

Legislative Fiscal Bureau

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February 10, 2004

Representative Dean Kaufert, Assembly Chair
Senator Alberta Darling, Senate Chair
Joint Committee on Finance
State Capitol
Madison, WI 53702

Dear Representative Kaufert and Senator Darling:

On January 15, 2004, I sent a letter to you that discussed this office's review of general fund, non-tax revenues and expenditures for the 2003-05 biennium. That letter indicated that once the January, 2004, economic forecast of Global Insight, Inc., was available, we would prepare our projections of general fund tax collections and inform you of the results of our analysis. We have now completed our review.

Based upon our analysis, we project the closing, gross general fund balance at the end of the biennium to be -\$32.2 million. This is \$218.6 million below the level (\$186.4 million) that was indicated upon enactment of the state's 2003-05 biennial budget (2003 Act 33).

The \$218.6 million is the net result of an increase in the 2003-04 opening balance of \$1.4 million, a decrease in estimated tax collections of \$222.4 million, a decrease in departmental revenues of \$0.3 million, and a reduction in net expenditures (sum sufficient appropriations and lapses) of \$2.7 million. [With the exception of the estimated tax collections and a recent revision of debt service payments, these revenue and expenditure amounts are identified in the January 15 letter.]

In addition to the projected gross general fund deficit of \$32.2 million, Act 33 requires that the state maintain a statutory balance in 2004-05 of \$40.0 million. Thus, to address the projected deficit and maintain the required statutory balance, the general fund would need to be improved by \$72.2 million.

The following table reflects the estimated general fund condition statement, which incorporates our revenue and expenditure projections.

TABLE 1

2003-05 General Fund Condition Statement

	<u>2003-04</u>	<u>2004-05</u>
Revenues		
Opening Balance, July 1	-\$282,221,000	\$74,542,200
Estimated Taxes	10,670,400,000	11,195,800,000
Departmental Revenues		
Tribal Gaming Revenues	79,158,400	80,595,400
Other	<u>328,979,100</u>	<u>329,206,800</u>
Total Available	\$10,796,316,500	\$11,680,144,400
Appropriations and Reserves		
Gross Appropriations	\$10,849,730,300	\$11,771,084,700
Compensation Reserves	109,152,900	163,019,600
Less Estimated Lapses	<u>-237,108,900</u>	<u>-221,725,400</u>
Total Expenditures	\$10,721,774,300	\$11,712,378,900
Balances		
Gross Balance	\$74,542,200	-\$32,234,500
Less Required Statutory Balance	<u>-35,000,000</u>	<u>-40,000,000</u>
Net Balance, June 30	\$39,542,200	-\$72,234,500

It is important to note that the above condition statement does not include the four sum certain GPR appropriation items that were identified in the January 15 letter. Unlike sum sufficient appropriations, which are automatically adjusted to fund selected programs, sum certain appropriations are those with a specific dollar amount that cannot be modified unless changed by the Legislature. Thus, if it is determined that a program under a sum certain appropriation will, unless modified, require a funding increase, the Legislature has the option of reducing the program's parameters, increasing the appropriation, prorating available funding, or letting the program cease due to insufficient funds.

The four sum certain appropriations are: (1) Elections Board federal matching funds (\$1.3 million); (2) foster care adoption assistance (\$5.1 million); (3) Office of the State Public Defender (\$9.2 million); and (4) medical assistance (MA) benefits. If the state is unable to secure any additional federal MA matching funds, \$401.0 million in state funds would be needed to support projected MA benefits in the 2003-05 biennium.

General Fund Taxes

The following section provides information on general fund tax revenues for the 2003-05 biennium, including a discussion of the national economic forecast for 2004 and 2005 and general fund tax revenue projections for fiscal years 2003-04 and 2004-05.

National Economic Forecast. This office first issued revenue estimates for the 2003-05 biennium in January, 2003, based on the January, 2003, forecast of the U.S. economy prepared by Global Insight, Inc. At that time, the recession that began in the first quarter of 2001 had ended and the economy had expanded during each of the four quarters of 2002. Although the economy was facing a great deal of uncertainty due to the possibility of war with Iraq, the resumption of a nuclear weapons program in North Korea, and the prospect of additional terrorist attacks, positive growth was expected to continue during calendar years 2003 through 2005, with growth in nominal (current-dollar) gross domestic product (GDP) estimated at 5.2% in 2003, 7.2% in 2004, and 5.7% in 2005. Global Insight, Inc. included the effects of a relatively brief war with Iraq in the first half of 2003 and new federal income tax cuts in its projections. The primary risk to the forecast was that a more protracted war would occur, leading to lower consumer confidence and continued reluctance by businesses to invest.

In considering the January, 2003, forecast, it was our judgment that Global Insight, Inc.'s projections may have been overly optimistic. Therefore, our estimates for the two largest tax sources (the individual income tax and sales tax) were based on lower estimates of economic growth.

In May, 2003, this office reviewed tax collections data and more recent economic forecasts to determine whether the revenue estimates should be adjusted prior to the Legislature's completion of work on the 2003-05 biennial budget bill. At that time, in the aggregate, collections were tracking closely with the 2002-03 estimates. In addition, while the new economic forecasts were less favorable than the January forecast, we believed they were still consistent with our January tax revenue estimates. Therefore, we concluded that a revision was not warranted.

The economy continued to expand throughout 2003, with relatively slow growth during the first half of the year followed by a very strong third quarter, when real GDP increased by 8.2% and nominal GDP increased by 10.0% over the same period in 2002. It is believed that growth moderated to a more sustainable level in the fourth quarter so that nominal GDP growth for all of 2003 is now estimated at 4.8% and annual real growth is estimated at 3.2%. Other economic

indicators (personal income, consumption, and business investment) have shown a similar pattern of slow initial growth followed by acceleration in the second half of the year. Corporate profits have shown strong increases throughout the year, with growth rates for before-tax profits in excess of 10% in three of the four quarters of 2003. If the effects of the federal bonus depreciation provisions are excluded, corporate earnings grew by approximately 25% in the second half of 2003. After declining in the first quarter, values of equity shares increased significantly throughout the remainder of the year. These gains were due, in part, to continued low interest rates and stimulative fiscal policy by the federal government.

Despite these positive developments, the economic growth experienced in 2003 was somewhat less than anticipated by Global Insight, Inc. last January. A continuing area of concern has been a slower than expected increase in employment. Following declines in 2001 and 2002, total employment (based on the survey of business establishments) continued to decrease slightly during the first three quarters of 2003, and began to rise in the fourth quarter. Total employment at the end of 2003 is now estimated at 130.1 million persons, virtually unchanged from the beginning of the year but 2.4 million lower than at the start of 2001, when employment peaked. It is believed that businesses have been able to take advantage of improvements in productivity and increased use of foreign contractors to boost production and achieve strong profits without significant increases in staff. However, it is possible that the official employment estimates generated by the business establishment survey may understate actual employment trends because they do not adequately account for business start-ups during the early stages of an economic recovery.

The current (January, 2004) economic forecast by Global Insight, Inc. is for continued positive growth in 2004 and 2005. Real growth is anticipated to be stronger than projected last January. However, with significantly lower rates of inflation, nominal growth is forecast to be somewhat weaker. Growth in real GDP is now estimated at 4.7% in 2004 and 4.0% in 2005, compared to projections of 4.7% and 3.3% last January. Nominal GDP, which is more relevant for tax revenue estimates, is now projected to increase by 6.1% in 2004 and 5.4% in 2005, compared to the previous estimates of 7.2% and 5.7%, respectively.

Global Insight, Inc. expects the main drivers of the economy to be continued low interest rates and federal tax cuts, which will result in higher refund checks this spring. The forecast anticipates that the Federal Reserve will not raise interest rates until June, 2004, when the federal funds rate will be increased from 1.0% to 1.5% (50 basis points). An additional 50 basis-point increase is expected by year-end. However, given the soft labor market and the expectation of continued low inflation, it is possible that the current rates will be maintained for a longer period of time. Further, even if rates are raised as projected by Global Insight, Inc., they would still be very low compared to historical levels. The forecast also assumes that Congress will not allow all of the recent federal income tax cuts to expire as scheduled, although it is anticipated that over time the tax code will be modified to bring the effective personal income tax rate closer to its historical average (8.3% of GDP). A weak dollar is also expected to contribute to significantly increased exports due to reduced real prices for American products overseas, and businesses are expected to replace equipment that has become obsolete.

These factors should lead to increased production and investment by manufacturing firms and other businesses and to higher levels of employment. After decreasing in 2001 and 2002 and growing slowly in 2003, overall industrial production (which includes manufacturing, mining, and utilities) is expected to increase by 5.1% in 2004 and 5.6% in 2005. If just the manufacturing sector is considered, output growth is expected to be even stronger, with projected increases of 5.6% and 6.2%, respectively. Business investment is estimated to increase by nearly 15% in 2004 and 10% in 2005. After declining in 2001 and 2002, exports of American products grew by an estimated 4.1% in 2003 and are projected to increase by more than 10% in each of the next two years.

The current low interest rates are also expected to boost residential construction to record levels in 2004; growth over 2003, which was also a record year, is estimated at 7.2%. As interest rates rise, residential construction is expected to decline slightly in 2005. Similarly, housing starts are also expected to peak in 2004. Following declines in the past two years, nonresidential construction is expected to rebound strongly, with growth of 4.5% in 2004 and 15.2% in 2005. It is believed that this sector will see small improvements during the next several months and then begin to increase rapidly as businesses gain confidence in the economy and commit to building offices, stores, and factories to support future operations.

In spite of the recent increases in economic output and corporate profits, job growth has not met prior expectations. As noted, Global Insight, Inc. now estimates total U.S. employment at the end of 2003 to be 130.1 million persons, which is 2.8 million (2.1%) fewer than was anticipated last January. The reduced jobs numbers are contributing to slower gains in personal income. The current forecast estimates personal income growth at 3.1% in 2003, 4.8% in 2004, and 5.6% in 2005. Compared to last January's forecast, these growth rates are significantly lower in 2003 and 2004 (-1.8%) and the same in 2005. The U.S. unemployment rate for 2003 is currently estimated at 6.0%, which is slightly lower than projected last January, but this reduction is due to people dropping out of the labor force rather than to additional jobs being created. The unemployment rate in 2004 and 2005 is projected to be 5.7% and 5.3%, respectively, which is somewhat higher than last year's forecast of 5.3% and 5.0%. Although hiring has picked up recently and is anticipated to increase more rapidly during the next two years, particularly in late 2004 and 2005, this growth will not be sufficient to raise personal income to the prior estimated levels. The forecast anticipates that total employment will reach its pre-recession level during the third quarter of 2004, and then continue increasing throughout 2005. Lost manufacturing jobs will be replaced with service-sector jobs, particularly in education and health services.

Growth in nominal personal consumption expenditures is now estimated at 5.0% in 2003, 4.9% in 2004, and 5.1% in 2005. The estimate for 2003 is 0.2% higher than projected last January, but the estimates for 2004 and 2005 are lower by 1.8% and 0.8%, respectively. Real spending is expected to be higher than estimated last January, but decreased estimates of personal income and prices result in the slower growth rates for current-dollar consumption. Car and light truck sales have grown continuously since 1996, and there is little pent-up demand for vehicles. In addition, the driving-age population will increase more slowly over the next five years than it has in recent years. Therefore, vehicle sales are expected to show relatively weak growth in 2004 (2.7%) and

decline slightly in 2005 (-0.7%). However, sales of computers, software, and restaurant meals are projected to show strong increases in both years. Purchases of services, which have been increasing more rapidly than other types of consumption in recent years, are anticipated to grow at about the same rate as overall consumption in 2004 and slightly faster in 2005. Following a large increase in 2003 due to higher oil prices, expenditures for gasoline and heating fuel are expected to decline by 4.9% in 2004 and increase moderately (by 3.3%) in 2005 as prices fall.

Before-tax corporate book profits were strong in 2002 and 2003, with growth of 6.9% and 13.6% in those years. Growth is expected to moderate somewhat to 11.6% in 2004 and then increase sharply to 24.0% in 2005. It should be noted, however, that book profits are calculated based on federal tax law, which includes the temporary bonus depreciation provisions that were implemented beginning in 2001. In general, these provisions permit an increased first-year depreciation allowance for equipment acquired after September 10, 2001, and placed into service before January 1, 2005. For certain types of property produced by the taxpayer, the placed-into-service date is extended to January 1, 2006. The 24% growth rate projected for book profits in 2005 is due primarily to the termination of bonus depreciation for most types of equipment, which will significantly increase the amount of earnings reported to the Internal Revenue Service.

The bonus depreciation provisions were not adopted for state tax purposes in Wisconsin. Therefore, in the near-term, a better measure of corporate earnings for state tax purposes is economic profits, which is before-tax book profits with adjustments to make the treatment of depreciation more consistent over time and across industry sectors and to account for gains or losses due to changing prices of inventory. Growth in economic profits was even stronger than book profits in recent years (17.4% in 2002 and 17.5% in 2003), because book profits were understated due to the bonus depreciation deductions. Continued strong growth of 14.5% is projected for 2004, as businesses continue to take advantage of productivity gains and a soft labor market. Economic profits are expected to decrease slightly (by 2.3%) in 2005 as the labor market tightens and wages increase. However, the decline is not anticipated to begin until the second half of the year, and economic profits are still estimated to be significantly higher than the pre-recession peak achieved in 1997.

As mentioned, inflation is expected to remain low, with a projected increase in the consumer price index (CPI) of 1.4% in 2004 and 1.3% in 2005. These estimates, which reflect falling oil prices, excess capacity in the U.S. economy, and increases in global manufacturing capacity, are significantly lower than last January's projections of 2.4% and 2.6% for those years. These lower inflation estimates contribute to decreased projections of nominal personal income and consumption, compared to last January's forecast.

The primary risk to the forecast is that businesses will be able to continue to meet demand without significant staffing increases, by making increased use of technology and foreign labor. The resulting lower levels of employment would lead to slower growth in personal income and consumption. Another recession is not contemplated under this scenario, but economic growth

(real GDP) would be about 1.0% lower in 2004 and 0.4% lower in 2005 than the baseline forecast. Global Insight, Inc. assigns a 20% probability to this sequence of events.

On the other hand, it is possible that the baseline forecast is too pessimistic regarding business investment, consumer spending, and foreign economic growth. Global Insight, Inc.'s "optimistic scenario" (which is also assigned a 20% probability) assumes that each of these factors is more favorable than under the baseline forecast, resulting in increased demand, output, and employment. Under these circumstances, real GDP growth would be about 0.7% higher in 2004 and 0.3% higher in 2005 than under the baseline forecast.

Table 2 presents a summary of national economic indicators as estimated by Global Insight, Inc.

TABLE 2
Summary of National Economic Indicators
Global Insight, Inc.
January, 2004
(\$ in Billions)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Nominal Gross Domestic Product	\$10,480.8	\$10,985.9	\$11,653.0	\$12,285.3
Percent Change	3.8%	4.8%	6.1%	5.4%
Real Gross Domestic Product	10,083.1	10,401.6	10,895.1	11,325.9
Percent Change	2.2%	3.2%	4.7%	4.0%
Consumer Price Index	1.6%	2.3%	1.4%	1.3%
Personal Income	8,910.3	9,190.0	9,627.1	10,169.6
Percent Change	2.3%	3.1%	4.8%	5.6%
Personal Consumption Expenditures	7,385.4	7,752.5	8,131.4	8,543.0
Percent Change	4.8%	5.0%	4.9%	5.1%
Corporate Profits Before Tax	745.0	846.3	944.2	1,171.0
Percent Change	6.9%	13.6%	11.6%	24.0%
Unemployment Rate	5.8%	6.0%	5.7%	5.3%

General Fund Tax Projections. In total, general fund tax collections in 2002-03 were approximately \$24 million less than the amount estimated last January, a variance of -0.2%. However, for individual taxes, the differences between actual collections and the estimates were

more pronounced. Individual income tax collections were \$68 million lower than estimated and sales tax collections were \$22 million lower. These reductions were partially offset by increased revenues from the corporate income and franchise tax (\$37 million), public utility taxes (\$16 million), and insurance company taxes (\$10 million). In total, revenues from the remaining taxes were about \$3 million higher than estimated.

The following table shows revised estimates of general fund tax revenues for the 2003-05 biennium. These estimates are based on actual collections last year, current-year collections data, and the January, 2004, Global Insight, Inc. forecast of national economic growth. In addition, the estimates reflect all of the tax law changes included in Act 33 and subsequent enacted legislation.

TABLE 3
Projected General Fund Tax Collections
(\$ in Millions)

<u>Source</u>	<u>2002-03</u> <u>Tax Collections</u>	<u>Budget Estimates</u> <u>(Act 33)</u>		<u>Revised Estimates</u> <u>January, 2004</u>	
		<u>2003-04</u>	<u>2004-05</u>	<u>2003-04</u>	<u>2004-05</u>
Individual Income	\$5,052.5	\$5,405.8	\$5,795.8	\$5,220.0	\$5,560.0
General Sales and Use	3,738.0	3,915.4	4,107.2	3,900.0	4,095.0
Corporate Income & Franchise	526.5	539.8	554.4	650.0	630.0
Public Utility	276.8	268.0	278.0	261.0	271.0
Excise					
Cigarette	293.7	288.4	284.7	290.0	286.0
Liquor and Wine	36.0	37.2	38.5	39.0	40.0
Tobacco Products	15.5	16.8	17.9	15.6	16.0
Beer	9.5	9.8	9.9	9.7	9.8
Insurance Company	114.9	105.0	95.0	125.0	120.0
Estate	68.7	85.0	90.0	85.0	90.0
Miscellaneous Taxes	<u>67.5</u>	<u>71.3</u>	<u>74.7</u>	<u>75.1</u>	<u>78.0</u>
TOTAL	\$10,199.6	\$10,742.5	\$11,346.1	\$10,670.4	\$11,195.8
Change from Prior Year					
Amount		\$542.9	\$603.6	\$470.8	\$525.4
Percent		5.3%	5.6%	4.6%	4.9%

As shown in Table 3, general fund tax collections are estimated to total \$10,670.4 million in 2003-04 and \$11,195.8 million in 2004-05. These amounts are lower than the Act 33 estimates by \$72.1 million in 2003-04 and \$150.3 million in 2004-05, which is a biennial decrease of 1.0% from the prior estimates. The reduction reflects a significant downward revision to the individual income tax and small decreases for the sales tax and utility taxes. These reductions are partially offset by a

sizable upward revision for the corporate income and franchise tax and smaller increases for insurance company, excise, and miscellaneous taxes.

Individual Income Tax. The current estimates of individual income tax collections are \$5,220.0 million in 2003-04 and \$5,560.0 million in 2004-05, which are lower than the estimates under Act 33 by \$185.8 million in the first year and \$235.8 million in the second year. The revised estimates reflect growth of 3.3% in 2003-04 and 6.5% in 2004-05. The decreases in the estimates compared to those under Act 33 are due primarily to lower than expected collections last year and reduced projections of growth in personal income. Last January, the Global Insight, Inc. forecast was for personal income growth of 5.0% in 2003 and 6.5% in 2004. As noted, the current forecast for personal income growth is 3.1% for 2003 and 4.8% for 2004.

Through January, 2004, both income tax collections and withholding tax payments (the largest component of income tax revenues) were 1.1% higher than last year at this time. However, approximately \$77 million in withholding tax payments that were deposited on Monday, February 2, had been received on the weekend and were associated with January collections. If this amount is added to actual withholding tax payments received through January 31, then such payments are 4.1% higher than at this time last year, and the adjusted total of income tax collections is 3.6% higher than income tax collections through January, 2003. The lower rate of growth for total collections, as compared to withholding, is a result of offsetting rates of growth in some of the other components of the individual income tax (for example, estimated tax payments, which reflect non-wage income, are 1.1% lower than at this time last year). An adjusted, year-to-date growth rate in individual income tax collections of 3.6% is consistent with the revised estimate for 2003-04, which assumes 3.3% growth.

General Sales and Use Tax. In 2002-03, state sales and use tax revenues amounted to \$3,738.0 million, which was an increase of 1.1% over the prior year. State sales and use tax revenues are currently estimated at \$3,900.0 million in 2003-04 and \$4,095.0 million in 2004-05. These figures are lower than the estimates under Act 33 by \$15.4 million and \$12.2 million in 2003-04 and 2004-05, respectively. The revised projections are based on current collections data and the most recent forecast of growth in personal consumption expenditures, with adjustments for expenditures on food, gas and oil, and services, to more closely reflect Wisconsin's sales tax base.

The revised estimates represent projected growth of 4.3% for 2003-04 and 5.0% for 2004-05. Through January, year-to-date sales tax collections were 3.7% higher than the level collected during the same period of the prior fiscal year. This year-to-date growth rate is 0.8% lower than the 4.3% growth rate currently projected for the 2003-04 fiscal year. However, growth in sales tax revenues is expected to increase in the second half of the fiscal year, based in part on continued improvement in the economy, generally, and in part on economic stimulus anticipated from federal tax refunds (which should be higher than in recent years as a result of federal tax law changes).

The sales tax estimates for the 2003-05 biennium do not reflect a December 1, 2003, decision of the Tax Appeals Commission in the case of Menasha Corporation vs. Wisconsin Department of

Revenue (DOR) with respect to sales and use taxes on computer software. While pre-written computer software is subject to the state sales tax on tangible personal property, sales of custom computer software are not subject to tax. The Commission ruling, which DOR has appealed to the Circuit Court, broadens the interpretation of what computer software is considered to be nontaxable custom software.

DOR has estimated that, were the Circuit Court (and any subsequent courts on appeal) to uphold the Commission's decision, state sales and use taxes would be reduced by \$55 million associated with such sales during 2003-04 and \$59 million for sales during 2004-05. In addition, DOR projects that the state would be required to pay up to \$228 million in refunds and interest for prior fiscal years. Generally, the statutes authorize claims for refunds to be filed for up to four years from the unextended due date of the claimant's income tax return for the year to which the claim relates. However, shorter or longer periods may apply under certain conditions. In the case of refund claims based on the taxability of computer software in the Menasha Corporation case, for example, a taxpayer may enter into an agreement with the Department under which the time to file a claim, for the years specified in the agreement, would be extended to six months after a final determination has been made.

Based on the Department's projections, the net effect of a final court decision upholding the Commission's ruling would be a reduction in the general fund of an estimated \$342 million. The timing of any effect on the general fund would depend on the timing of the Circuit Court decision, whether any subsequent appeals were filed, and the timing of the receipt by the Department of associated refund requests. It is possible that final resolution of the case will occur after the current biennium.

Corporate Income and Franchise Tax. Corporate income and franchise tax collections were \$526.5 million in 2002-03, which was approximately \$37 million more than estimated in January, 2003. The increase reflected the early stages of economic recovery, productivity gains, and a related growth in corporate profits. Collections are projected to be \$650 million in 2003-04 and \$630 million in 2004-05. These amounts represent an annual increase of 23.5% in 2003-04 and a decrease of 3.1% in 2004-05, and are higher than the January, 2003, estimates by \$110.2 million in 2003-04 and \$75.6 million in 2004-05.

The new estimates reflect the effects of long-run productivity growth, elements of the recession and recent recovery, and corporate income and franchise tax collections. Through January, collections were 42.6% higher than 2002-03 collections for the same period. It should be noted that about \$46 million of the increase is due to one-time payments from delinquencies and audit activities conducted by the Department of Revenue. Declaration payments, which exclude these one-time monies, are up by more than 11% over a year ago. Productivity has been strong since the mid-1990s as a result of the incorporation of computer and communications technologies into business operations. This has led to improved corporate earnings, and since the economic downturn and resulting layoffs, the corporate share of earnings has increased relative to the share allocated to labor. The current forecast projects relatively strong exports, investment in equipment,

and industrial production over the next few years, which should continue earnings increases. However, productivity growth is expected to moderate and employment is projected to increase, so that the long-term corporate share of profits should decline somewhat. In addition, the estimate is adjusted to reflect the one-time funds that are included in 2003-04 collections.

Public Utility Taxes. Public utility taxes were \$276.8 million in 2002-03. Approximately \$10.0 million of this amount represented one-time revenues following an audit and a property value dispute settlement, in each case related to telecommunications property. Utility taxes are currently estimated at \$261.0 million in 2003-04 and \$271.0 million in 2004-05. These projections are \$7.0 million lower in both 2003-04 and 2004-05 than had previously been projected. These reductions primarily reflect decreased estimates of the taxes on utilities paying the ad valorem tax, particularly telecommunications companies and pipelines. The downward revisions are based on: (a) actual and anticipated decreases in the value of, and investment in, such utility property; and (b) a decrease in projected property tax rates compared to prior estimates.

Excise Taxes. Cigarette excise tax revenues, which were \$293.7 million in 2002-03, are estimated to be \$290.0 million in 2003-04 and \$286.0 million in 2004-05. The current estimates represent increases of \$1.6 million and \$1.3 million over prior estimates for 2003-04 and 2004-05, respectively. The adjustments are based primarily on collections through January.

Excise tax revenues from liquor sales were \$36.0 million in 2002-03, and are estimated at \$39.0 million in 2003-04 and \$40.0 million in 2004-05. The estimates for liquor excise tax revenues have been increased by \$1.8 million in 2003-04 and \$1.5 million in 2004-05 over the estimates under Act 33, based on year-to-date collections through January.

Also based on year-to-date collections, it is anticipated that tax revenues from tobacco products (excluding cigarettes) and beer will be slightly lower than the Act 33 estimates. Excise tax revenues from tobacco are currently estimated at \$15.6 million in 2003-04 and \$16.0 million in 2004-05, which are \$1.2 million lower for 2003-04 and \$1.9 million lower for 2004-05 than the previous estimates. State tax revenues from the occupational tax on beer are estimated at \$9.7 million in 2003-04 and \$9.8 million in 2004-05, which are \$100,000 lower in each year than the estimates under Act 33.

Insurance Premiums Taxes. Insurance premiums taxes increased from \$96.1 million in 2001-02 to \$114.9 million in 2002-03, which reflected strong increases in written premiums throughout the insurance industry in 2002 and 2003. Premiums taxes are projected to increase to \$125 million in 2003-04 and then decrease to \$120 million in 2004-05. The projected increase in 2003-04 reflects year-to-date monthly premiums tax collections through January, which are higher than 2002-03 for the same period. The decrease in premium tax revenues in 2004-05 is based on expected moderation in the growth in life insurance and property and casualty insurance premium payments.

Estate Tax. Estate tax revenues totaled \$68.7 million in 2002-03, and are estimated at \$85.0 million in 2003-04 and \$90.0 million in 2004-05. The estimates, which are unchanged from those under Act 33, represent growth of 23.7% and 5.9% for 2003-04 and 2004-05, respectively. The expected increase of 23.7% over the base year reflects a state law change under 2001 Act 16 (the 2001-03 biennial budget) that decoupled the state estate tax from current federal law for deaths occurring from October 1, 2002, through December 31, 2007.

Miscellaneous Taxes. Miscellaneous taxes include the real estate transfer fee, certain court-related fees, and the occupational tax on coal. In 2002-03, the state collected \$67.5 million in miscellaneous taxes, with over 80% coming from the real estate transfer fee. The current estimates for miscellaneous tax revenues are \$75.1 million in 2003-04 and \$78.0 million in 2004-05, which exceed the Act 33 estimates by \$3.8 million in the first year and \$3.3 million in the second year. The increases reflect year-to-date collections as well as construction forecasts (which are relevant for projections of the real estate transfer fee) over the remainder of the biennium.

We will continue to monitor tax collections, economic forecasts, and expenditures and keep you apprised if any further modifications are necessary.

Sincerely,

A handwritten signature in black ink that reads "Bob". The letters are stylized and cursive.

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature