The Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: the general fund, and nongeneral funds. About half of state revenues are "nongeneral funds," or funds earmarked by law for specific purposes. For example, motor vehicle and gasoline taxes are earmarked by law for transportation programs, student tuition and fees support higher education, and federal grants are designated for specific activities.

General fund revenues are derived from general taxes paid by citizens and businesses in Virginia. Since general fund revenue is not dedicated to any particular purpose and can be used for a variety of government programs, these are the funds that the Governor and the General Assembly have the most discretion to spend.

General fund revenues are derived primarily from five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are public service gross receipts / consumption taxes**,** corporate income taxes, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

Fiscal year 2003 collections experience marginal growth

In fiscal year 2003, collections of the two largest revenue sources – individual income taxes and sales and use taxes – fell short of the forecast, while receipts of corporate, public service consumption taxes, and the tax on premiums of insurance companies were above expectations. Collectively, the five major sources ended the year with a surplus of $39.0 million.

Miscellaneous taxes and other revenues ended the year $21.4 million above the estimate. The bulk of the surplus was due to higher-than-expected collections of wills, suits, deeds and contract fees, which are primarily recordation taxes.

In total, general fund revenues for fiscal year 2003 increased by 1.8 percent to $10.9 billion, exceeding the official target by $60.4 million.

General fund revenue forecast reflects the economic expansion and tax reform

The general fund revenue forecast for the final year of the current biennium and the upcoming 2004-2006 biennium reflect both the economic expansion in Virginia and the impacts of the Governor's tax reform package.

Governor Warner announced his proposed tax reform legislation in November and the expected impacts on general fund revenues have been included in the forecast. The package impacts various revenue sources, but the largest impact will be on individual income and sales tax collections. Growth rates, therefore, will be distorted, particularly in these two sources.

General fund tax revenues are expected to increase by 6.7 percent in fiscal year 2004, 6.9 percent in fiscal year 2005, and 6.8 percent in fiscal year 2006.

Forecast for the major general fund revenue sources

For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2003 and the forecast for the next three fiscal years:

Individual income taxes

Net individual income tax receipts of $6,775.7 million trailed the official estimate by $23.2 million in fiscal year 2003. Individual income tax receipts increased by one percent over the previous year.

Weak job growth and an increased volume of tax refunds restrained growth in fiscal year 2003.

Over the forecast horizon, withholding is expected to grow at rates more consistent with an expanding economy. In addition, solid gains in most of the stock indices and a generally stronger business environment should lead to gains in non-withholding collections.

The general fund forecast for 2004 and the 2004-2006 biennium

	Fiscal Year 2004		2004-2006 biennium	
	Actual **2003**	*Forecast* **2004**	*Forecast* **2005**	*Forecast* **2006**
Major tax sources				
Corporate income	343.3	415.9	453.3	453.7
Individual income	6,775.7	7,236.4	7,661.6	8,104.1
Insurance premiums	333.0	357.8	391.2	424.9
Public utility	91.2	84.4	86.3	89.1
State sales & use	2,336.0	2,457.2	3,041.9	3,387.0
Miscellaneous	987.9	1,040.3	763.0	775.8
Total revenues	10,867.1	11,592.0	12,397.3	13,234.6
Transfers				
ABC Profits	14.2	9.0	11.6	13.3
Lottery Profits	375.1	386.1	395.0	402.0
Transfers per the Appropriation Act	653.4	586.4	114.2	110.4
Total general fund	**$11,909.8**	**$12,573.5**	**$12,918.1**	**$ 13,760.3**

Dollars in millions. Excludes balances available for appropriation. Figures may not add due to rounding. Source: Department of Taxation

Sales and use taxes

Sales and use tax collections declined by 3.9 percent in fiscal year 2003, $6.6 million short of the forecast. However, receipts were distorted due to legislation that required accelerated collections of sales tax. Excluding the effects of the accelerated collections, growth in sales tax receipts was 2.1 percent, slightly behind the adjusted 2.7 percent forecast.

In fiscal year 2004, strong job growth and higher levels of consumer confidence should drive a rate in the growth of sales tax collections typical of an economic expansion. In fiscal years 2005 and 2006, the combined effects of tax reform and economic growth are expected to boost growth above trend rates.

Corporate income taxes

The corporate income tax is the most volatile of Virginia's revenue sources and tends to be even more sensitive to the business cycle than personal income taxes.

Corporate income tax collections have been difficult to forecast due to: (1) the tenuous link between profits and tax liability, (2) Virginia's profit / loss carry-forward, carry-back provisions, and (3) the varying time lag between the booking of profits and the payment of taxes. In addition, large fluctuations are often caused by payments from, or refunds to, a few large corporations.

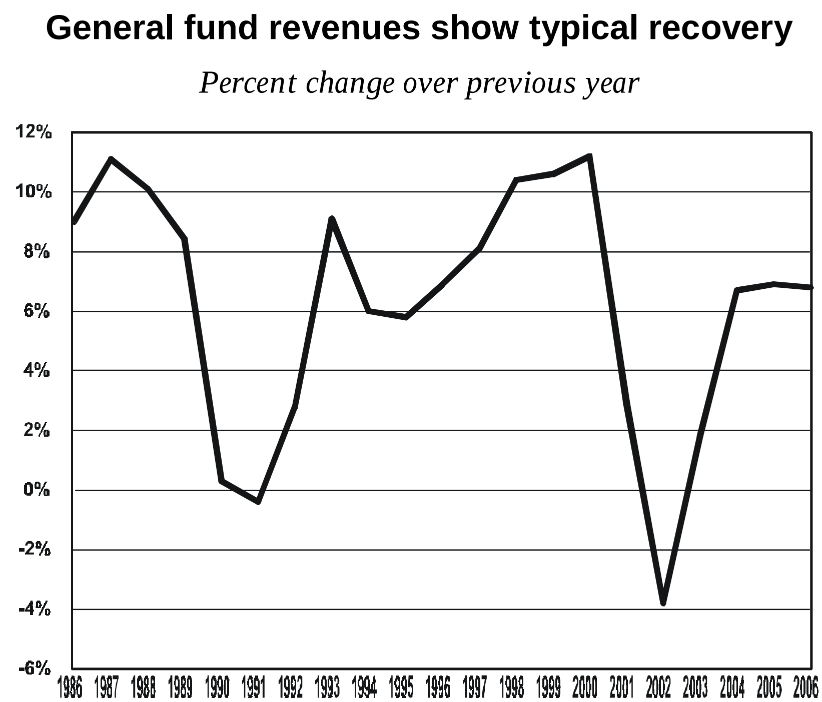
Corporate income tax collections were $343.3 million in fiscal year 2003. The strong growth followed two years of double-digit declines in corporate receipts. Gross payments rose 8.2 percent in fiscal year 2003, while refunds fell 7.7 percent.

Over the forecast horizon, the markedly improved business climate should support higher growth in corporate income tax collections.

Public service gross receipts / consumption taxes

Rough winter weather and an improving economy boosted demand for electricity and natural gas in fiscal year 2003. Legislation signed into law in 1999 and 2000 began the process of deregulation of the electric and natural gas public utilities. As part of the deregulation process, a consumption tax on users of natural gas and electricity was enacted.

Collections from this source are expected to be relatively flat over the forecast horizon, assuming somewhat normal weather patterns.



Data for 2004, 2005, and 2006 are forecasts. Source: Department of Taxation

Insurance company premiums taxes

Tax collections on insurance company premiums exceeded the forecast by $21.4 million in fiscal year 2003. Increasing home values and growth in premiums paid by businesses following the terrorist attacks buoyed collections in this source.

Over the forecast horizon, collections of insurance premiums taxes are anticipated to increase at higher rates due to the anticipated rise in premiums.

Miscellaneous taxes and other revenue

Miscellaneous taxes and other revenues exceeded projections by $21.5 million in fiscal year 2003. Most of the surplus was the result of higher-than-anticipated collections of fees on wills, suits, deeds and contracts (mainly the recordation fee charged on home financing activities.) Collections of miscellaneous taxes and other revenues are expected to increase in fiscal year 2004, decline in fiscal year 2005, and level off in fiscal year 2006.

Over half (55%) of state revenue is nongeneral fund revenue

Although most public attention is focused on general fund revenue, over one-half of all revenue in the state budget is nongeneral funds that are earmarked by law for specific purposes.

Nongeneral fund revenue is expected to increase by 13.8 percent in 2004, by 1.3 percent in 2005, and by 4.5 percent in 2006. Nongeneral funds will comprise about 54.7 percent of total state revenue during the 2004-2006 biennium.

Federal grants

Federal grants are the largest source of nongeneral fund revenue, more than 36 percent of the total.

Frequently these grants do not come to the state as simple cash transfers. The federal government mandates many program requirements as conditions of the grants and often states must provide matching funds. The Medicaid program for indigent health care is an example of a federal entitlement program that requires a state contribution.

In 2003, federal grants and contracts totaled $5.4 billion. This source is projected to increase by 18.6 percent to $6.4 billion in 2004, then decline by 7.9 percent in 2005 to $5.9 billion before increasing again in 2006 to $6.2 billion or by 5.6 percent. This pattern is caused by some large one-time payments related to a temporary extension of federal unemployment benefits through 2004.

The nongeneral fund forecast for the 2004-2006 biennium

	Actual 2003	Forecast 2004	Forecast 2005	Forecast 2006
Motor vehicle fuel tax	$868.4	$886.4	$918.9	$950.2
Unemployment compensation payroll tax	216.1	394.6	555.5	616.9
Special highway tax from sales tax	375.7	399.7	421.8	467.5
Motor vehicle sales and use tax	536.4	567.1	593.5	612.5
Other taxes	105.9	82.1	241.9	237.7
Rights and privileges	643.1	680.3	698.6	706.9
Sales of property and commodities	412.7	428.1	454.6	478.9
Institutional revenue	3,013.1	3,296.4	3,424.9	3,531.5
Interest dividends and rents	90.1	73.3	69.8	84.3
Federal grants and contracts	5,388.8	6,392.5	5,886.9	6,217.1
Master Tobacco Settlement Agreement Funds	90.0	75.7	75.7	76.7
Other revenue	1,400.9	1,679.6	1,807.8	1,856.2
Total	**$13,141.1**	**$14,956.0**	**$15,149.9**	**$15,836.2**

Dollars in millions. Figures may not add due to rounding. Total excludes balances and bond proceeds available for appropriation, as well as Lottery, Literary, and internal service funds.

Source: Department of Planning and Budget, based on data submitted by agencies.

Institutional revenue

The second largest class of nongeneral fund revenue is institutional revenue. The principle sources of this revenue are patient fees at teaching hospitals and mental health institutions as well as tuition and fees paid by students at institutions of higher education. In 2003, institutional revenue collections were $3.0 billion, almost 23 percent of all nongeneral fund revenue. Institutional revenues are projected to grow by 9.4 percent to $3.3 billion in 2004 and by 3.9 percent in 2005 and by 3.1 percent in 2006. These growth rates are affected by two offsetting trends. An increase in tuition is assumed for institutions of higher education for the next biennium, but the collection of additional revenues at correctional institutions for out-of-state prisoners is expected to decline in the out years.

Transportation Fund

State transportation revenue comes from several sources including the motor vehicle fuels tax, the motor vehicle sales and use tax, road taxes, vehicle license fees, state sales tax, interest earnings, and other miscellaneous taxes and fees. Money in this fund is used to support highway construction and maintenance and operating costs. Federal, local, and toll revenues are also used to finance transportation programs.

Commonwealth transportation revenues from state taxes and fees amounted to $2.0 billion in 2003, an increase of $25.4 million over the prior year. Total collections declined $47.9 million, or 2.3 percent below the original forecast. Fiscal year 2003 growth of 1.3 percent in Commonwealth Transportation Fund (CTF) revenues was the lowest growth rate since fiscal year 1991. The official forecast was based on an economic scenario of a slow but forward-moving recovery, which did not anticipate significant combat operations in Iraq. Both the Iraqi war and its buildup had a significant impact on CTF revenues. Motor fuel prices surged, consumer confidence dropped, and the job market continued to decline. In addition, consumers became increasingly inured to incentives to buy a new vehicle.

For 2004 and 2005, total fund revenues from state sources are expected to be about $2.1 billion. For 2006, they will grow to $2.2 billion. These amounts are equal to annual growth of 2.8 percent, 3.3 percent, and 3.3 percent respectively.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be higher each year of the biennium, reflecting higher wage and employment growth and the decrease in the fund balance factor (solvency level) that governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2004, unemployment tax collections are expected to increase to $394.6 million from actual collections of $216.1 million in 2003. For 2005 and 2006, revenues are anticipated to increase to $555.5 million and $616.9 million, respectively.

Master Tobacco Settlement Agreement Funds

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 46 states, the District of Columbia, and five United States' territories on November 23, 1998. The settlement agreement releases participating manufacturers from past, present, and future smoking-related claims of the states in return for an annual cash payment to the states in perpetuity. These payments are to be adjusted over time for several factors, including inflation and changes in volume of domestic cigarette shipments.

The Commonwealth's plan for the use of MSA funds has three elements. First, legislation passed by the 1999 General Assembly (Chapter 880, 1999 Acts of Assembly) earmarked 60 percent of the allocation in two separate trust funds. The Tobacco Indemnification and Community Revitalization Fund receives 50 percent of the MSA allocation. This share is used to compensate tobacco growers and tobacco quota holders for the economic loss resulting from quota loss or elimination and to promote economic growth and development in tobacco-dependent communities in the Southside and Southwest regions of the state.

The Virginia Tobacco Settlement Fund receives the next 10 percent of the MSA allocation for the purposes of discouraging, eliminating, or preventing the use of tobacco products by minors and for health care. Programs targeted at minors include but are not limited to educational and awareness programs on the health effects of tobacco and on laws restricting the distribution of tobacco products to minors.

For fiscal years 2004, 2005, and 2006, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive $63.1 million, $63.1 million, and $63.9 million, respectively. The Virginia Tobacco Settlement Fund will take in $12.6 million, $12.6 million, and $12.8 million over the same period.

The remaining 40 percent share of the MSA funds is deposited to the general fund.