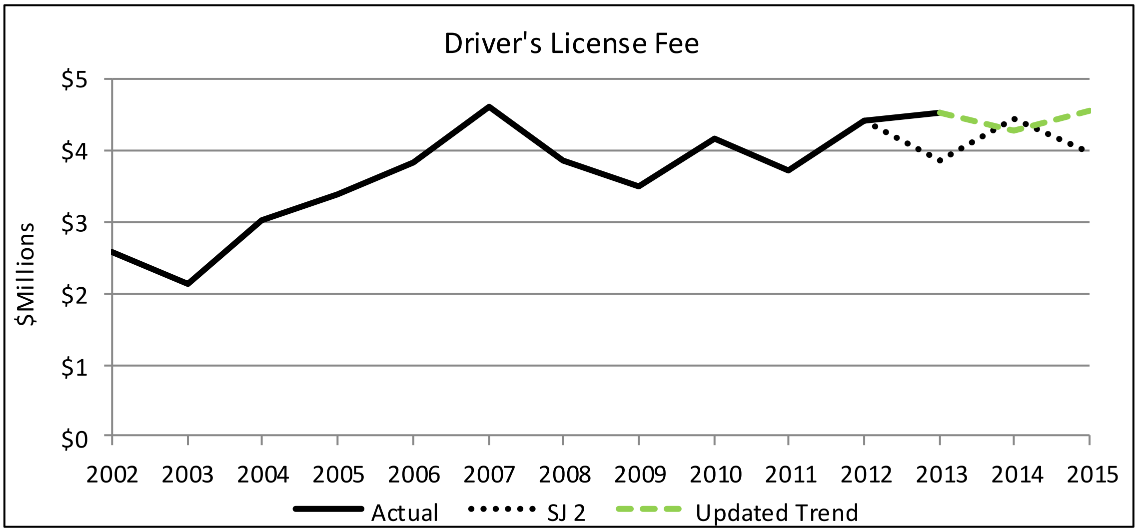
Video gambling revenue was $0.4 million less than anticipated in SJ 2. Revenue from this source is estimated using IHS forecasts for Montana personal income as well as historical permit and license data. The updated trend is above SJ 2 due to the higher IHS forecast of personal income.



Other Business Taxes

Driver's License Fee

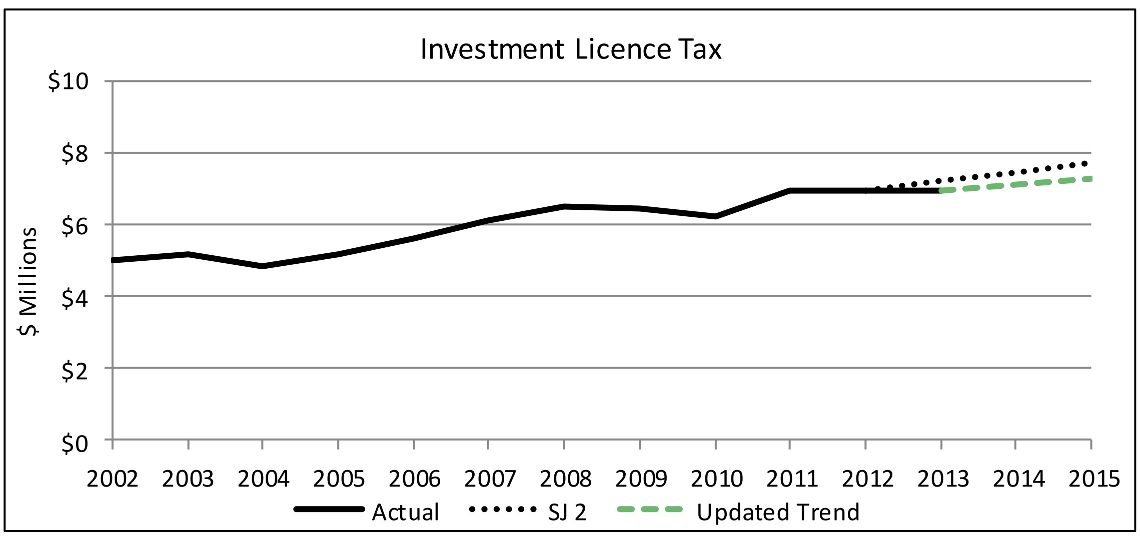
Total driver's license revenue exceeded the estimate contained in SJ 2 by $0.7 million for FY 2013. Since fees are fixed, this increase was caused by a larger-than-expected number of Class D (standard) driver's license purchases. The SJ 2 estimate was based on IHS forecast of Montana residents over the age of 16.



The updated trend is based on forecast population data and historical ratios between licenses and actual populations. Actual ratios from the most recent fiscal years are applied accordingly to forecast years.

Investment License Fee

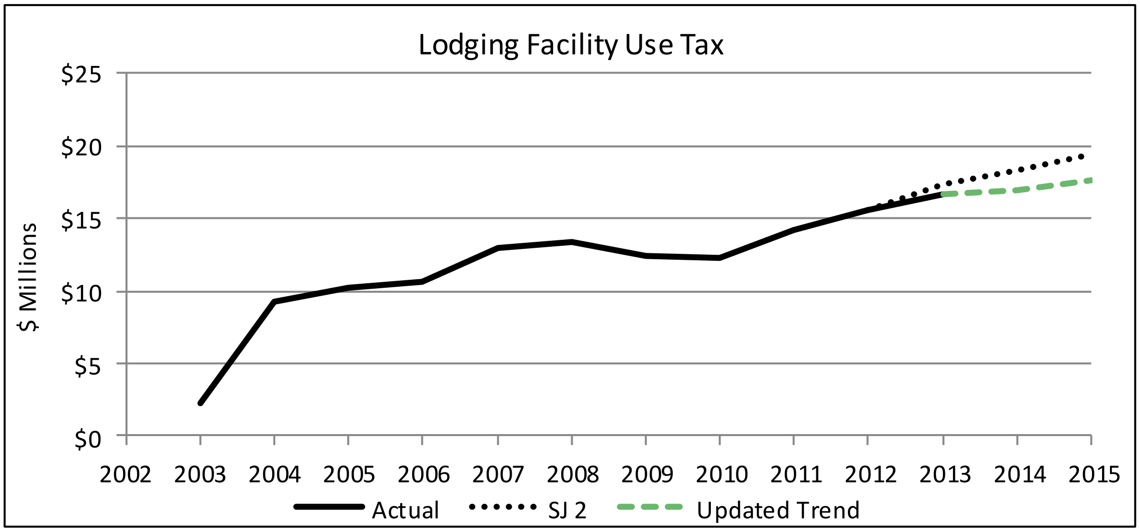
Investment license fee collections were $0.3 million below the estimate contained in SJ 2 in FY 2013. According to Lynne Egan, the Deputy Securities Commissioner at the State Auditor's Office (SAO), the reduction in revenue is a reflection of broader changes in the investment industry. As larger investment firms continue to acquire smaller firms, and the large firms merge, the total number of firms has been steadily declining. This trend is expected to continue. The growth in the number of individual brokers had been offsetting the reduction in revenue; however, this growth has slowed recently, resulting in the slower investment fee growth.



Collections were forecast in SJ 2 based on the S&P 500 Index and CPI. With the information from SAO, the updated model also accounts for the declining number of firms.

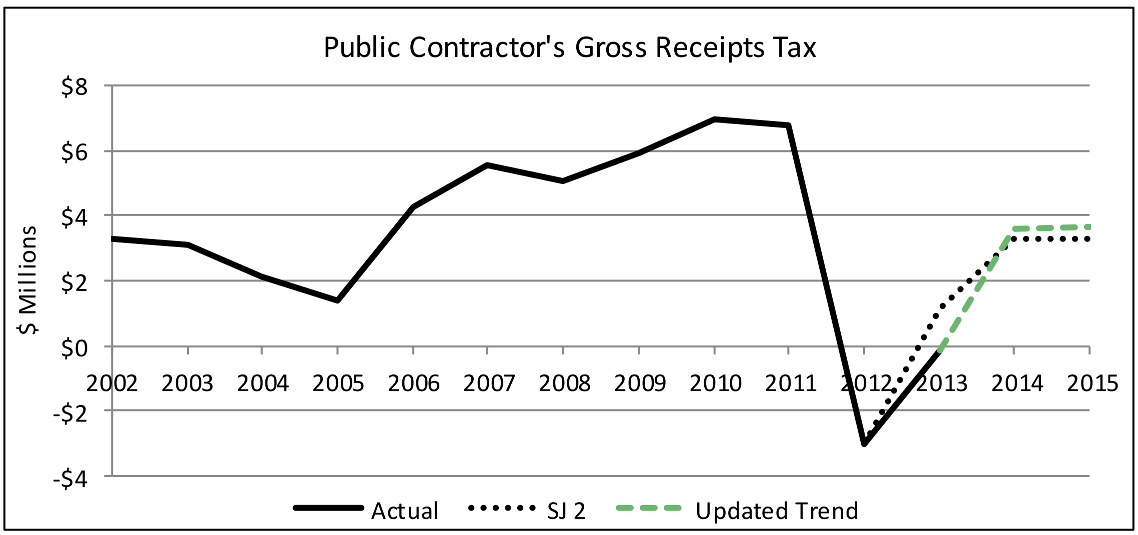
Lodging Facilities Sales Tax

Lodging facilities sales tax collections were $0.6 million below the estimate contained in SJ 2 in FY 2013. This revenue source was forecast in SJ 2 based on Montana retail sales, as well as two other variables. The revised model is only based on the IHS forecast of Montana retail sales.



Public Contractor's Tax

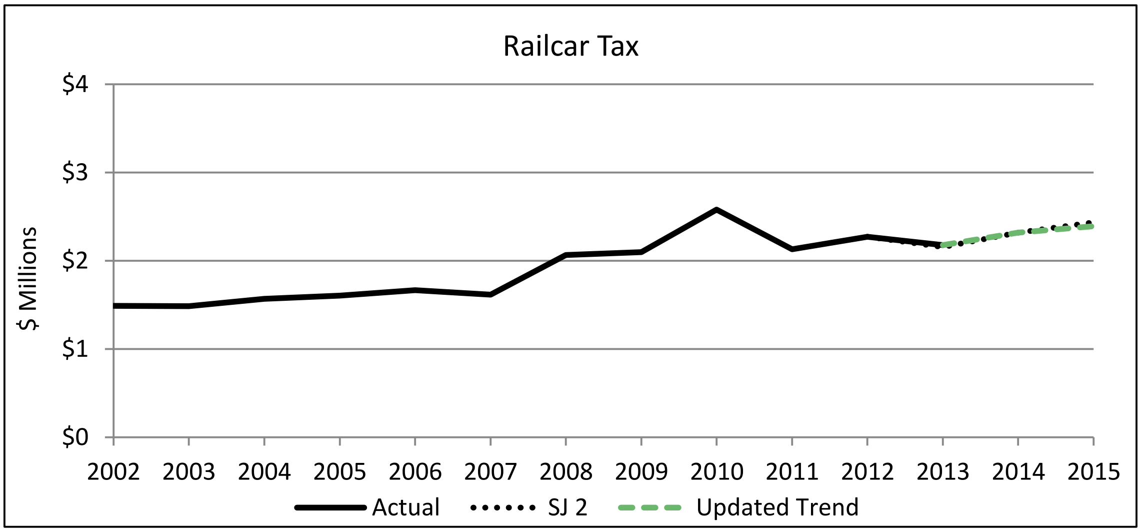
Public contractors' gross receipts tax collections were $1.3 million below the estimate contained in SJ 2 in FY 2013. Higher levels of credits & refunds due to the increased number of public projects funded through the American Recovery & Reinvestment Act (ARRA) in 2009 and 2010, coupled with the subsequent decrease in publicly funded projects may account for a large share of the net negative income.



This source was estimated in SJ 2 based on budgeted highway construction spending and a ten-year average of other construction. The model was partially revised to account for a strong historical trend in highway construction.

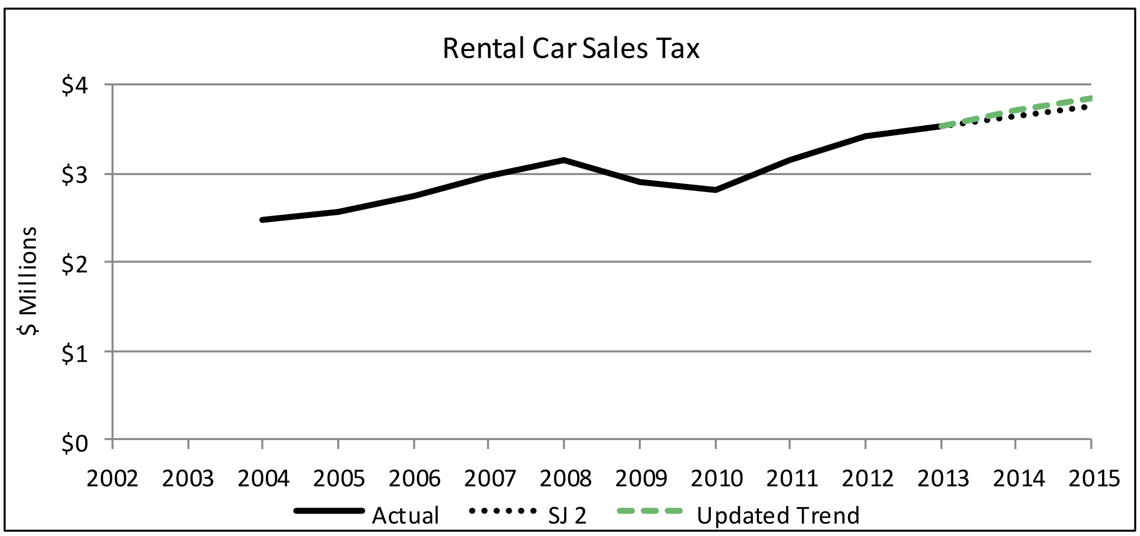
Railroad Car Tax

Railroad car tax revenue has been reasonably consistent over the last several years, and FY 2013 was no exception. Actual FY 2013 collections were less than 1% above the SJ 2 estimate. The updated trend based on the IHS forecast of Montana retail sales and the calculated railcar tax rate is very similar to that found in SJ 2, as a small decrease in the tax rate is mostly offset by an increase in forecast retail sales.



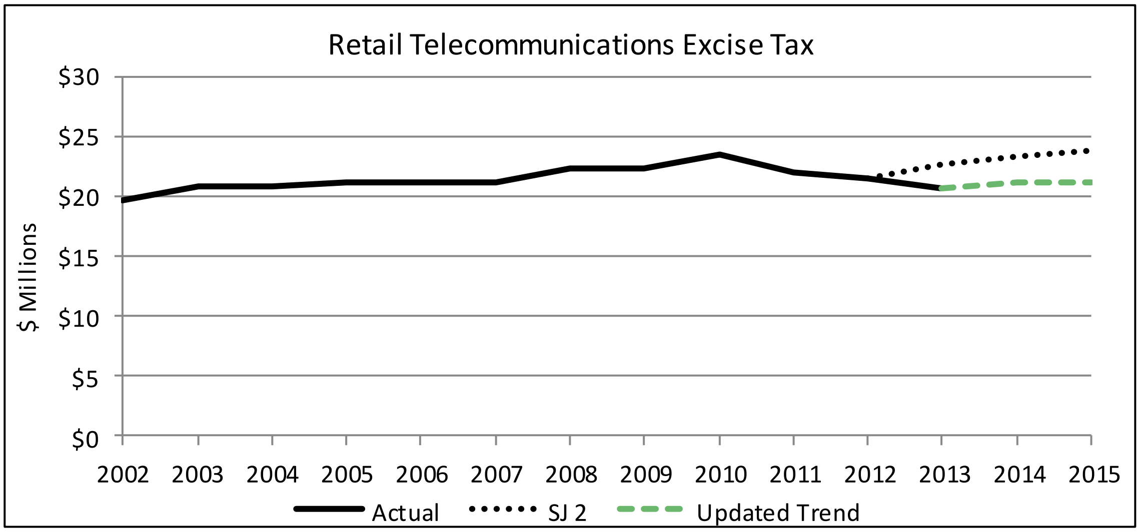
Rental Car Sales Tax

Rental car sales tax collections were very close to the estimate contained in SJ 2 in FY 2013. Rental car sales tax was forecast in SJ 2 based on Montana retail sales; the modeling method has not changed, but a slightly higher forecast of Montana retails sales from IHS resulted in a small increase in this revenue source.



Retail Telecommunications Excise Tax

Retail telecommunications excise tax collections were $2.0 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decline in revenue since FY 2011 is the state's 2011 loss of a court case to allow charging the tax on the pre-paid wireless service. According to the Department of Revenue, the impact of the case is an annual reduction in revenue of approximately $1.0 million.

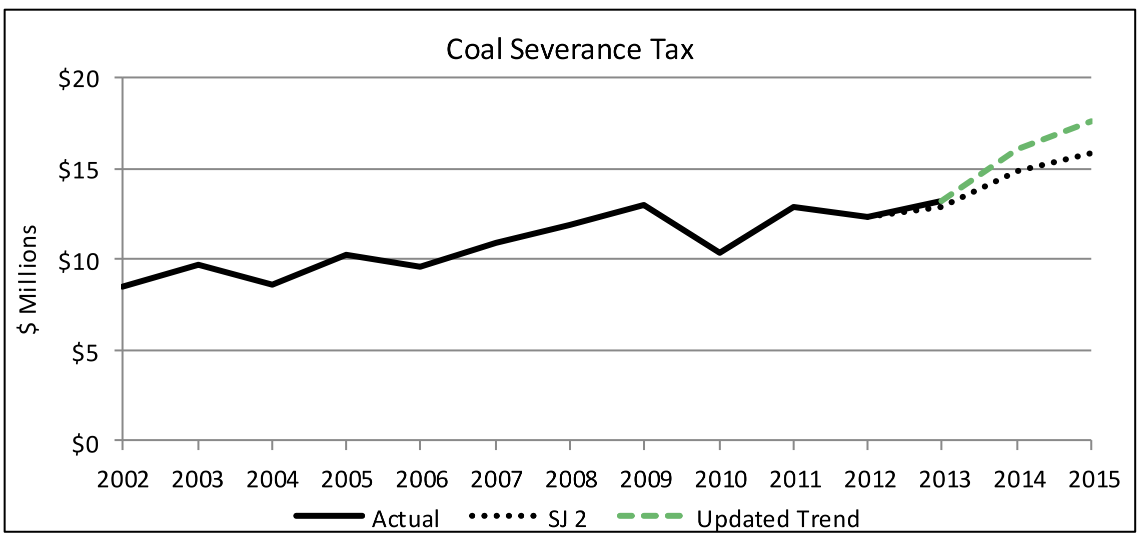


Collections were forecast in SJ 2 based on GSP for the information sector. Revised modeling based on U.S. Census Bureau data for landline use decline and cell phone use growth, and the IHS forecast of Montana population growth suggests slower growth, which is consistent with recent trends.

Other Natural Resource Taxes

Coal Severance Tax

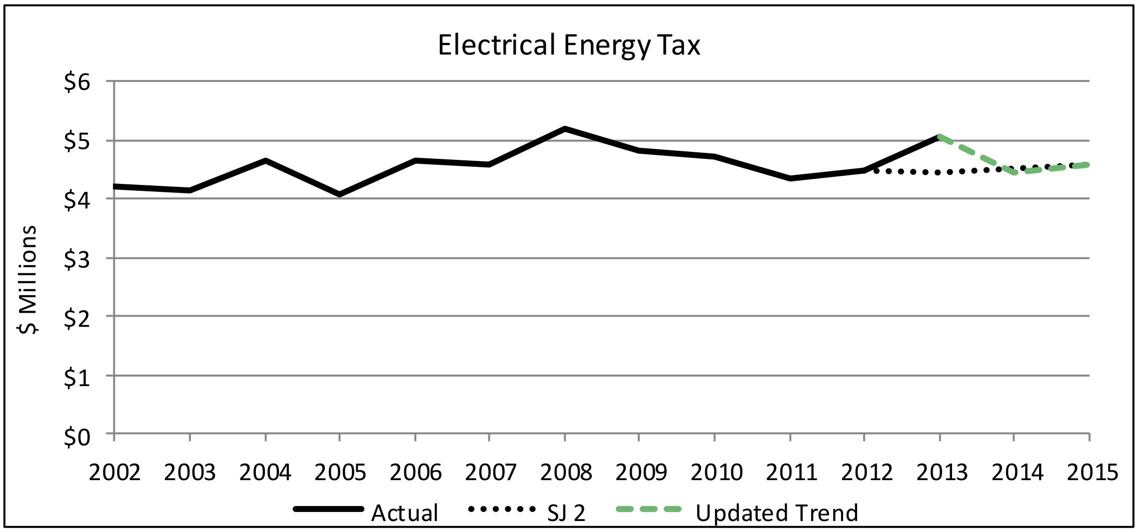
The coal severance tax was above the SJ 2 estimate by $0.4 million for FY 2013. The updated trend continues the increased growth, based on higher production estimates from coal producer surveys; the contract sales price is consistent with the estimate in SJ 2.



Contributing to the general fund growth is SB 100 from the 61st Legislature (2009), which increased the coal severance tax allocation to the Coal Natural Resource account from 2.9% to 5.8%, and expired September 2013. As a result, the allocation the Coal Natural Resource account has reverted to 2.9%, with the other 2.9% returning to the General Fund. This allocation change was included in SJ 2.

Electrical Energy Tax

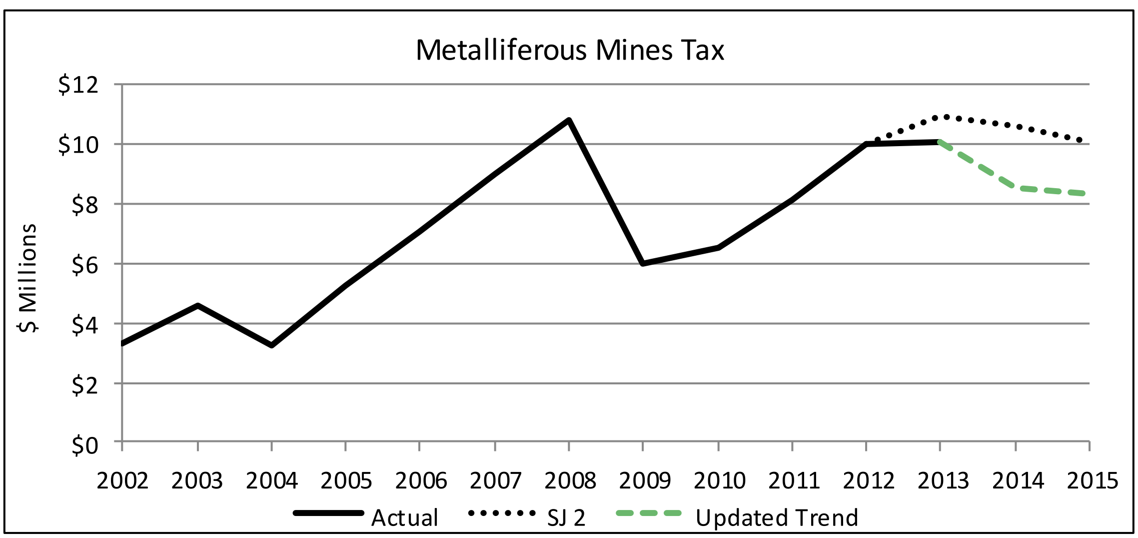
Taxable energy production was below forecast; however, the general fund tax revenue was $0.6 million (14.1%) above forecast. This is due to a larger than usual accrual which was calculated based on actual fourth quarter FY 2013 collections that were 15% higher than fourth quarter FY 2012 collections.



The forecast is driven by surveys of electricity producers. New surveys have been conducted, and despite an upturn in production in FY 2013, producers are expecting similar production to the levels contained in SJ 2. Thus the updated trend converges to the SJ 2 forecast for FY 2014 and FY 2015.

Metalliferous Mines Tax

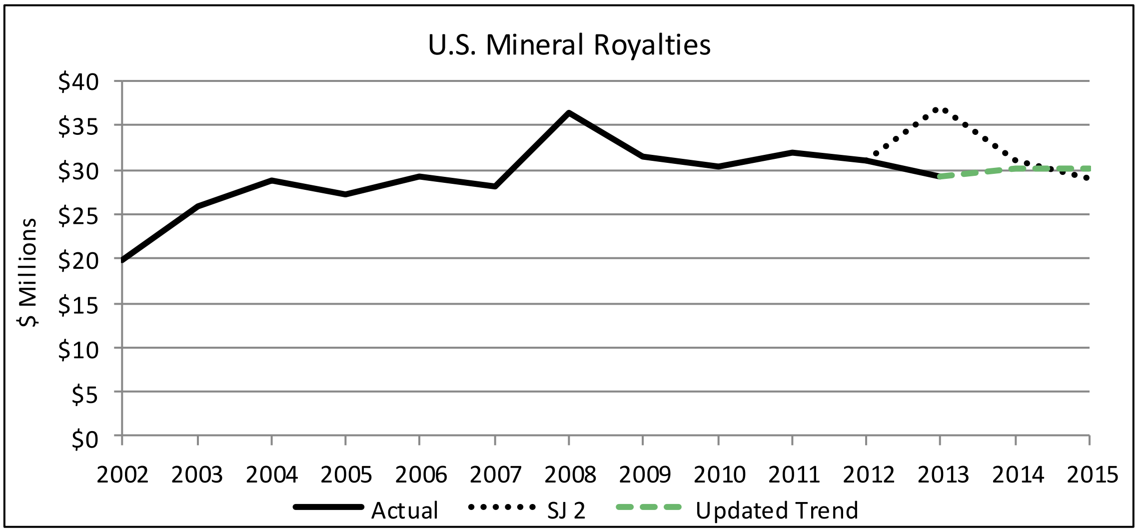
Metal mines tax collections were $0.9 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decrease in revenue was the lower-than-forecast prices for most metals.



Based on updated survey information provided by each of the major metal mines producers in the state, overall production will decline for some metals in the forecast period. The decline in production is driving the reduction in expected tax revenue.

U.S. Mineral Royalties

Revenue from U.S. mineral leases in the state was below estimate in FY 2013 by $7.8 million. While data from the Federal Office of Natural Resources Revenue is not yet available, the decline is primarily due to two factors: a $1.6 million decrease in payments due to the sequestration and the loss of the Montana portion of a large oil and gas lease that failed to materialize in McCone County. Donco Inc. paid $13.3 million for the lease (Billings Gazette 10/24/2012) which was subsequently included in the FY 2013 forecast. The company later backed out of the lease, forgoing a deposit of $0.3 million (Petroleum News Bakken 05/26/2013).

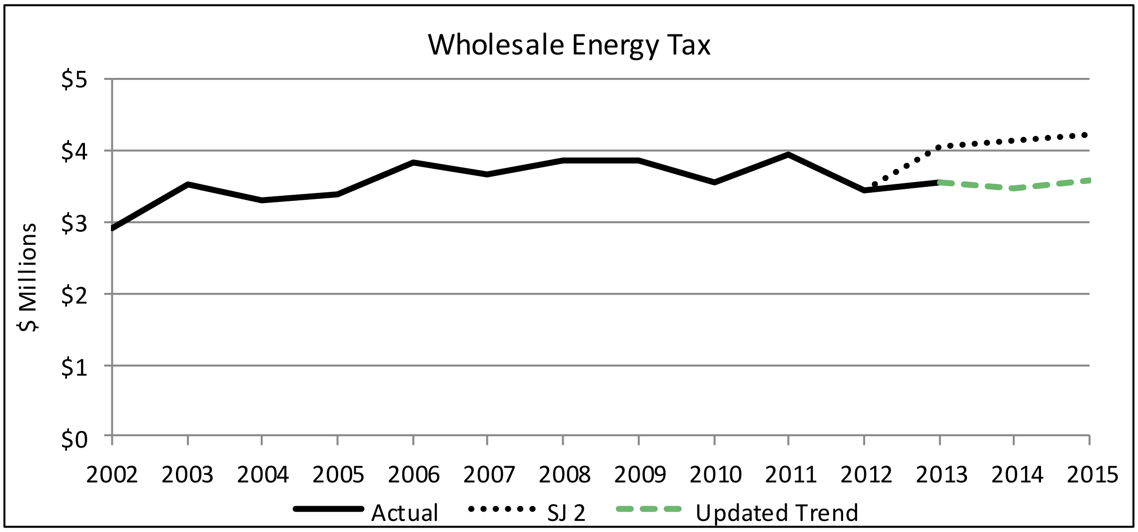


The updated trend includes an increase in FY 2014 primarily due to the $1.6 million return of the previously sequestered funds, per a U.S. Department of Interior letter. The differences are summarized in the table below:

U.S. Mineral Royalty Differences from SJ 2 *(in Millions)*		
Reason for Difference	FY 2013	FY 2014
Montana portion of canceled lease	-$6.2	
Federally sequestered funds	-1.6	
Returned federally sequestered funds		$1.6
Total	-$7.8	$1.6

Wholesale Energy Transaction Tax

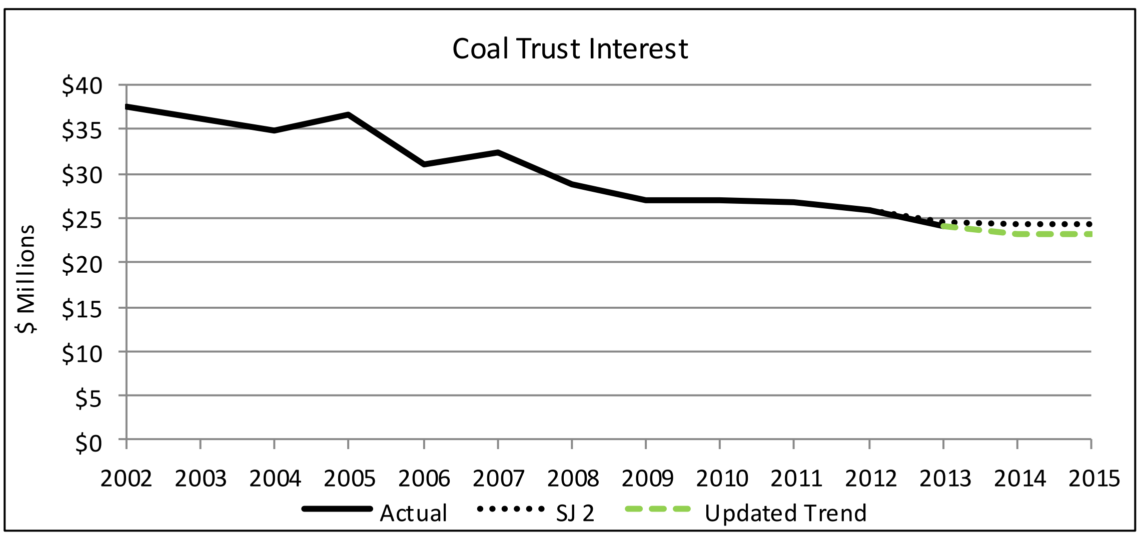
Wholesale energy transaction tax, imposed on transmission services providers, was $0.5 million below the SJ 2 forecast in FY 2013. New surveys of energy transmission companies have been conducted since SJ 2 and the combined kilowatt hours for electrical transmission companies have been revised downward, closer to observed levels in FY 2013. The decrease—primarily attributable to out-of-state transmissions—is driving the reduction in the updated trend.



Other Interest Earnings

Coal Trust Interest Earnings

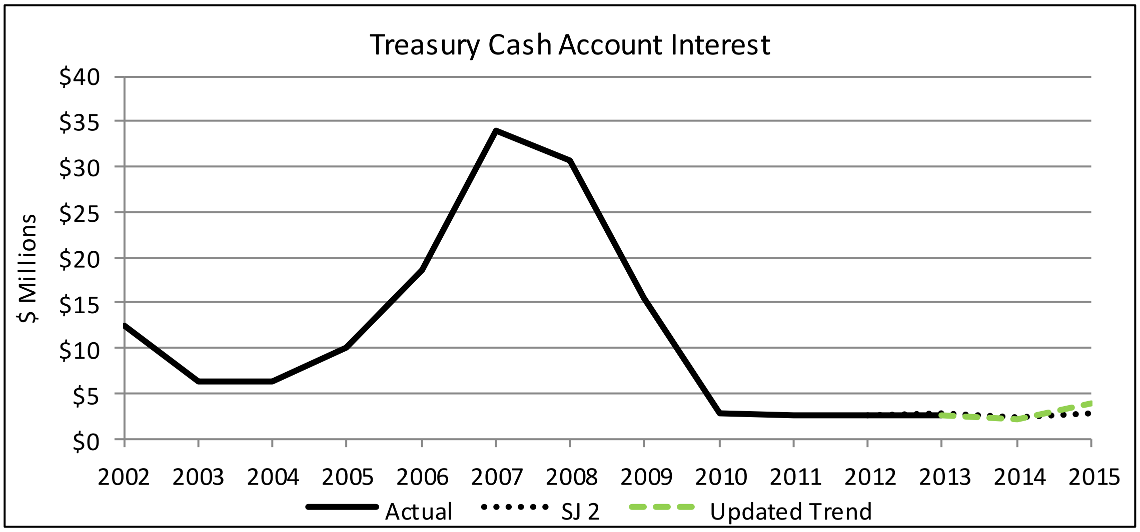
Coal trust earnings were below the estimate contained in SJ 2 by only $0.3 million. Revenue from this source is estimated using year-end balance amounts and forecast interest rates based on IHS estimates and suggestions from the Board of Investments (BOI).



The model used for this revenue forecast has not changed. The small discrepancy between SJ 2 estimates and the updated trend is due to a slightly smaller return rate than was forecast in SJ 2.

Treasury Cash Account Interest

Based on year-end data for FY 2013, revenue from TCA interest earnings was $0.3 million below the estimate provided in SJ 2. Low interest rates continue to yield less-than-favorable rates of return for TCA interest earnings.

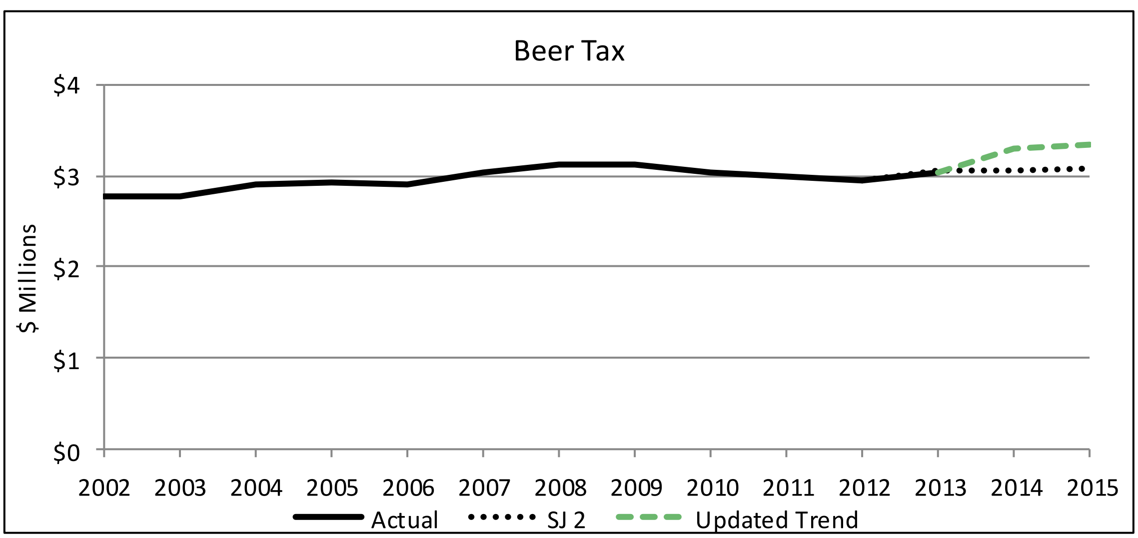


The updated trend is based on general fund projections as there is a strong correlation between the average treasury cash balance and total general fund revenue. Using the cash balance estimate, interest rates are forecast using IHS estimates and applied accordingly. Until interest rates begin to rebound, revenue from this source will continue to be far below historical amounts.

Other Consumption Taxes

Beer Tax

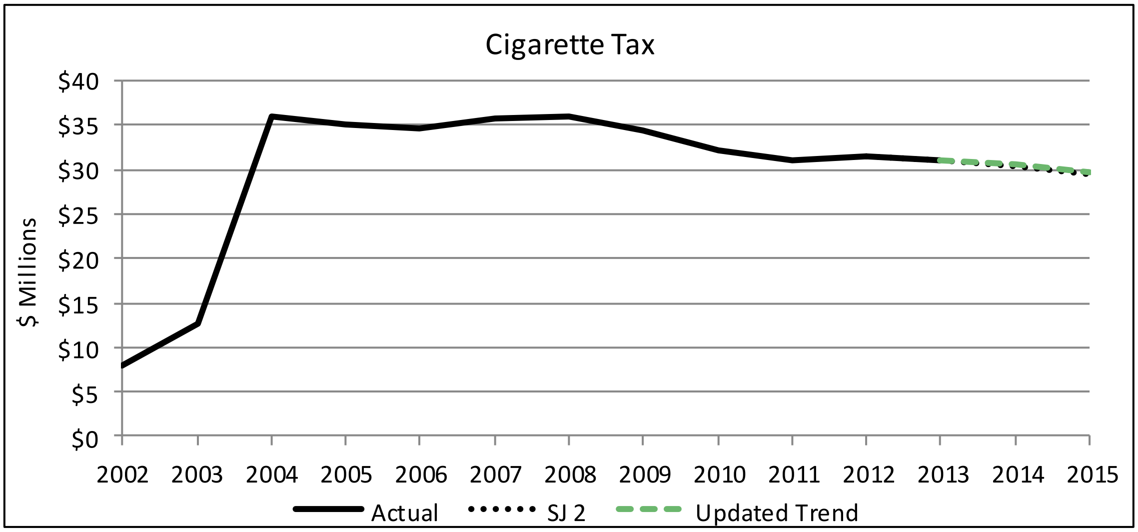
FY 2013 beer tax revenue came in just below the SJ 2 estimate. Although the estimate was low for actual number of barrels sold, it was high for the effective tax rate. Both the SJ 2 estimate and the updated trend use a regression of a proxy for barrels sold against Montana retail sales and Montana's over-21 population. The increase in the updated trend is primarily due to the increase in forecast retail sales and population provided by IHS.



Also built into this update is a trend for the changing effective tax rate. The tax rate for distributors moving less than 5000 barrels per year is only $1.30 per barrel, and for those distributing between 5,001 and 10,000 the rate is $2.30, much less than the nominal $4.30 for larger distributors. There is a small but steady decline in effective tax rate as the number of smaller breweries, and therefore smaller distributors, increases. The revised effective tax rate is based on growth trends for the various distributor sizes.

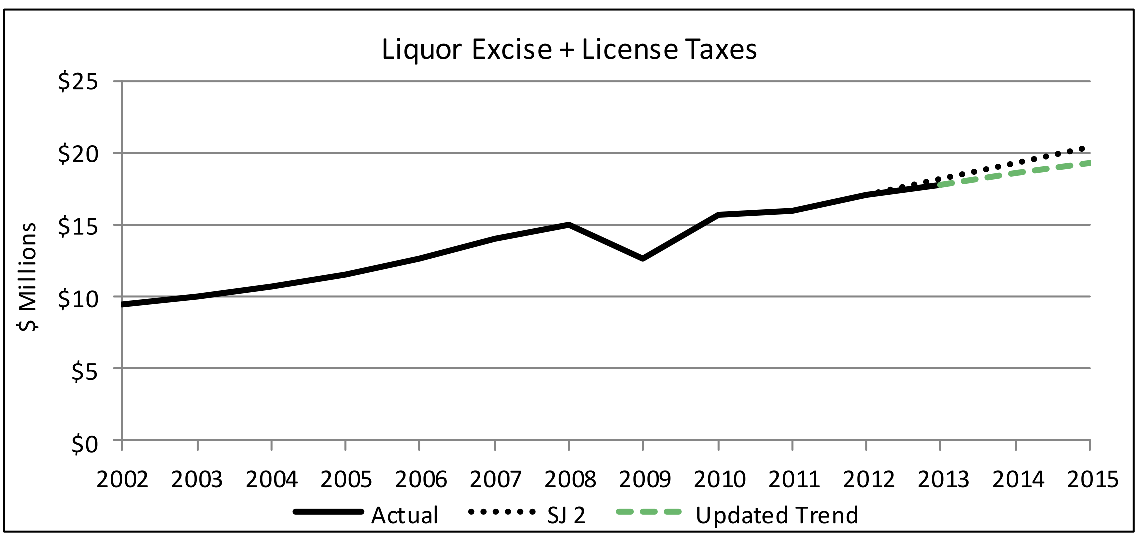
Cigarette Tax

Cigarette taxes slightly exceeded the SJ 2 revenue estimate in FY 2013. Since the tax rate stabilized at $1.70/pack in 2006, tax revenue has been generally declining. Packs sold per year have declined since 1997, but have stabilized in recent years. For SJ 2, this revenue source was forecast using the independent ratio of the Consumer Price Index (CPI) for tobacco to consumer spending on tobacco products. The updated trend also incorporates the actual packs sold in the previous fiscal year.



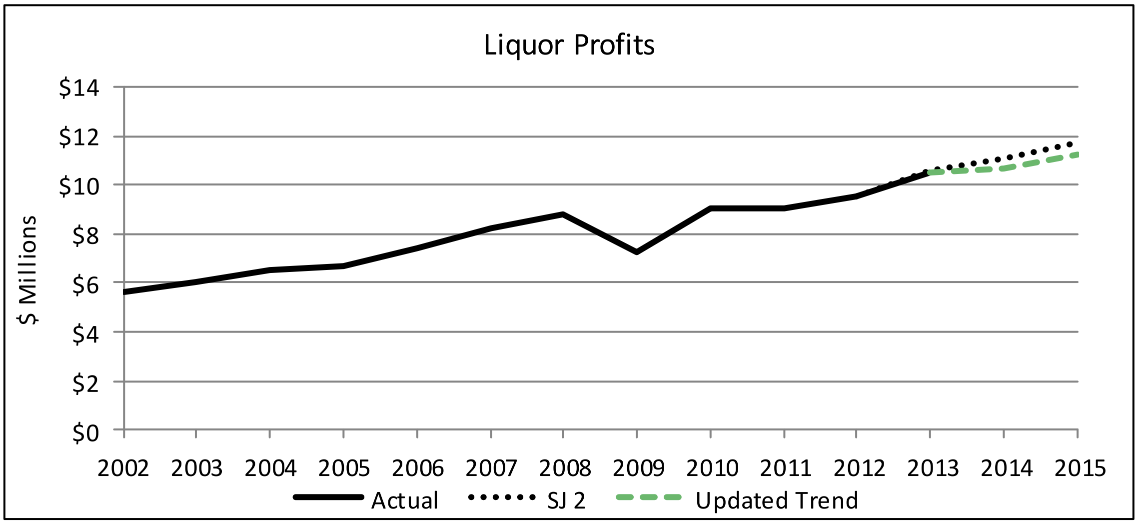
Liquor Excise & License Tax

Liquor excise tax revenue came in $0.5 million under the FY 2013 estimate in SJ 2. The updated trend is simply adjusted to account for FY 2013 actual collections.



Liquor Profits

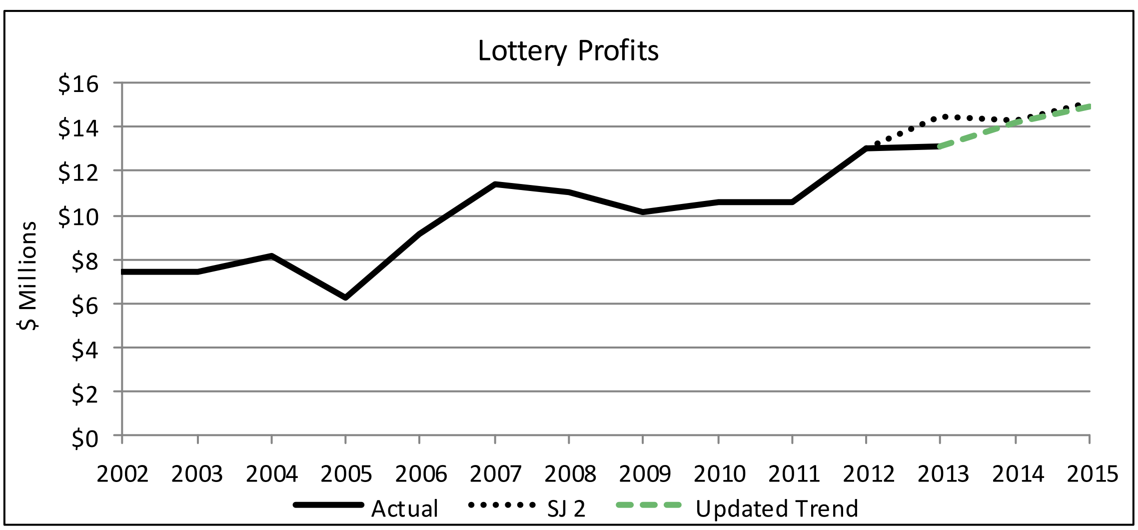
FY 2013 liquor profits came in at $0.1 million below the estimate contained in SJ 2. Since the license and excise rates are constant, the updated trend is simply accounts for the FY 2013 actual collections.



Lottery Profits

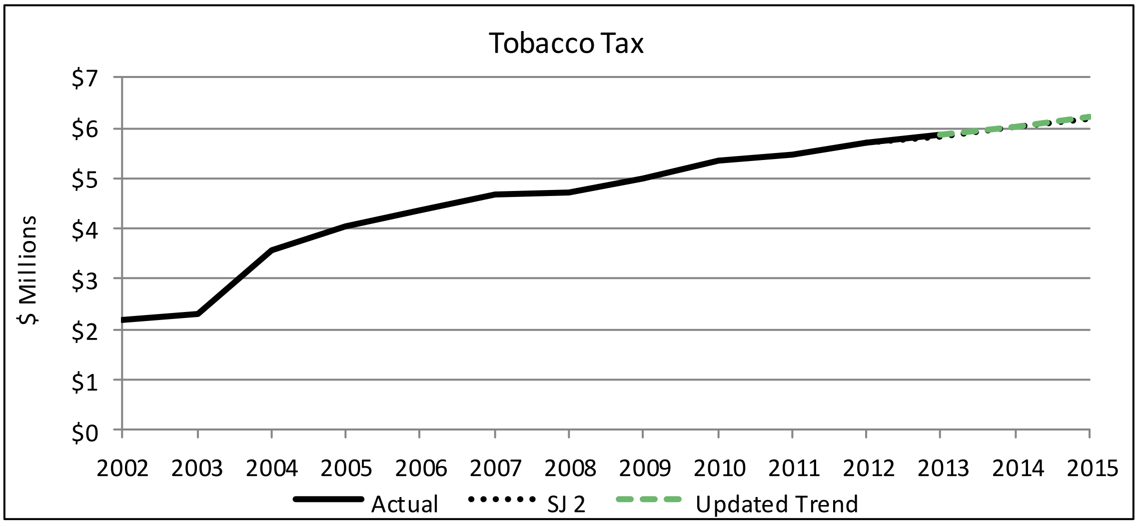
Lottery profits for FY 2013 came in $1.4 million under the SJ 2 revenue estimate. In FY 2012, there was a transfer of $0.5 million in appropriation authority from FY 2013, and in FY 2013 the Lottery received supplemental authority for $2.0 million, of which it spent $0.8 million. As a result, profits transferred in FY 2013 were reduced by about $1.3 million. At the time of the SJ 2 estimate, information regarding the FY 2012 transfer was available; however, an adjustment was not incorporated into the estimate. The supplemental appropriation had not yet been made at the time of SJ 2.

Disregarding the one-time-only transfer and supplemental appropriation, the updated trend is still lower than the SJ 2 estimates for the next two years. FY 2013 sales were higher than projected in SJ 2, but the prize/ticket ratio was also higher, and incorporating those new numbers into the trend bring profits down slightly.



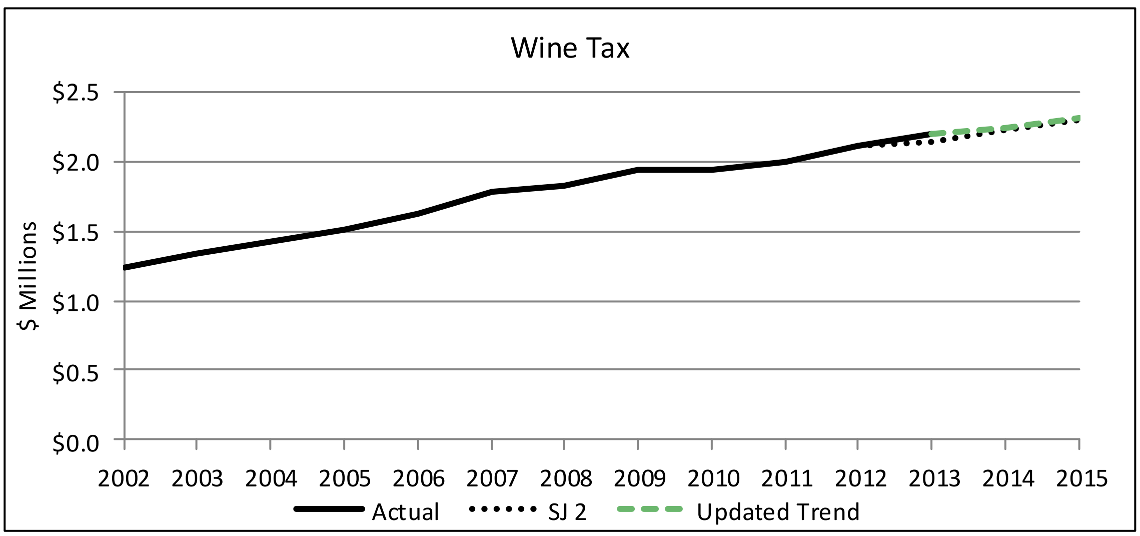
Tobacco Tax

Tobacco tax revenue came in over the SJ 2 estimate in FY 2013 by a very small amount. The underestimate for moist snuff balanced the overestimate for other non-cigarette tobacco products, resulting in a close overall estimate. The methodology for this revenue source has been updated, but the trend has not changed much. Both moist snuff and other tobacco (non-cigarette) products are now forecast using the same variables—Montana retail sales and Montana's over-18 population—then the respective tax rates are applied and the resulting amounts summed.



Wine Tax

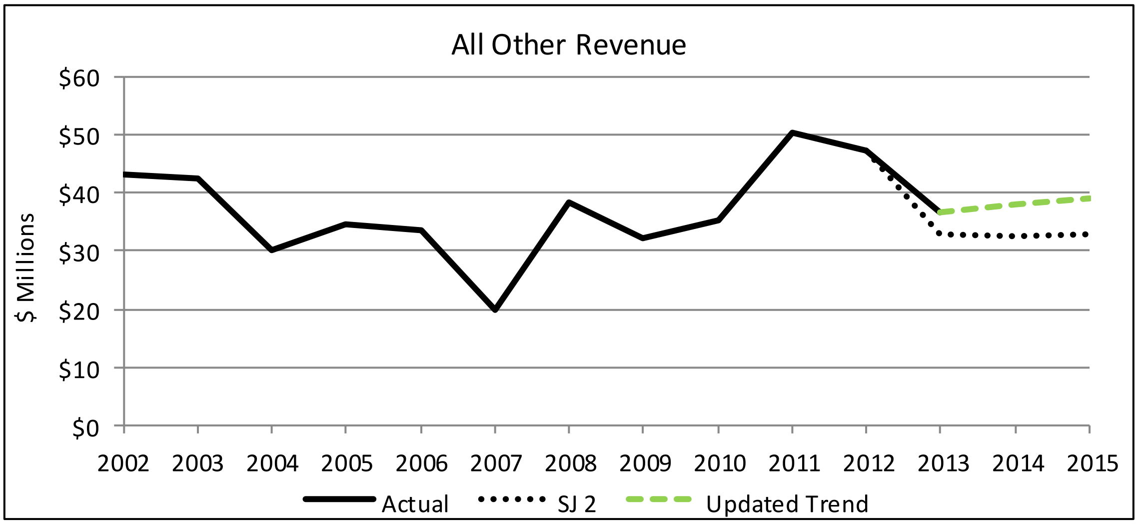
FY 2013 wine tax revenue was above the SJ 2 estimate by $0.1 million. The updated trend includes FY 2013 actual collections and the updated population estimate from IHS.



Other Sources

All Other Revenue

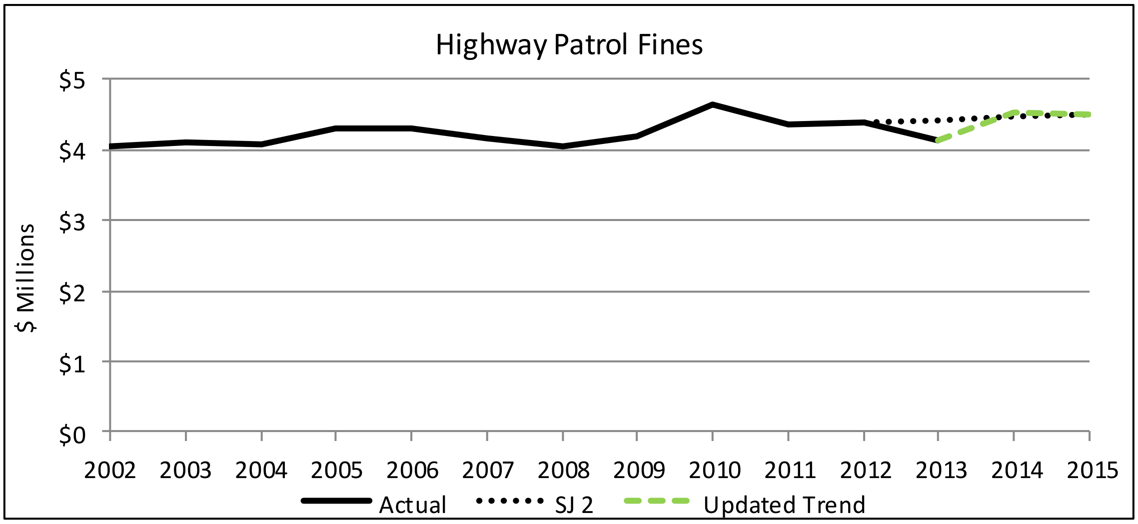
Combined revenue from all other general fund sources exceeded the SJ 2 estimate by $3.7 million. This was due primarily to increased transfers to the general fund.



The modeling for this source has changed. Previously, numerous sources earning under $1.0 million were estimated independently. They are now estimated aggregately. The remaining seven sources that typically earn over $1.0 million are still estimated on an individual basis. The increase updated trend is primarily driven by actual collections in FY 2013.

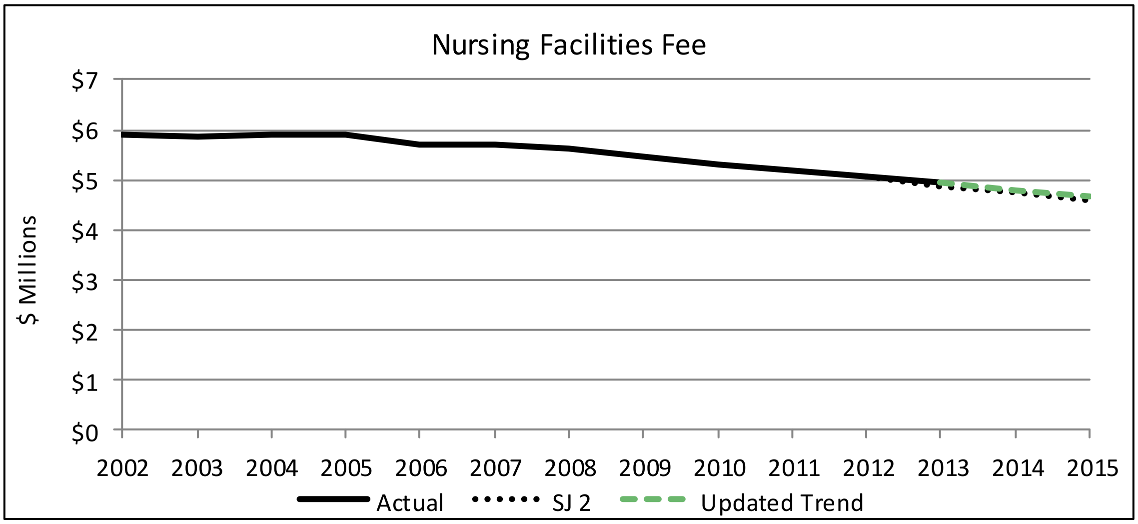
Highway Patrol Fines

Revenue generated from highway patrol fines in FY 2013 was $0.3 million less than the estimate provided in SJ 2. The old model used the most recent per capita fine rate in forecast years. The revised model attempts to account for historical fluctuations to estimate the fine rate.



Nursing Facilities Fee

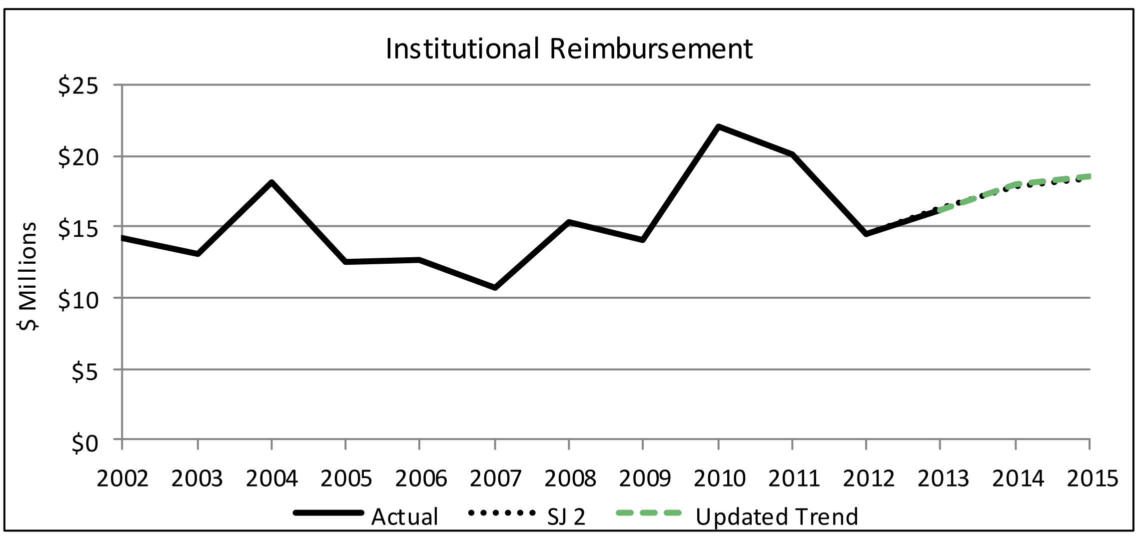
Nursing facilities fees came in $0.1 million over the SJ 2 revenue estimate. This source has been on a linear decline since 2007; the update continues to use the same linear time trend approach from earlier estimates and includes FY 2013 collections, which produces a slightly higher estimate than SJ 2.



Public Institution Reimbursements

Public institution reimbursements were $0.1 million less than SJ 2 in FY 2013. The updated trend is slightly higher than the SJ 2 estimate due to including the FY 2013 actual collections and higher-than-anticipated Medicaid payments. The increase in Medicaid payments appears to be due to higher costs per capita rather than an increase in bed days.

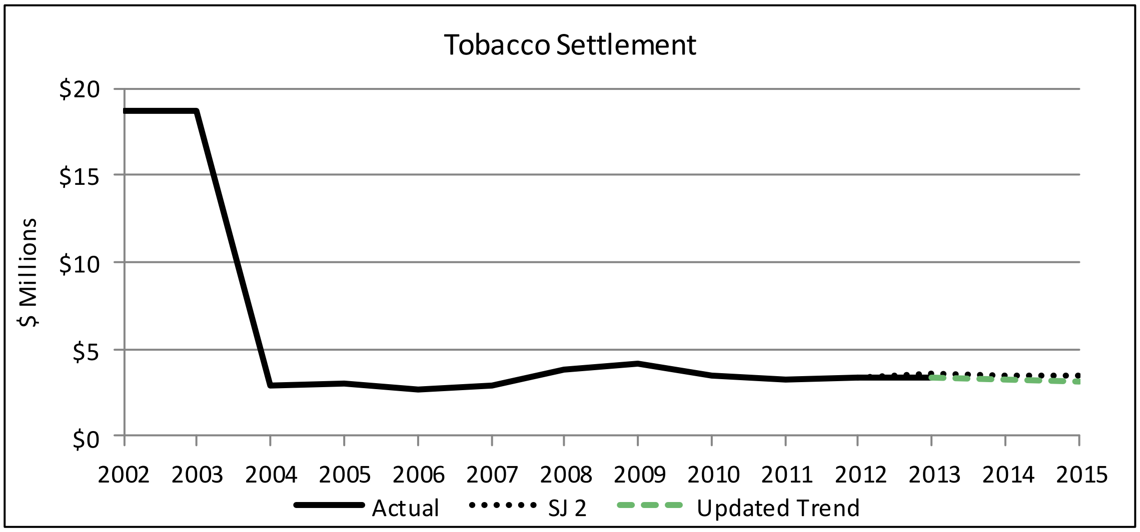
FY 2013 bed days were fewer than anticipated by the SJ 2 estimate, but three of the five facilities saw increases in Medicaid- or Medicare-eligible bed days. Additionally, per-bed-day contributions from Medicare and Medicaid due to changes in coverage were higher than forecast, and higher than previous years.



In general, bed days are expected to continue to decline as community-based services become more available and better funded.

Tobacco Settlement

Tobacco settlement revenue was below the SJ 2 estimate by $0.2 million for FY 2013 due to a decrease in market share. Changes in the tobacco settlement received by Montana are based on market share of the participating manufacturers and volume of cigarettes sold. The updated trend is slightly below that from SJ 2 due to including actual collections from FY 2013.



Tobacco Settlement
$20
$15
$10
$5
$0
$ Millions
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
Actual
SJ 2
Updated Trend