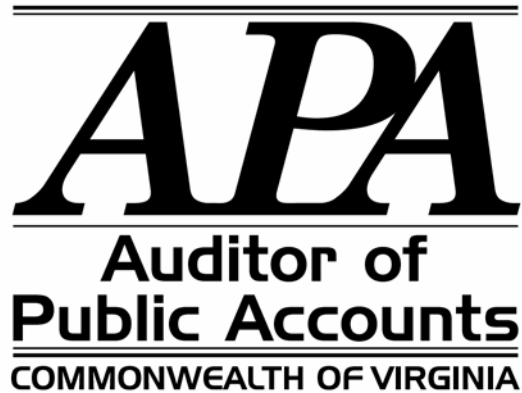


REVENUE STABILIZATION FUND

**CALCULATIONS
FOR THE YEAR ENDED
JUNE 30, 2005**





Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 27, 2005

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>
2003	\$ 9,455,077
2004	10,448,160
2005	12,036,699
Average for three years	\$10,646,645
Maximum fund allowed (10% of average)	\$ 1,064,665

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 2005 we calculated the mandatory deposit and have shown an alternative calculation, which includes the tax increases and exemption repeals.

Mandatory Deposit: Excluding Tax Increases and Exemption Repeals

Excluding the effect of tax increases and exemption repeals, certified tax revenues increased by 11.31 percent between fiscal years 2004 and 2005, and the average growth for the preceding six years was 5.22

percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 6.09 percent.

As a result, the General Assembly must make a mandatory deposit of at least \$354,057,244 during the fiscal year ending June 30, 2007, related to fiscal year 2005 tax collections excluding tax increases and exemption repeals, as required by the Virginia Constitution. Exhibit 1 provides the certified tax revenue amounts used in the mandatory deposit calculation and the funding progress of the Revenue Stabilization Fund based on the required mandatory deposit.

To perform this calculation, we used estimates provided by the Department of Taxation (Taxation) related to the effect of tax increases and exemption repeals on certified tax revenues for fiscal year 2005. We reviewed the methodology and data Taxation used to arrive at the estimated amounts to ensure the amounts were reasonable. Taxation could not establish a methodology to estimate the additional tax revenue associated with the elimination of the common carrier sales and use tax exemption; therefore, we could not eliminate the effect of this tax change from the mandatory deposit calculation. The amounts provided by Taxation related to the effect of tax increases and exemption repeals are included in the schedule below.

EFFECT OF TAX INCREASES AND EXEMPTION REPEALS (IN THOUSANDS)

<u>Tax Source</u>	<u>Tax Category Effected</u>	<u>Amount</u>
State sales and use tax rate	State sales and use	\$ 295,256*
Income adjusted age deduction	Individual and fiduciary income	44,980
Public service corporation exemption	State sales and use	29,770
Delaware holding companies deduction	Corporate income	32,582
Pass-through entities tax base	Individual and fiduciary income	3,950

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

Alternative Deposit: Including Tax Increases and Exemption Repeals

Since the Virginia Constitution allows the Governor and General Assembly to include the effect of tax increases and exemption repeals, in whole or in part, under the alternative calculation certified tax revenues increased by 15.2 percent between fiscal years 2004 and 2005, and the average revenue growth for the preceding six years was 5.22 percent. Under the provisions of the Revenue Stabilization Fund, the difference between last year's revenue growth and the average growth is 9.98 percent.

Based on fiscal year 2005 certified tax revenues including tax increases and exemption repeals, the General Assembly may make a deposit during the fiscal year ending June 30, 2007, in addition to making the mandatory deposit calculated above, of up to \$246,550,366, or a total deposit of \$600,607,610, which includes the mandatory deposit. Exhibit 2 provides the certified tax revenue amounts used in the alternative deposit calculation and the funding progress of the Revenue Stabilization Fund based on the alternative deposit, which includes the effect of tax increases and exemption repeals.

In the Comptroller's General Fund Preliminary Annual Report for the fiscal year ended June 30, 2005, the Governor has indicated that it is his intention to make a deposit of \$402,223,000 during fiscal year 2007 related to fiscal year 2005 tax revenues, which does not include the effect of revenue increases resulting from the repeal of the public service corporation exemption and the state sales and use tax rate increase enacted by the 2004 General Assembly. This amount is within the range of deposit amounts calculated under this alternative.

CALCULATION OF STATUTORY DEPOSIT

Section 2.2-1829 of the Code of Virginia, as discussed in Appendix A, requires the Governor to include an additional deposit to the Revenue Stabilization Fund in his budget recommendations if certain conditions occur. Under each funding alternative, as shown in Exhibit 3, the growth of certified tax revenues meets the requirements of two of the three conditions. However, estimated general fund revenues for fiscal year 2006 are not 5 percent greater than actual general fund revenues for fiscal year 2005 as required by the third condition; therefore, there is no need for an additional deposit. Should the Governor revise the revenue forecast above 5 percent after the date of this letter, this change could lead to the need for an additional deposit.

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

AUDITOR OF PUBLIC ACCOUNTS

WJK:aom
Enclosure

Exhibit 1

CALCULATIONS USED FOR THE REVENUE STABILIZATION FUND 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
1999	6,087,888	420,421	2,065,265	8,573,574	10.26%	7.85%
2000	6,829,587	565,909	2,201,533	9,597,029	11.94%	8.04%
2001	7,226,407	363,757	2,272,954	9,863,118	2.77%	9.21%
2002	6,710,857	290,215	2,429,845	9,430,917	(4.38)%	8.50%
2003	6,775,799	343,319	2,335,959	9,455,077	0.26%	6.77%
2004	7,430,870	434,493	2,582,797	10,448,160	10.50%	5.36%
2005 ^a	8,303,557	584,108	2,742,495	11,630,160	11.31%	5.22%

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

SCHEDULE OF FUNDING PROGRESS MANDATORY DEPOSIT

	Amounts (In Thousands)
Balance at June 30, 2004	\$ 340,067
Interest earned during fiscal year 2005	7,724
June 2005 constitutional deposit	<u>134,468</u>
Total in fund at June 30, 2005	\$ 482,259
Percentage of maximum fund	45%
Required future deposits:	
June 2006 constitutional deposit	268,936
Less June 2004 prepayment	<u>(87,000)</u>
Required 2006 mandatory deposit	181,936
Required June 2007 constitutional deposit	<u>354,057</u>
Total required deposits to date	<u>\$1,018,252</u>

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		
1999	6,087,888	420,421	2,065,265	8,573,574	10.26%	7.85%
2000	6,829,587	565,909	2,201,533	9,597,029	11.94%	8.04%
2001	7,226,407	363,757	2,272,954	9,863,118	2.77%	9.21%
2002	6,710,857	290,215	2,429,845	9,430,917	(4.38)%	8.50%
2003	6,775,799	343,319	2,335,959	9,455,077	0.26%	6.77%
2004	7,430,870	434,493	2,582,797	10,448,160	10.50%	5.36%
2005 ^a	8,352,488	616,690	3,067,521	12,036,699	15.20%	5.22%

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

SCHEDULE OF FUNDING PROGRESS ALTERNATIVE DEPOSIT

	Amounts (In Thousands)
Balance at June 30, 2004	\$ 340,067
Interest earned during fiscal year 2005	7,724
June 2005 constitutional deposit	<u>134,468</u>
Total in fund at June 30, 2005	\$ 482,259
Percentage of maximum fund	45%
Required future deposits:	
June 2006 constitutional deposit	268,936
Less June 2004 prepayment	<u>(87,000)</u>
Required 2006 mandatory deposit	181,936
Required June 2007 constitutional deposit	354,057
Alternative June 2007 maximum deposit	<u>246,551</u>
Total potential deposits	<u>600,608</u>
Total fund including mandatory and alternative deposits	<u>\$1,264,803*</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 2007 when the actual deposit is made which will be based on certified tax revenue collected in fiscal years 2004, 2005 and 2006.

Exhibit 3

CALCULATIONS FOR STATUTORY DEPOSIT

	Excluding Effect of Tax Increases and <u>Exemption Repeals</u>	Including Effect of Tax Increases and <u>Exemption Repeals</u>
Growth of certified tax revenues collected in most recently ended fiscal year	11.31%	15.20%
Average revenue growth for the preceding six years multiplied by 1.5	7.84%	7.84%
Estimate of general fund revenues for the fiscal year in which the deposit is to be made as a percentage of actual general fund revenues for the immediately preceding fiscal year	(3.77)%	(3.77)%

APPENDIX A HISTORICAL INFORMATION

Mandatory Deposit

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

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

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

Item 280 of Chapter 951 of the 2005 Acts of Assembly changed the date that this Office was required to report the General Assembly from December 1st of each year to November 1st.

Statutory Deposit

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

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

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