



COMPTROLLER
of MARYLAND
Serving the People

William Donald Schaefer
Comptroller

David F. Roose
Director
Bureau of Revenue Estimates

August 28, 2006

To: Honorable William Donald Schaefer
Honorable Nancy K. Kopp
Secretary Cecilia Januszkiewicz

From: David F. Roose *DFR*
Director, Bureau of Revenue Estimates

Subject: Fiscal Year 2006 Revenues

General fund revenues totaled \$12.390 billion in fiscal year 2006, \$46.5 million (0.4%) over the forecast. Growth of 7.3% (8.6% in ongoing revenues) was driven largely by the income taxes, sales tax, and interest income, while the revenue overattainment resulted primarily from interest income and the corporate income tax. The general fund's two major revenue sources—the individual income tax and the sales tax—were a combined \$2.0 million under the estimates, just two basis points from the \$9.6 billion estimate.

The individual income tax grew by 9.5% to \$6.2 billion, missing the estimate by \$6.6 million (0.1%). Employment growth was relatively consistent on a monthly basis throughout the fiscal year, between 1.2% and 1.4% with only a handful of exceptions. Over the course of the fiscal year, employment increased by 1.4%, a slight deceleration from the 1.5% growth recorded in fiscal year 2005. Net wage and salary income (wage and salary income including the residence adjustment) grew by 5.8% in the first three quarters of the year, a one percentage point slowdown from the same period in fiscal year 2005, but growth in the first quarter of the fiscal year was the second-best since 2000 at 7.3%. Despite the fact that this level of economic growth is not spectacular (both measures are slightly below the average annual growth rate for the past ten years, and slightly above the average for the past fifteen years), the individual income tax posted its fourth best performance in the last eighteen years, easily exceeding the 5.3% average annual growth over that period.

Income tax withholding grew by 8.1% in fiscal year 2006 to \$9.248 billion, only a slight slowdown from the 8.3% growth of the prior year. Adjusted for law changes (including changes to the local income tax rates), baseline growth was actually slightly higher in 2006. Withholding exceeded the forecast by \$25.0 million (0.3%), while nonwithheld payments grew by 14.9%, barely over half the 29.0% rate from fiscal year 2005. Estimated payments grew by 17.8%, slightly ahead of last year's 17.3% pace, missing the forecast by \$4.5 million (0.3%). Final payments slowed precipitously from 40.5% last year to 14.0% this year, missing the estimate by \$52.5 million (3.8%), while fiduciary payments actually declined by 10.8%, falling short by \$14.3 million (14.0%).

Despite the fact that final and fiduciary payments were disappointing relative to the estimates, the 14.9% growth in nonwithheld payments was the second-best performance since 1998, and the fourth best in the past fifteen years. Individual income tax refunds grew by 11.9%, but were \$22.3 million (1.2%) under the forecast.

Once again, a major driver of individual income tax growth is capital gains, especially gains from residential real estate sales. Preliminary analysis suggests that growth in potentially taxable gains in tax year 2005 (paid in estimated payments throughout the tax year and as final payments in April 2006) slowed from around 80% in 2004 but still exceeded 50%, adding \$1 billion or more to taxable income. And as was also the case last year, it is likely that net capital gains were boosted by the exhaustion of loss carryforwards from several years prior, although this factor is diminishing over time.

Corporate income tax receipts were very strong throughout the fiscal year, finishing with 21.7% growth, \$18.5 million (3.0%) above the \$604.7 million forecast. Corporate profits before tax, which have grown over 10% each of the past fifteen quarters, grew over 30% in every quarter in calendar year 2005, and 16.6% in the first quarter of 2006. For the first three quarters of the fiscal year, growth was 25.6%. Baseline growth is difficult to determine due to decoupling from federal tax law, Delaware holding company issues, and the ever-present tax year and timing issues with the corporate income tax, but clearly fiscal year 2006, along with fiscal year 2005, have been the best years for the corporate income tax over the past two decades.

Sales tax receipts increased by 7.2% to \$3.355 billion, beating the estimate by \$4.6 million (0.1%). Revenues from the consumer component grew by 5.7% to over \$2.2 billion. While month-to-month performance was more volatile in the second half of the year, perhaps related to heating costs and interest rate increases, growth was almost identical in both halves of the fiscal year. The construction sector contributed \$559.5 million, growth of 11.2%, as the housing market, though decelerating through the last half of the fiscal year, continued at historically high levels. Sales taxes are generated both on the materials used to build housing, and from the expenditures homebuyers make on appliances, furniture, and the like. The utility component of the sales tax grew by 11.8%, reaching \$284.6 million, spurred in part by higher energy prices. As was the case for all but one year since 2000, revenues from capital goods posted the worst performance of the four major categories, growing just 5.4% in fiscal year 2006. The distribution to the Transportation Trust Fund (45% of the sales tax collected on car rentals) grew by 9.1% to \$26.5 million.

Lottery revenues exceeded the forecast by \$9.1 million (1.9%), growing by a strong 5.4%. Sales were up by 5.1%, led by Mega Millions at 16.6% and instant tickets at 6.2%. All of the other games grew at or over 4.75% except for Bonus Match 5 (2.3%) and the lottery's oldest game, Pick 3, which with growth of 0.7% at least posted the second consecutive year of growth for the first time in ten years. With a \$16.5 million increase, Pick 4 provided more than half of the \$24.0 million increase in revenues. The remainder essentially came from Mega Millions, with increases in the rest of the games

offset by the \$9.3 million decline in revenues from Pick 3. The general fund was also boosted by a budgeted \$735,000 drop in Mega Millions revenue distributed to the Stadium Authority.

Business franchise taxes were one of only two major revenue sources to decline in fiscal year 2006, dropping 0.8% to \$196.2 million, \$4.5 million under the estimate. High energy prices and resulting conservation have resulted in an essentially stagnant electricity market and a decline in revenues from the public service company franchise tax, though this decline was nearly offset by an increase of almost \$4 million in filing fees. Taxes on insurance premiums increased by 2.2% to \$274.9 million. A slight decline had been expected, resulting in revenues \$9.2 million over the forecast.

Despite growing 21.2%, death taxes missed the estimate by \$24.0 million, bringing in only \$221.9 million. Inheritances taxes performed slightly better than expected, exceeding the estimate of \$47.1 million by \$3.3 million. Volatile estate taxes, however, fell \$27.4 million short of the forecast. Growth of 46% through February was followed by a drop of 17.1% over the last four months of the fiscal year. Only 12 estates made payments over \$500,000 over the last third of the year, totaling \$12.5 million, compared to 21 the prior year, which paid \$26.0 million.

Excise taxes performed largely as expected, finishing a combined \$2.6 million (0.8%) above the forecast. Cigarette taxes grew by 1.4%, the second consecutive year of growth (pack sales increased by 1.1%), and were \$1.9 million (0.7%) over the estimate. Taxes on other tobacco products were \$200,000 over the \$8.5 million forecast. The tax on distilled spirits finished about the same, \$224,000 over the \$13.4 million estimate. Taxes on wine were \$11,000 over the \$4.9 million forecast, offset by the \$12,000 shortfall from beer taxes. All together, alcoholic beverage excise tax revenue increased by 2.2%. Motor vehicle fuel tax revenues distributed to the general fund were \$125,000 under the forecast (0.9%). As a result of the high gasoline prices throughout the year, particularly in the aftermath of hurricane Katrina when prices in Maryland were among the highest in the country, growth was only 0.4%, the second-lowest growth of the past thirteen years.

Court revenues finished \$5.2 million over the forecast. Revenues from the clerks of court, driven largely by conditions in the housing market, were expected to decline due to the deterioration of that market but instead grew by 5.8%, hence beating the forecast by \$6.9 million (11.8%). Hospital patient recoveries were nearly flat, and finished \$2.8 million above the estimate. Interest income was forecast to grow by 110%, but finished the year with 152% growth. For the fiscal year, interest finished \$28.5 million over the estimate at \$162.5 million, the greatest overattainment among major revenue sources. Miscellaneous revenues were \$1.1 million over the forecast. Most of the miscellaneous revenues were at or near their estimate; uninsured motorist penalty fees finished well ahead of expectations, offsetting underperformance from abandoned property. The 21% decline in miscellaneous revenues is largely a result of the decline in abandoned property revenue (2005 was boosted by a one-time impact from insurance company demutualizations).

While the revenue outlook is generally favorable, it does seem likely that the next round of revenue estimates will continue to show decelerating growth. The Revenue Monitoring Committee will be analyzing the fiscal year 2006 results and the current economic outlook over the next several weeks, and will present you with preliminary fiscal year 2007/2008 estimates in mid-September. In the meantime, should you have any questions, please feel free to contact me.

**Actual and Estimated General Fund Revenue
Fiscal Year 2006**

	Fiscal Year 2006				Fiscal Year 2005		
	Actual	Estimated ¹	Difference from Estimate		Actual	Growth FY 05-FY 06	
			\$	%		\$	%
INCOME TAXES							
Individual	6,200,193,771	6,206,781,000	(6,587,229)	-0.1%	5,660,614,331	539,579,440	9.5%
Corporations ²	623,223,544	604,737,000	18,486,544	3.0%	512,236,928	110,986,616	21.7%
Total	6,823,417,315	6,811,518,000	11,899,315	0.2%	6,172,851,259	650,566,056	10.5%
SALES AND USE TAXES	3,355,168,053	3,350,608,000	4,560,053	0.1%	3,129,352,440	225,815,613	7.2%
STATE LOTTERY RECEIPTS	480,470,617	471,338,000	9,132,617	1.9%	455,863,364	24,607,253	5.4%
OTHER REVENUES							
Business Franchise Taxes	196,235,413	200,717,000	(4,481,587)	-2.3%	197,907,370	(1,671,957)	-0.8%
Tax on Insurance Companies	274,900,782	265,742,000	9,158,782	3.3%	268,912,495	5,988,287	2.2%
Death Taxes	221,908,826	245,937,000	(24,028,174)	-10.8%	183,115,297	38,793,529	21.2%
Tobacco Tax	280,704,775	278,176,000	2,528,775	0.9%	276,044,215	4,660,560	1.7%
Alcoholic Beverages Excises	27,953,097	27,730,000	223,097	0.8%	27,341,243	611,854	2.2%
Motor Vehicle Fuel Tax	13,206,799	13,332,000	(125,201)	-0.9%	13,159,119	47,680	0.4%
District Courts	91,281,358	92,971,000	(1,689,642)	-1.9%	87,407,950	3,873,408	4.4%
Clerks of Court	58,704,050	51,777,000	6,927,050	11.8%	55,464,938	3,239,112	5.8%
Hospital Patient Recoveries	86,237,315	83,475,000	2,762,315	3.2%	85,139,015	1,098,300	1.3%
Interest on Investments	162,492,508	133,976,000	28,516,508	17.5%	64,397,240	98,095,268	152.3%
Miscellaneous	297,222,106	296,117,400	1,104,706	0.4%	377,712,555	(80,490,449)	-21.3%
Total	1,710,847,031	1,689,950,400	20,896,631	1.2%	1,636,601,438	74,245,593	4.5%
TOTAL CURRENT REVENUES	12,369,903,015	12,323,414,400	46,488,615	0.4%	11,394,668,500	975,234,515	8.6%
Extraordinary Revenues ³	20,392,562	20,392,562	-	0.0%	153,364,536	(132,971,974)	-86.7%
GRAND TOTAL	12,390,295,577	12,343,806,962	46,488,615	0.4%	11,548,033,036	842,262,541	7.3%

¹ The fiscal year 2007 budget increased 2006 revenue estimates by \$4.3 million; the estimate for miscellaneous revenues has been adjusted accordingly.

² Fiscal year 2006 corporate income tax revenues do not include \$20.4 million from a settlement with MCI; 2005 corporate income tax receipts do not include \$151.0 million from the legislatively-mandated Delaware holding company settlement; these revenues are included as extraordinary revenues.

³ Extraordinary revenues include the MCI settlement in fiscal year 2006 and Delaware holding company settlement receipts and several miscellaneous transfers in fiscal year 2005.

There were additional budgeted transfers from other funds into the general fund totaling \$474.6 million in fiscal year 2005 and \$138.5 million in fiscal year 2006.



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John D. Kenney
Director
General Accounting Division

Statutory Fund Balance
June 30, 2006

General Fund Balance, June 30, 2005 available for 2006 operations		\$ 1,174,425,981
2006 Estimated Revenues		12,343,806,962
Transfer from special funds - 2005 session		138,500,000
2006 General Fund Appropriations		
Appropriated by the 2005 General Assembly	\$ 11,940,882,495	
Appropriated to State Reserve Fund	249,685,441	
Deficiency appropriations - 2006 General Assembly	182,347,080	
Estimated agency reversions	<u>(27,200,200)</u>	
Subtotal Appropriations		<u>12,345,714,816</u>
Estimated 2006 General Fund Balance		\$ 1,311,018,127
Add:		
Actual Revenues in Excess of Estimates		46,488,615
Actual Reversions in Excess of Estimates:		4,205,397
2006 General Fund Balance		<u>\$ 1,361,712,139</u>
Designated for 2007 Operations		<u>(1,188,917,240)</u>
Undesignated General Fund Balance, June 30, 2006		<u>\$ 172,794,899</u>

8/28/2006