

86<sup>th</sup> Legislative Session – 2011

Committee: Joint Appropriations

Thursday, March 03, 2011

P - Present  
E - Excused  
A - Absent

Roll Call

P Sutton  
P Haverly  
P Heineman  
P Novstrup (Al)  
P Peters  
P Putnam  
P Rampelberg  
P Dennert  
P Wismer  
P Juhnke  
P Bolin  
P Romkema  
P Dryden  
P White  
P Tidemann  
P Carson  
P Brown, Vice-Chair  
P Wink, Chair

OTHERS PRESENT: See Original Minutes

The meeting was called to order by Senator Corey Brown.

MOTION: TO APPROVE THE MINUTES OF FEBRUARY 1, 2011

Moved by: Dennert  
Second by: Tidemann  
Action: Prevailed by voice vote.

MOTION: TO APPROVE THE MINUTES OF FEBRUARY 17, 2011

Moved by: Romkema  
Second by: Tidemann  
Action: Prevailed by voice vote.

MOTION: TO APPROVE THE MINUTES OF FEBRUARY 15, 2011

Moved by: Heineman  
Second by: Putnam  
Action: Prevailed by voice vote.

MOTION: TO APPROVE THE MINUTES OF FEBRUARY 2, 2011

Moved by: Novstrup (Al)  
Second by: Tidemann  
Action: Prevailed by voice vote.

### **Revenue Projections**

#### Bureau of Finance and Management Revenue Estimate

**Mr. Jim Terwilliger**, Bureau of Finance and Management (BFM), distributed a handout entitled “South Dakota and US Economic Overview” (Document #1) There are four key variables used on forecasting and tracking the economy for both the state and the nation: nonfarm employment, unemployment rate, nonfarm income, and real gross domestic product (GDP). This information would give the committee an idea of the economic forecasting for FY2011 and FY2012 and how BFM incorporates these variables into the econometric model used to forecast the sales tax, contractor's excise tax, and other larger revenue sources going into the general fund.

The monthly nonfarm employment levels are slowly recovering since the recent recession, but the levels have remained flat in recent months. From January 2008 to February 2010, the United State's economy lost 8.7 million (6.3%) jobs. From August 2008 to February 2010, South Dakota lost 13,600 (3.3%) jobs.

The unemployment rate in South Dakota is 4.7% and has been stable at rate for the last several months. The national unemployment rate is around 9%; which is high for historical records.

The BFM anticipates a steady increase for nonfarm employment in South Dakota for FY2011 and FY2012. The preliminary January and February value is 402,900 jobs; which is less than the figure used in the projections currently.

Mr. Terwilliger said that the South Dakota nonfarm income forecast has improved. He said that the February forecast increased because Congress passed the bill extending the Bush tax cuts

which included a 2% decrease withholding of the employee share of the social security. Government social security payments are a deduction for nonfarm income. Since the deduction was smaller, that increased the forecast for the four quarters of 2011. This is a one year extension. In the first quarter of 2012, the levels of nonfarm income decrease. That will act as a tax increase to all employees next year on January 1, resulting in a net take home pay decrease until Congress extends the tax exemption again.

The South Dakota nonfarm average income growth is 4.6% from 2001 to 2009. The growth was a negative 0.2% in 2009; which was the first time the state had a negative income growth in nonfarm income since 1939. The BFM anticipates a 2.8% growth in 2010, a 4.8% growth in 2011, and a 2.8% growth in 2012.

Mr. Terwilliger explained some of the potential risks to the state revenue forecast. They include:

- Potential of more job losses in the financial services area because the federal government took over servicing student loans;
- The credit card act had an impact on the credit card service jobs; and
- A recent 30-40% increase in gas prices.

In response to committee questions, Mr. Terwilliger stated that the original prediction was 404,800 jobs and the revised figure was 402,900 – a decrease of almost 2,000 jobs in the states nonfarm employment.

Representative Dryden asked about the nonfarm income growth in 2011 and 2012. Mr. Terwilliger responded that part of the reason for the increase in 2011 is due to Congress passing the extension on the 2% withholding on social security payments. The BFM is predicting state employees will not receive a raise in 2012 and with the implementation of the 2% social security withholding, employee paychecks will decrease.

Mr. Terwilliger discussed Document # 2, entitled “Revenue Forecasts”.

#### Sales and Use Tax

The average annual increase in net collections between FY2002 and FY2010 was 4.52%. Net collections from the sales and use tax account for approximately 62% of continuing general fund revenues in FY2012. In the first seven months of FY2011, sales and use tax collections, excluding audits and net of large project refunds, were \$428.0 million. This is an increase of 8.48% from the first seven months of last year. Year-to-date collections are 61.9% of the estimate. The BFM estimates \$689,343,069 in total receipts for FY2011 (a change of 7.09%) and \$719,637,982 in total receipts for FY2012 (a change of 3.05%).

Representative Wismer asked about the effect agriculture has on projections. Mr. Terwilliger said that the agricultural economy has helped increase sales tax. Agricultural income is variable and

difficult to predict due to the weather. Therefore, it is difficult to bring agricultural related income into the revenue equation because it is not statistically significant. However, the state sales tax has been affected by the agricultural economy, and the increased sales tax is used in the model.

#### Contractor's Excise Tax

The average annual increase in net contractor's excise tax collections between FY2002 and FY2010 was 1.86%. Net collections account for approximately 5.8% of continuing general fund revenues in FY2012. In the first seven months of FY2011, net contractor's excise tax collections were \$42.2 million. This is a decrease of 3.92% from the first seven months of last year. Year-to-date collections are 69.0% of the estimate. The BFM estimates \$61,189,558 in total receipts for FY2011 (a change of 0.09%) and \$67,491,204 in total receipts for FY2012 (a change of 10.3%).

Senator Brown asked about the estimated 10.3% growth for FY2012. Mr. Terwilliger stated that some of the growth is not real growth because there has been a large amount of tax collected this year for large projects and a portion of those collections needs to be withheld in order to pay the refunds. The BFM is anticipating those amounts will not be as large during FY2012.

#### Cigarette Tax

Through the first seven months of FY2011, the total collections from the tobacco taxes totaled \$33.3 million and the fill \$30.0 million general fund portion has been collected in this category. Mr. Terwilliger stated that this is a declining revenue source. The revenue has decreased 5% year-to-date and BFM expects the revenue to decline over the years.

Senator Brown asked about the impact on the cigarette tax due to the smoking ban. Mr. Terwilliger responded that there are a couple things occurring with cigarette tax collection that makes it volatile: the federal government placed a sixty cent per pack tax and the bill from last session changes the discount given to wholesalers (was 3% and now 1% to 2%). This encouraged the wholesalers to stock-up on cigarettes and that made it tax revenue appear higher than last year's collections. The total impact is not able to be determined at this time.

#### Bank Franchise Tax

Ninety-five percent of the taxes paid by banks organized under SDCL 51A-2-38 to 51A-2-43 (bank card taxpayers) and 26 2/3% of all other revenues are deposited in the general fund. The remaining 5% of collections from bank card taxpayers and the 73 1/3% of revenues received from all other banks are remitted to the county where the bank or financial institution is located.

Through the first seven months of FY2011, \$2.8 million has been collected from this tax. This is a decrease of 86.01% from the first seven months of last year. The year-to-date collections are 69.64% of the estimate. The Bureau estimate for bank franchise tax is \$3,980,661 (decrease of 81.63%) for FY2011 and \$4,222,484 (increase of 6.07%) for FY2012.

Mr. Terwilliger explained that the state has a liability to pay \$27.5 million to the institutions that have overpaid this fee.

#### Property Tax Reduction Fund

Revenues deposited in the Property Tax Reduction Fund (PTRF) come from three sources:

- 49 ½% of video lottery net machine income;
- 60% of the revenue collected from the 4% tax on the gross receipts of telecommunication services; which was imposed by House Bill 1104 in the 2003 Legislature; and
- 33% share of the revenues in excess of \$35 million generated by the tobacco taxes from Initiated measure 2.

Through January of FY2011, video lottery receipts were down 4.33% compared to the same time period last year. Since the statewide smoking ban was initiated, the average net machine income has declined by 16.64% through February 12, 2011. Through the first seven months of FY2010, the state's share of receipts from the telecommunications tax was \$3.4 million; a decrease of 10.33% from last year.

Mr. Terwilliger noted that the casino being constructed in Iowa that is to open in May or June has a potential impact on the lottery revenue. This was not included in the estimate.

When comparing the January FY2011 budget estimate to the March FY2011 budget estimate, there is an increase of \$4,007,007 (0.35%).

Mr. Terwilliger stated, in response to Senator Putnam's question that the pie charts on page 1 of Document #2 shows the total revenue including one-time revenue for FY2012. The largest one-time receipt is in the amount of \$27,475,000 for the payment South Dakota owes to all the bank institutions that have over paid the Bank Franchise Tax.

Representative Bolin asked if the one-time payment to the bank institutions for the over payment of the fee could be made from the reserves. Mr. Terwilliger stated that the Governor wants one-time revenue to pay for one-time expenses. If the Legislature decides to use the reserves, the payment would be a one-time expense.

Mr. Terwilliger stated, in response to Representative Wismer's question, that the state worked with the Bank Franchise Tax payment recipients to have the payment made in FY2012 versus FY2011 because the state would have one-time funds to cover the payment in FY2012. However, if the recipients requested the payment sooner, the state would be legally required to make the payment.

#### Legislative Research Council Revenue Estimate

**Mr. Fred Schoenfeld** and **Mr. Aaron Olson** presented the Legislative Research Council's (LRC) revenue projections. Distributed was a chart entitled "2011 General Fund Estimates to the Joint Committee on Appropriations" (**Document #3**) and the "2011 LRC Revenue Estimate Notes" (**Document #4**).

Mr. Schoenfeld explained the Document #3. For FY2011, the LRC estimate is \$1,157,095,095; which is \$14,195,864 higher than the BFM estimate. The LRC estimate for FY2012 is \$1,175,435,320; which is \$10,561,467 higher than estimate provided by BFM. The variance between the two estimates for both fiscal years is 1.07%

Mr. Schoenfeld said that about 56% of the variance in FY2011 can be explained by the Sales and Use Tax estimate and nearly 70% of the variance can be explained by the net Sales and Use Tax, Contractor's Excise Tax, and the Property Tax Reduction Fund estimates in FY2012. The LRC estimate for Sales and Use Tax is \$706,234,975 for FY2011 and \$723,890,850 for FY2012. Actual receipts booked into the general funds from the BFM report were used to forecast the Sales and Use Tax. Through the first eight months of FY2011, the tax collections were \$476.5 million. The year-to-date collections are 71.0% of the estimate. A conservative growth rate of 2.5% was used to project the FY2012 Sales and Use Tax revenue.

Mr. Schoenfeld explained the trend analysis method the LRC uses to forecast revenues. He stated that the LRC trend methodology has produced good results in recent years. The LRC estimate has been closer to the actual than the BFM regression model in the last four of the six years in projecting out the remainder of the current fiscal year.

Mr. Schoenfeld noted that the LRC expects the sales tax will gradually return to normal CAGR of 5.5% in the long run. However, for this to occur, a growth rate exceeding 5.5% in some periods is needed to return to normalcy.

#### Contract's Excise Tax

Mr. Olson stated that based on the trend calculation the Contractor's Excise Tax is estimated to be \$60,499,227 for FY2011. Assuming a 2% growth rate, the estimate for FY2012 is \$61,709,212.

Through the first eight months of FY2011, the net Contractor's Excise Tax collections were \$42.2 million based on the report from the BFM. However, the LRC believed that approximately \$5 million has been collected through February but not yet deposited in the general fund. The additional \$5 million was included in the LRC estimate.

Mr. Olson noted that the reason for the variance was that the BFM assumed a growth rate of 10% for FY2012 and the LRC used a growth rate of 2%.

Property Tax Reduction Fund (PTRF)

The projections for Video Lottery, Telecommunication Excise Tax, and the Cigarette Tax were not estimated separately. Mr. Olson noted that the LRC did adjust the PTRF downward as a result of the estimated 15% decline in Video Lottery revenues due to the expanded smoking ban. The PTRF cigarette tax revenues are adjusted seasonally.

The LRC PTRF estimate for FY2011 and for FY2012 is \$112,308,374. Mr. Olson commented that the LRC projected no growth from FY2011 to FY2012.

Insurance Company Tax

Mr. Olson stated that based on the trend calculation the Contractor's Excise Tax is estimated to be \$62,256,919 for FY2011. Assuming a 4.31% growth rate, the estimate for FY2012 is \$64,941,467. The variance between the LRC estimate and the BFM estimate is minimal.

Licenses, Permits, and Fees

Due to the timing of the quarterly Securities Fee deposits, the LRC used the December year-to-date total to project the FY2011 estimate of \$43,953,275. Based on a 1.54% growth rate, the LRC's estimate for FY2012 is \$44,628,378.

Net Transfers In

Mr. Olson stated that the LRC estimates the revenue from the Net Transfers In to be \$32,212,812 and both FY2011 and FY2012 because the LRC projects no growth for the next fiscal year.

The Net Transfers In excludes one-time transfers in the LRC forecast and the Net Transfers In cigarette tax revenues are adjusted for seasonality. The 5.5% variance between the LRC estimate and the BFM estimate is due to the adjustment in the cigarette tax revenues.

Trust Fund

The FY2011 estimate is \$30,689,216 and \$30,327,000 for FY2012. Mr. Olson stated that the information is provided by the South Dakota Investment Council, therefore little variance exists between the two estimates.

Cigarette Tax

Mr. Olson stated that the LRC estimate for FY2011 and FY2012 is \$30,000,000. There is no variance between the two estimates.

Charges for Good and Services

Mr. Olson stated that based on the trend calculation the Contractor's Excise Tax is estimated to be \$26,254,085 for FY2011. Assuming a 3.53% growth rate, the estimate for FY2012 is \$24,681,189.

There was a downward adjustment for the FY2012 estimate by \$2.5 million due to large unforeseen unclaimed property deposited that was not anticipated.

Senator Heineman asked about the variance between the two estimates for the Net Transfers In revenue. Mr. Olson stated that the numbers used by the LRC were forecasted a year ago for the Net Transfers In for cigarette tax revenues from the Health Care Tobacco Tax Fund and Education Enhancement Tobacco Tax Fund. The revenues from those taxes are deposited in the Net Transfers In category. The numbers the LRC used in the calculation were about \$8.2 million and \$8.0 million. The BFM estimates today were about \$7.4 million and \$7.2 million. The difference in those two funds accounts for most of the variance in the estimates.

Representative Wismer asked about the 15% and 17% decreased projection for the PTRF. Mr. Olson responded that the LRC discounted the video lottery by taking the average video lottery receipts for last four months of the last two fiscal years. Those amounts were reduced by 15% to align with the trend for the remainder of the year. The months of December, January, and February already showed a discount of 15%; therefore, the LRC continued to discount the remainder of the fiscal year by 15%.

MOTION: ADJOURN

Moved by: Carson  
Second by: Tidemann  
Action: Prevailed by voice vote.

Lisa Shafer  
Committee Secretary

---

Dean Wink, Chair