State of Wisconsin

Notice of **Material Information** #2006-01

Dated January 31, 2006

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Type of Information: Other Secondary Market Information

Legislative Fiscal Bureau memorandum of January 19, 2006 that contains projections of General Fund tax collections, re-estimates of departmental revenues and expenditures, and projected General Fund condition statement for the 2005-07 biennium.

Type of Filing: Filed in electronic form with each Nationally Recognized Municipal Securities Information Repository through DisclosureUSA. This notice is also available on the State of Wisconsin Capital Finance Office web site at:

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The undersigned represents that he is the Capital Finance Director, State of Wisconsin Capital Finance Office, which is the office of the State of Wisconsin responsible for providing Annual Reports and Notice of Material Events when notice is required by the State's Master Agreement on Continuing Disclosure. I am authorized to distribute this information publicly.

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January 19, 2006

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

Dear Senator Fitzgerald and Representative Kaufert:

In January of each year, this office conducts a review of the status of the state's general fund and presents its findings to the Legislature. In even-numbered years, the analysis includes an examination of economic forecasts and tax collection and expenditure data for the first six months of the current fiscal year, and projections for each fiscal year of the current biennium. 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 $106.7 million. This is $93.0 million above the $13.7 million balance that was indicated in my October 18, 2005, memorandum to the Joint Committee on Finance following release of the <u>2004-05 Annual Fiscal Report.</u>

The $93.0 million is the net result of an increase in estimated tax collections of $45.7 million, an increase in departmental revenues of $3.2 million, an increase of $31.5 million in sum sufficient appropriation expenditures (primarily in the homestead tax credit program and tax reciprocity agreements with Minnesota and Illinois), and an increase in estimated lapses to the general fund of $75.6 million. The increase in the lapse estimate is due mainly to projected GPR underspending in the medical assistance (MA) program.

Although the gross balance is shown as $106.7 million, it should be noted that the required statutory balance is $65 million. Thus, the net balance at the end of the biennium (June 30, 2007) is projected to be $41.7 million.

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

TABLE 1

2005-07 General Fund Condition Statement

	2005-06	2006-07
Revenues		
Opening Balance, July 1	$4,111,000	$408,700
Taxes	11,949,600,000	12,560,000,000
Departmental Revenues		
Tribal Gaming	118,628,600	86,349,100
Other	685,850,200	505,645,700
Total Available	$12,758,189,800	$13,152,403,500
Appropriations, Transfers, and Reserves		
Gross Appropriations	$12,696,202,600	$13,192,596,600
Compensation Reserves	90,054,100	178,302,800
Transfers to Medical Assistance Trust Fund	290,449,000	0
Less Lapses	-318,924,600	-325,212,100
Net Appropriations	$12,757,781,100	$13,045,687,300
Balances		
Gross Balance	$408,700	$106,716,200
Less Required Statutory Balance	- 65,000,000	-65,000,000
Net Balance, June 30	-$64,591,300	$41,716,200

As Table 1 indicates, the gross balance at the end of the biennium is projected to be $106.7 million. There are, however, two items (tribal gaming revenues and medical assistance) that should be noted regarding the condition statement.

Tribal Gaming Revenues. Under 2005 Act 25 (the 2005-07 budget act), the tribal gaming revenue projections include $60.0 million ($30.0 million annually) in payments by the Ho-Chunk Nation that were due in the 2003-05 biennium. These payments have not yet been made to the state. However, Table 1 assumes the payments will be received as $30.0 million annual payments in 2005-06 and in 2006-07. The state payments by the Ho-Chunk are currently in dispute and an arbitrator has been appointed to settle the matter under binding arbitration provisions contained in the 2003 compact amendments.

In addition, the tribal gaming revenue projections of Table 1 include $43.6 million in 2005-06 to reflect that a scheduled 2004-05 payment in this amount by the Forest County

Potawatomi was not made by June 30, 2005, and is expected to be remitted to the state in 2005-06.

Medical Assistance. It is estimated that the amount of GPR funding that is currently budgeted to support MA benefits will exceed projected costs of the program by $63.6 million in 2005-07. Because of the biennial nature of the MA benefits appropriation, the $63.6 million is included in the estimated lapses of Table 1 in 2006-07. The projected lapse is primarily due to lower spending for managed care capitation payments and lower caseload than had been estimated in the 2005-07 budget.

On the other hand, it is now estimated that the segregated MA trust fund will experience a shortfall of $76.7 million in the biennium. The projected shortfall in the MA trust fund reflects: (a) the Governor's partial vetoes in Act 25, which reduced revenue to the trust fund compared to the bill passed by the Legislature (-$60.2 million); (b) reestimates of revenue the state will receive by billing MA for treatment services residential care centers provide to certain children (-$16.7 million); and (c) other revenue reestimates ($0.2 million).

If funds are transferred from the general fund to offset the MA trust fund deficit, the balance shown in Table 1 would need to be reduced by a corresponding amount. For example, if the entire deficit in the MA trust fund were to be eliminated by transfer from the general fund, the $106.7 million gross balance of Table 1 would be reduced to $30.0 million and the net balance would be -$35.0 million.

General Fund Taxes

The following section provides information on general fund tax revenues for the 2005-07 biennium, including a discussion of the national economic forecast for 2006 and 2007 and general fund tax revenue projections for fiscal years 2005-06 and 2006-07.

National Economic Forecast. This office first prepared revenue estimates for the 2005-07 biennium in January, 2005, based on the January, 2005, forecast of the U.S. economy by Global Insight, Inc. At that time, positive economic growth was expected to continue in 2005, 2006, and 2007, although at a slower pace than that of 2004. The primary risk to the forecast was that the economy's excess production capacity was less than estimated, which would lead to an acceleration in inflation and interest rates and a lower level of economic growth.

In May, 2005, this office revised its 2005-07 revenue estimates upward by approximately 1%. The revision was based on 2004-05 tax collections through April, 2005, and on more recent economic forecasts. The May forecast by Global Insight, Inc. projected higher levels of inflation and nominal (current-dollar) personal income, consumption, and corporate profits than the January forecast. Due to the increased inflation, the level of nominal gross domestic product (GDP) was also estimated to be higher than in January. However, the estimate of real (inflation-adjusted) GDP was reduced from the January projections. In May, growth in nominal GDP for 2004 was reported at 6.6% and growth was projected to be 6.1% in 2005, 5.1% in 2006, and 5.0% in 2007. As in the January, 2005, forecast, the primary risk was that the economy's spare capacity was less than estimated.

Despite unusually severe hurricanes and high energy prices, the economy continued to expand throughout 2005. The third quarter was especially strong, with nominal GDP growth of 7.6% and real growth of 4.1%, but it is believed that growth slowed in the fourth quarter following the hurricanes and the spike in gas prices. Auto sales also decreased considerably in the fourth quarter following solid sales during the summer. Fourth quarter growth in nominal GDP is estimated at 5.4% and real growth is estimated at 3.1%. For the entire year, nominal GDP growth is estimated at 6.4% and real growth is estimated at 3.6%. Both of these growth rates are slightly higher than projected last May. Growth in personal consumption was also higher than forecast, while growth in personal income and corporate profits was slightly lower than projected. With the high energy prices, the consumer price index (CPI) was 0.5% higher than anticipated last May. Last year was the fourth consecutive year of economic growth following the recession of 2001.

In the near-term, the current (January, 2006) economic forecast by Global Insight, Inc. anticipates stronger overall growth than at the end of 2005 due to reconstruction activity in the Gulf states and a recovery in energy production that was hindered by the hurricanes. The forecast anticipates that federal government spending in response to the storms will total $110 billion over the next several years. The forecast also assumes an additional 150,000 housing starts to replace homes destroyed by the hurricanes. In the first quarter of 2006, nominal GDP growth is projected to be 6.9% and real growth is projected to be 3.8%.

Growth is expected to moderate beginning in the second quarter as the housing market cools and consumers continue to face high energy prices. However, these negative impacts are expected to be cushioned by increased business spending. Nominal GDP growth is estimated at 5.6% for the second quarter of 2006, and approximately 5.0% for the last six months of the year. Nominal growth is expected to fluctuate between 4.4% and 5.0% throughout 2007. On an annualized basis, nominal GDP is expected to increase by 6.0% in 2006 and 4.8% in 2007. Real GDP is expected to show a similar pattern, with growth of 3.8% in the first quarter, approximately 3.0% over the remainder of 2006, and slightly lower in 2007. Annual growth is estimated at 3.4% for all of 2006 and 2.7% for 2007. The 2006 growth rates are higher than forecast last May, and the 2007 growth rates are slightly lower.

Gasoline prices increased steadily during the first half of 2005 and then spiked in September following the Gulf hurricanes. National average prices fell in the fourth quarter (from $2.63 per gallon to $2.51 per gallon) and are expected to decrease again in the first quarter of 2006 (to $2.29 per gallon). Prices are forecast to stay within the range of $2.20 to $2.30 per gallon for the remainder of 2006 and 2007. Natural gas prices are expected to remain high during the first quarter of 2006 (nearly double last year's prices) and then decline significantly beginning in the second quarter. However, even with these anticipated price decreases, gasoline and natural gas will be significantly more expensive than in 2004 and earlier years.

The high energy prices resulted in a higher level of overall inflation in 2005 than was forecast last May. The CPI increased by 3.4% in 2005, which was 0.5% higher than the May forecast. The CPI is expected to increase by 2.6% in 2006 and 1.8% in 2007. These figures are higher than the May estimates by 0.6% in 2006 and lower by 0.1% in 2007. The larger inflation estimate for 2006 reflects the continued high energy prices; however, as energy prices fall and overall economic growth slows somewhat, lower levels of inflation are forecast for 2007. Core inflation (excluding food and energy) is expected to show the opposite pattern--slightly lower growth in 2005 followed by slightly higher levels in 2006 and 2007-- as producers pass their increased energy costs forward to consumers.

Last December, the Federal Reserve increased the federal funds rate by 25 basis-points (from 4.0% to 4.25%). This was the thirteenth such increase since the Federal Reserve began raising rates in June, 2004. The forecast assumes that two more quarter-point increases will occur by the end of March, 2006, followed by an extended pause. In its statement accompanying the December increase, the Federal Reserve no longer described monetary policy as "accommodative" and no longer stated that rates would be raised at a "measured pace." In addition, Federal Reserve officials noted that robust competition, including from foreign producers, was helping contain cost and price pressures. The forecast assumes that the Federal Reserve now believes interest rates are in a "neutral" area and that future increases will be more intermittent.

Also regarding interest rates, the yield curve inverted at the end of 2005 as the yield on 10-year Treasury notes fell slightly below the yield on two-year notes. Normally, the yield on long-term bonds exceeds that of short-term bonds because investors expect to be compensated for committing their money for a longer period of time. This results in an upward-sloping yield curve. An inverted (downward-sloping) yield curve indicates that investors believe interest rates will fall in future years, and is often followed by a recession. Global Insight, Inc. believes that the yield curve is a cause for concern, but notes that the inversion was very modest and brief (the slope became positive again in early January). Also, in previous instances when an inverted yield curve was followed by a recession, real short-term rates were at least 4%, reflecting very tight monetary policy. This is not the case today, as real short-term rates are just above 2%. With current monetary policy more in the accommodative or neutral range, Global Insight, Inc. does not believe the inverted yield curve was signaling the beginning of a recession.

As noted, after several years of very strong growth, the housing market is expected to cool in 2006 and 2007. Housing continued to be a positive factor in the economy during 2005, with stable mortgage interest rates and significant price increases throughout most of the year. Housing starts reached 2.1 million units in 2005, which was one of the best years on record. However, mortgage rates rose by about 0.5% in the fourth quarter of 2005 and are expected to continue increasing throughout 2006 and 2007. With the higher interest rates and a larger inventory of unsold homes, it is expected that the big price increases of recent years will slow significantly. Prices are not expected to fall, but increases are anticipated to be below the overall rate of inflation for the next several years. Even with rebuilding in the areas affected by the hurricanes, housing starts are estimated to decrease by 8.8% in 2006 and 4.5% in 2007. The reduced housing activity is expected to lead to lower expenditures for furniture and appliances, and the slower pace of appreciation in home values will make it more difficult for families to use housing gains as a means of financing consumption.

Personal income growth is estimated at 5.4% in 2005, which was slightly below last May's forecast of 5.6%. Wage and salary disbursements were somewhat higher than estimated last May, but proprietors' income and rental income were significantly lower than anticipated. Personal income growth is projected to be 6.0% in 2006 and 5.8% in 2007. These estimates are higher than the May projections by 0.3% and 0.5%, respectively. The increased personal income estimates reflect slightly higher levels of employment and wages compared to the May figures. In addition, the growth in non-wage income from business activities and investments is forecast to be stronger than anticipated last May. Employment growth is estimated at 1.6% in 2005, the same growth rate forecast last May. Total employment is projected to grow by 1.5% in 2006 and 1.4% in 2007. These figures are higher than the May estimates by 0.1% in 2006 and 0.5% in 2007. Areas of strength include mining, professional and business services, and health care. Manufacturing employment is expected to weaken slightly, with declines of 0.3% in 2006 and 1.0% in 2007. With the higher overall job levels, the unemployment rate is expected to be slightly below 5% in 2006 and 2007, a decrease of 0.3% in each year compared to the May forecast.

Personal consumption expenditures grew by an estimated 6.4% in 2005, which was 0.6% more than forecast last May. However, the sectors showing the strongest growth were energy-related and generally exempt from the state sales tax. For example, purchases of natural gas and gasoline and oil grew by nearly 25%, and purchases of fuel oil and coal grew by almost 20%. Sales of other generally nontaxable items also showed strong growth, with purchases of food for home consumption increasing by 7.7% and purchases of services increasing by 6.1%. Purchases that generally are taxable (durable goods and other types of nondurable goods) grew more slowly at 4.9%. Expenditures for cars, light trucks, and other vehicles showed no growth from 2004, which was also a weak year.

It is anticipated that overall consumption growth will slow in 2006 and 2007 due to higher interest rates and a slower housing market, which will put downward pressure on sales of durable goods. Total personal consumption expenditures are estimated to increase by 5.5% in 2006 and 5.0% in 2007. Although these amounts are lower than the growth experienced in 2005, they are somewhat higher than last May's estimates. Spending for natural gas is expected to again increase by almost 25% in 2006, due to much higher prices this winter, but then decline by 13% in 2007 as production recovers and prices fall. Gasoline expenditures are anticipated to increase by about 1% in each year, and outlays for fuel oil and coal are expected to fall by 3.6% in 2006 and 10.4% in 2007. Services expenditures are again expected to increase more rapidly than overall consumption, with growth of 6.5% in 2006 and 5.7% in 2007. Sales of durable goods and non-durable goods, excluding food and energy, are expected to grow by 4.0% in 2006 and 4.8% in 2007. The higher growth rate in 2007 reflects improved motor vehicle sales following several weak years dating back to 2003.

Business investment was an area of strength in the economy in 2005, and is expected to continue to show robust growth in 2006 and 2007. Corporations have large cash reserves after several years of exceptionally strong profits, and businesses are continuing to realize high returns on investments in information technology. It is estimated that business fixed investment increased by 11.0% in 2005, and it is projected that investment growth will be 12.3% in 2006 and 6.1% in 2007. The largest gains are anticipated in manufacturing plants and, in 2006, mining and petroleum, as facilities damaged by Hurricane Katrina are restored. Continued high levels of investment in information processing are also expected. As consumers scale back somewhat, the share of GDP represented by business investment is forecast to increase from approximately 10% in recent years to 11.3% in 2006 and 11.4% in 2007.

As noted, corporate profits have been quite strong, with double-digit growth in each year since 2002. In 2005, profits increased by an estimated 16.1%. An important factor in the recent profit growth has been productivity gains. Since 2002, manufacturing output per hour has increased by an average of 6% per year. Strong profit growth is also projected for 2006 (15.6%) followed by a decline in 2007 (-0.7%). The decrease in 2007 reflects a slowing economy and anticipated increases in wages and other business costs as additional capacity is utilized and productivity gains diminish. The reduced rate of growth in consumer purchases and the slower housing market are expected to negatively impact demand and industrial production. However, it is anticipated that these factors will be offset by growth in business investment and government expenditures. Public expenditures are expected to increase because of hurricane-related rebuilding projects, the federal highway bill, and improved state and local revenue collections nationwide.

The U.S. trade deficit (exports minus imports) has been increasing steadily for several years, and reached $804 billion in the fourth quarter of 2005. Exports grew by approximately 11% in 2005, while imports rose by 13%. A significant factor in the growth of imports was the high price of oil. In addition, the dollar rose throughout 2005 relative to currencies of the nation's major trading partners, which contributed to the increased trade deficit. It is anticipated that the dollar will weaken considerably throughout 2006 and 2007, as the Federal Reserve discontinues regular interest rate increases and foreign central banks act to tighten monetary policy. A weaker dollar hurts consumers in this country but makes U.S. products more affordable in foreign markets. It is expected that the lower dollar will lead to some improvement in the trade deficit, but continued high oil prices will prevent more significant reductions.

Global Insight, Inc. has also prepared two alternative forecasts, one more optimistic and the other more pessimistic than the baseline forecast. In the optimistic scenario, which is assigned a probability of 20%, productivity growth and foreign economic growth are stronger and energy prices are lower than under the baseline forecast. These factors lead to lower levels of inflation and interest rates and to increased domestic production, investment, and housing starts. The federal budget deficit is also lower than under the baseline forecast due to increased tax revenues and lower expenditures for transfer payments and interest. Under this alternative forecast, real GDP growth is higher by 0.8% in 2006 and 1.0% in 2007.

Under the pessimistic alternative (25% probability), there is less excess capacity in the global economy than estimated under the baseline forecast and the dollar falls more rapidly relative to foreign currencies. As a result, productivity gains are lower and inflation is significantly higher. The acceleration in inflation leads the Federal Reserve to adopt additional interest rate increases, which contribute to significant declines in home values and a reduction in overall economic activity. The federal budget deficit is also higher than under the baseline forecast. The economy does not go into a recession under this scenario, but real GDP growth is lower than the baseline by 0.6% in 2006 and 1.2% in 2007.

Table 2 shows a summary of national economic indicators drawn from the January, 2006, forecast by Global Insight, Inc.

TABLE 2

Summary of National Economic Indicators
Global Insight, Inc., January, 2006
($ in Billions)

	2004	2005	2006	2007
Nominal Gross Domestic Product	$11,734.3	$12,488.7	$13,242.4	$13,876.9
Percent Change	7.0%	6.4%	6.0%	4.8%
Real Gross Domestic Product	10,755.7	11,144.9	11,526.6	11,839.7
Percent Change	4.2%	3.6%	3.4%	2.7%
Consumer Price Index	2.7%	3.4%	2.6%	1.8%
Personal Income	9,713.3	10,234.7	10,849.6	11,480.3
Percent Change	5.9%	5.4%	6.0%	5.8%
Personal Consumption Expenditures	8,214.3	8,741.2	9,222.0	9,684.6
Percent Change	6.5%	6.4%	5.5%	5.0%
Economic Profits	1,161.5	1,348.4	1,558.7	1,548.4
Percent Change	12.6%	16.1%	15.6%	-0.7%
Unemployment Rate	5.5%	5.1%	4.8%	4.9%

General Fund Tax Projections. Table 3 shows our revised estimates of general fund tax revenues for the 2005-07 biennium, which are based on tax collections to date and the January, 2006, forecast of the U.S. economy by Global Insight, Inc. The estimates reflect all of the tax law changes adopted in Act 25 and other enacted legislation.

TABLE 3

Projected General Fund Tax Collections
($ in Millions)

		Budget Estimates (Act 25)		Revised Estimates January, 2006	
Source	2004-05 Actual	2005-06	2006-07	2005-06	2006-07
Individual Income	$5,650.1	$6,144.5	$6,502.8	$6,025.0	$6,405.0
General Sales and Use	4,038.7	4,181.6	4,358.1	4,181.6	4,358.1
Corporate Income & Franchise	764.1	683.3	670.2	770.0	785.0
Public Utility	254.4	267.5	281.1	257.9	283.4
Excise					
Cigarette	294.3	287.8	286.8	296.5	294.7
Liquor and Wine	39.5	40.8	41.6	42.4	43.5
Tobacco Products	15.8	16.5	17.4	16.1	16.4
Beer	9.8	9.6	9.6	9.9	10.0
Insurance Company	129.8	131.0	137.7	135.0	142.4
Estate	112.4	105.0	110.0	124.0	130.0
Miscellaneous Taxes	87.7	89.5	91.5	91.2	91.5
TOTAL	$11,396.6	$11,957.1	$12,506.8	$11,949.6	$12,560.0
Change from Prior Year					
Amount		$560.5	$549.7	$553.0	$610.4
Percent		4.9%	4.6%	4.9%	5.1%

As shown in Table 3, general fund tax revenues are estimated to total $11,949.6 million in 2005-06 and $12,560.0 million in 2006-07. These amounts are lower than the Act 25 estimates by $7.5 million in the first year and higher by $53.2 million in the second year, for a net increase of $45.7 million. The estimates for the corporate income and franchise tax, cigarette tax, and estate tax have been revised upward significantly, while the projections for the individual income tax have been reduced. The general sales and use tax estimates were not changed from the May figures, and small increases are estimated for most of the other tax sources.

Individual Income Tax. Individual income tax revenues are currently estimated at $6,025.0 million in 2005-06 and $6,405.0 million in 2006-07. The current estimates are lower than the Act 25 estimates by $119.5 million in the first year and $97.8 million in the second year.

The revised estimates reflect growth of 6.6% in 2005-06 and 6.3% in 2006-07. It should be noted, however, that the growth rate for 2005-06 is affected by a change in the state's accounting mechanism regarding accrued tax revenues in 2004-05 that led to a one-time reduction in income tax revenues of approximately $50 million in 2004-05. The projected growth in income tax revenues for 2005-06 would reflect a 5.7% increase over 2004-05 in the absence of this accounting change.

The decrease in the current estimates, compared to Act 25, is primarily related to changes in projected growth in the taxable components of personal income. Taxable personal income excludes nontaxable government transfer payments, fringe benefits, and certain other types of nontaxable income. Based on the May, 2005, Global Insight, Inc. forecast, while national personal income growth was estimated at 5.6% in 2005 and 5.7% in 2006, the taxable portion was estimated at 5.3% and 5.6% for the two years, respectively. The current estimates for national personal income growth, which are 5.4% in 2005 and 6.0% in 2006, include growth in taxable income of 4.8% in 2005 and 5.9% in 2006. These projected growth rates for taxable personal income are 0.5% lower in 2005 and 0.3% higher in 2006 than the May estimates. While the growth rate in the second year is currently projected to be higher than was the case last May, the net result of the reduced first-year growth is a reduction in estimated individual income tax revenues in each of the two fiscal years.

The current projection of 5.7% growth in individual income tax revenues in 2005-06 (after taking into account the effect of the change in the accrual process, mentioned above), is consistent with withholding tax collections to date for the fiscal year. As of early January, which includes collections made at the end of December but not processed until the start of January, growth in withholding collections over the same period in the prior fiscal year was 5.7%.

General Sales and Use Tax. In 2004-05, state sales and use tax collections were $4,038.7 million, which was a 3.6% increase over the prior year. Under Act 25, state sales and use tax revenues were estimated at $4,181.6 million in 2005-06 and $4,358.1 million in 2006-07, representing growth of 3.5% and 4.2% for the two years, respectively. Based on current projections of taxable personal consumption expenditures and on year-to-date tax collections, no change has been made to the Act 25 sales and use tax estimates.

It should be noted that state sales tax revenues could be affected by a case pending before the Court of Appeals with respect to the taxability of computer software. While pre-written computer software is subject to the state sales tax on tangible personal property, sales of custom computer software are exempt. In the case Menasha Corporation v. Wisconsin Department of Revenue (DOR), a decision by the Tax Appeals Commission on December 1, 2003, broadened the interpretation of what computer software is considered to be nontaxable custom software. The case was appealed to the Circuit Court, which reversed the Tax Appeals Commission decision on October 26, 2004, and ruled that DOR was correct in collecting sales tax on the computer software in question. On December 13, 2004, Menasha Corporation filed an appeal of the Circuit Court decision, and the case is now pending before the Court of Appeals.

It is expected that a decision in favor of Menasha Corporation would affect the interpretation of taxable computer software generally. Based on past estimates by DOR, it is expected that, were a higher court to reverse the Circuit Court decision, state sales tax revenues would be reduced by approximately $50 million associated with each year of the current biennium. In addition, the state could be required to pay approximately $250 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 case, for example, taxpayers were permitted to enter into agreements with the Department under which the time to file a claim, for the years specified in the agreement, was extended to six months after a final determination has been made.

Based on these projections, the effect of a final court decision reversing the Circuit Court ruling would be a reduction in the general fund of an estimated $350 million for the period ending on June 30, 2007. The timing of the effect of such a decision on the general fund would depend on the timing of the Appeals Court decision, whether any subsequent appeals were filed, and the timing of the receipt by the Department of associated refund requests. Ongoing revenue losses in subsequent years would also occur.

Corporate Income and Franchise Tax. Corporate income and franchise tax collections were $764.1 million in 2004-05, which was about $14 million more than estimated in May, 2005. The increase reflected continued consumer spending and productivity gains, and related growth in corporate profits. Collections are projected to be $770.0 million in 2005-06 and $785.0 million in 2006-07. These amounts represent an annual increase of 0.8% in 2005-06 and 1.9% in 2006-07, and are higher than the May, 2005, estimates by $86.7 million in 2005-06 and $114.8 million in 2006-07.

The new estimates reflect better than anticipated corporate earnings in 2005, and continued growth in profits through 2006. Consumer demand and increases in productivity, combined with somewhat improved pricing power, have greatly improved corporate balance sheets. Businesses have been able to control labor costs by scaling back benefits, primarily health care, and continuing productivity gains through investment in computers and equipment. As a result, corporate net worth has increased while debt has become more manageable. Internally generated funds from profits and depreciation allowances increased over 24% in 2005, the largest increase in 25 years. The additional funds are expected to be used for increased business investment in plant and equipment, and continued hiring. The increased investment is projected to contribute to employee productivity and demand for business products, which will somewhat offset the decline in consumer spending as the housing market cools.

It should be noted that these estimates have been adjusted to reflect the effect on collections of the phase-in of the single sales factor apportionment formula, repeal of the manufacturer's sales tax credit, implementation and expansion of the dairy investment tax credit, and updating state tax references to the federal Internal Revenue Code.

Public Utility Taxes. Public utility tax revenues were $254.4 million in 2004-05, and are currently projected at $257.9 million in 2005-06 and $283.4 million in 2006-07. These figures are lower than the Act 25 estimates by $9.6 million in 2005-06 and higher than the Act 25 estimates by $2.3 million in 2006-07. The revisions reflect the effects of anticipated decreases in tax receipts from telecommunications companies (Telcos) and expected increases in tax receipts from light, heat, and power companies.

The utility tax on Telcos is an ad valorem tax, one that is based on property values. The reduced tax estimates for Telcos are a result of a significant decrease in total telecommunications property value in 2005. According to the Department of Revenue, the reduced property value follows multiple mergers and consolidations of Telcos that involved writing off assets, the use of newer equipment that is more efficient and less expensive than equipment used previously, and certain changes in the depreciation schedules and the tax assessment process. It is believed that the effect of these factors has now been incorporated into the Telco property base and that property values will again increase, starting with tax year 2006. Therefore, there is a larger reduction in the reestimates of Telco taxes in 2005-06 than in 2006-07.

The utility tax on light, heat, and power companies is based on the gross revenues of such companies. The estimated increases in tax revenues from light, heat, and power companies are a result of higher energy costs of such companies and associated higher sales receipts.

The net effect of the anticipated changes in tax revenues described above is that total utility taxes are currently expected to increase by 1.4% in 2005-06 and by 9.9% in 2006-07, rather than by 5.1% per year, as had been estimated under Act 25.

Excise Taxes. General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), tobacco products, and beer. Excise tax collections were $359.4 million in 2004-05. Under Act 25, total excise tax revenues were estimated at $354.7 million in 2005-06 and $355.4 million in 2006-07. Excise tax revenues are currently estimated at $364.9 million in 2005-06 and $364.6 million in 2006-07. The revised estimates are $10.2 million higher in 2005-06 and $9.2 million higher in 2006-07 than the Act 25 estimates, primarily as a result of higher than anticipated cigarette tax collections to date in 2005-06.

Insurance Premiums Taxes. Insurance premiums taxes increased from $123.6 million in 2003-04 to $129.8 million in 2004-05, reflecting strong premium growth in the insurance industry in 2004 and 2005. Premiums taxes are projected to increase to $135.0 million in 2005-06 and to $142.4 million in 2006-07. The projected increase in 2005-06 collections is primarily based on year-to-date monthly premiums tax collections through December, which are significantly higher than collections for 2004-05, for the same period. The projected increase in

2006-07 reflects expected continued growth in insurance premiums, and one-time additional revenues generated by audits conducted by the Office of the Commissioner of Insurance.

Estate Tax. In 2004-05, state estate tax revenues were $112.4 million. Under Act 25, estate taxes were estimated at $105.0 million in 2005-06 and $110.0 million in 2006-07. However, based on collections to date in 2005-06, estate taxes are reestimated at $124.0 million in 2005-06 and $130.0 million in 2006-07. The revised estimates are $19.0 million higher in 2005-06 and $20.0 million higher in 2006-07 than the Act 25 estimates. It should be noted, however, that estate tax collections are significantly affected by the settlement, or lack thereof, of a small number of large estates. Collections may, therefore, vary considerably from year to year.

Miscellaneous Taxes. Miscellaneous tax revenues were $87.7 million in 2004-05, and are estimated at $91.2 million in 2005-06 and $91.5 million in 2006-07. The first-year estimate is $1.7 million higher than the Act 25 estimate, and the second-year estimate is unchanged from Act 25. The revised estimate reflects year-to-date collections from the real estate transfer fee. Other miscellaneous taxes include municipal and circuit court related fees and the occupational tax on coal.

We will continue to monitor economic forecasts and data regarding tax collections and expenditures and inform you if any further revisions are necessary.

Sincerely,

Bob

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature