

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 sales and motor fuel taxes are earmarked by law for transportation programs; students' tuition and other 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 can primarily be attributed to five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are corporate income taxes, wills, suits, deeds, and contract fees, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

FY 2023 in Review

In Fiscal Year 2023, total General Fund revenues fell 3.5 percent to \$27.9 billion, well ahead of the official forecast of a 14.0 percent decline. All major revenue sources except Wills, Suits, and Deeds (mainly recordation taxes) exceeded the official forecast. Most of the excess revenues can be attributed to individual non-withholding collections, related to stronger than expected economic performance and timing issues associated with the new Pass-Through Entity Tax (PTET).

The official forecast was based on the October 2021 IHS Markit Standard Outlook, and the corresponding Virginia state forecast developed by the Department of Taxation and incorporated policy actions adopted during the 2022 and 2023 sessions of the General Assembly.

Composition of General Fund Revenues

General fund revenues totaled \$27.9 billion in FY 2023, with more than two-thirds derived from individual income taxes. The general fund portion of the state sales and use tax accounted for 17 percent, corporate income taxes accounted for seven percent. Other major sources include the insurance premiums license tax (two percent) and taxes on wills, suits, and deeds, predominantly recordation taxes (one percent).

Individual Income Taxes

The Virginia Individual Income Tax applies to the entire income of Virginia residents and to income from Virginia sources received by nonresident individuals. Generally, all residents and nonresidents with Virginia taxable income are required to file a return.

Individual income tax rates are as follows:

<u>Income</u>	<u>Tax Rate</u>
\$0 to \$3,000	2.00%
\$3,001 to \$5,000	3.00%
\$5,001 to \$17,000	5.00%
\$17,001 and over	5.75%

Withholding: In FY 2023, withholding receipts (57 percent of GF revenues) increased 4.0 percent to \$15,957.1 million, exceeding the projected revenue figure of \$15,319.7 million by \$637.4 million.

Non-withholding: Collections of individual non-withholding (24 percent of GF revenues) decreased by 2.7 percent to \$6,629.2 million, significantly outperforming the projected estimate of \$5,213.6 million. Approximately two-thirds of this surplus is attributable to the timing of PTET payments and refunds. Another \$500 million in excess is due to the stronger than expected stock market performance in FY 2023.

Refunds: FY 2023 refunds amounted to \$3,602.8 million, compared to the \$3,800.9 million projected in the forecast. This represents a 107 percent increase from FY 2022's \$1,740.5 million. Two major policy initiatives contributed to this growth: a one-time tax rebate totaling approximately \$1 billion and the standard deduction for individuals and married couples increasing from \$4,500/\$9,000 to \$8,000/\$16,000.

Retail Sales and Use Taxes

In general, all sales, leases, and rentals of tangible personal property in or for use in Virginia, as well as accommodations and certain taxable services, are subject to Virginia sales and use tax, unless an exemption or exception is established. The sales tax rate for most locations in Virginia is 5.3 percent which includes both general fund and non-general fund revenues, and the local option 1.0 percent tax. Several areas have an additional regional or local tax. In all of Virginia, food for home consumption (e.g., grocery items) and certain essential personal hygiene items are exempt from the state sales tax but are subject to the 1.0 percent local option sales tax.

Collections of sales and use taxes (17 percent of GF revenues) totaled \$4,734.5 million, \$236.7 million over the forecast. This represented year over year growth of 3.9 percent.

Corporate Income Taxes

Corporations that are subject to the state corporate income tax are required to pay an income tax equal to 6.0 percent of the corporation's Virginia taxable income. In FY 2023, corporate income tax collections totaled \$2,031.1 million, \$294.1 million over the forecast. The forecast had anticipated weak corporate profits for the year and a 12.2 percent decline in revenues from this source. Unexpectedly strong economic growth allowed corporate income tax, like non-withholding, to exceed expectations and grow 2.6 percent year-over-year.

Wills, Suits, Deeds, and Contract Fees

Virginia imposes a state tax on the recordation of deeds, deeds of trusts, mortgages, leases, and contracts relating to real estate. This category is comprised predominantly of state recordation taxes. Revenues from Wills, Suits, Deeds, and Contract Fees came in at \$430.6 million, a 34.2 percent year over year decline and \$163.1 million less than the forecast had predicted. Interest rates increased sharply in FY 2023 causing real estate transaction volumes to decline from their pandemic heights.

Insurance Premiums License Taxes

Any insurance company with premiums allocated to Virginia on its annual statement is subject to an annual tax on its direct gross premiums income, which includes all premiums, assessments, dues, and fees collected, received, or derived, or obligations taken from business in the Commonwealth during the calendar year, decreased by returns for cancellation and all amounts returned to subscribers or credited to their accounts as savings.

One-third of the revenue from the Insurance Premiums License Tax from the prior year is deposited into the Priority Transportation Fund (a sub-fund of the Commonwealth Transportation Fund) and the remaining revenue from the Insurance Premiums License Tax goes to the General Fund. General Fund revenues from the insurance premiums license tax were \$450.9 million, exceeding the forecast by \$44.8 million. Collections grew 5.6 percent year over year.

The general fund forecast for fiscal years 2024 through 2026

	Actual 2023	Forecast 2024	Forecast 2025	Forecast 2026
Corporate income	\$2,031.1	\$2,213.5	\$2,063.8	\$2,161.3
Individual income	18,983.6	18,516.1	18,100.4	18,300.1
Insurance premiums	450.9	446.3	439.3	452.3
State sales & uses	4,734.5	4,515.8	5,400.9	6,664.5
Wills, suits, deeds & contract Fees	430.6	425.6	456.7	457.2
Miscellaneous	1,279.2	1,615.4	1,660.3	1,611.5
Total revenues	\$27,909.9	\$27,732.6	\$28,121.4	\$29,646.9
ABC profits	\$164.3	\$174.1	\$206.2	\$231.0
Sales Tax (0.25%)	557.0	550.9	590.7	648.9
Transfers per the Appropriations Act	94.3	-775.4	947.1	193.3
Total transfers	\$815.6	-\$50.4	\$1,744.0	\$1,073.2
Total general fund	\$26,725.5	\$27,682.2	\$29,865.4	\$30,720.1

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

General Fund revenue collections expected to grow moderately over the forecast horizon

In the December standard forecast, the total General Fund, including transfers, would increase by \$1.4 billion in FY 2024. The increase from the official revenue forecast comes mainly from upward revisions to non-withholding and corporate income tax collections. Under the mild recession forecast, General Fund resources would grow by 7.9 percent and 2.9 percent in FY 2025 and FY 2026, respectively.

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.

Total transportation revenues in FY 2023 were over \$4.8 billion, an increase of \$223.6 million over last year. Revenue collections grew by 4.9 percent, slightly ahead of the official forecast of 3.9 percent, resulting in a forecast variance of 0.9 percent.

Strong growth in motor vehicle sales tax collections, mainly attributable to a surge in new and used vehicles prices, drove the surplus in the Commonwealth Transportation Fund. In addition, higher interest rates resulted in an upturn in interest earnings.

The December 2023 mild recession forecast shows an increase of \$66.3 million in FY 2024 and a decline of \$54.1 million in FY 2025 then showing an increase of \$14.2 million in FY 2026, as compared to the official forecast.

Around 62 percent of state revenue is nongeneral fund

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

Nongeneral fund revenue collections increased by 0.2 percent in 2023, and are expected to increase by 10.2 percent in 2024, and 8.7 percent in 2025. Nongeneral funds are around 62 percent of total state revenue during the 2022-2024 biennium.

Federal grants and other contracts

Federal grants and other contracts are the largest single source of nongeneral fund revenue, about 52 percent of the total. Frequently 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 2023, federal grants and other contracts decreased to \$22.0 billion. This source is projected to decrease by 9.8 percent in 2024, increase by 12 percent in 2025, and increase by 4.7 percent in 2026, resulting in projections of \$19.9 billion in 2024, \$22.3 billion in 2025 and \$23.3 billion in 2026.

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. Institutional revenue collections are expected to be \$9.7 billion in 2024, \$10.7 billion in 2025 and \$11.3 billion in 2026.

Master Tobacco Settlement Agreement Funds

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 45 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 the state's MSA 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 annual amount received by this Fund was securitized and turned into an endowment. Thus, the Fund now receives earnings on this endowment. The Virginia Tobacco Settlement Fund receives the next 8.5 percent of the MSA allocation for the purposes of restricting tobacco use by minors, reducing childhood obesity, and preventing substance use by youth. Programs targeted at minors include but are not limited educational and awareness programs. The final portion of the allocation (41.5 percent) goes to the Virginia Health Care Fund. Appropriation Act language requires that this Fund only be used to cover the state share of Medicaid costs.

For 2025 and 2026, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund may expend up to 10.0 percent of the endowment, an amount estimated at \$43.0 million each year. Over the 2024-2026 biennium, the Virginia Tobacco Settlement Fund is expected to receive \$11.3 million each year and the Virginia Health Care Fund is estimated to take in \$55.0 million annually.

Nongeneral fund forecast for the 2024-2026 biennium*

	Actual FY 2023	Forecast FY 2024	Forecast FY 2025	Forecast FY 2026
Motor vehicle fuel tax	\$1,409.7	\$1,480.1	\$1,533.6	\$1,583.9
Unemployment compensation payroll tax	\$290.1	\$588.9	\$518.9	\$442.4
Special highway tax from sales tax	\$1,416.6	\$1,372.1	\$1,392.2	\$1,467.4
Motor vehicle sales tax and use tax	\$1,218.9	\$1,178.9	\$1,193.5	\$1,220.6
Other taxes	\$2,409.4	\$2,631.3	\$2,600.5	\$2,716.2
Rights and privileges	\$1,427.3	\$1,354.8	\$1,399.6	\$1,430.9
Sale of property and commodities	\$2,953.4	\$2,822.3	\$2,543.9	\$2,624.5
Assessment & receipts for special Services	\$2,788.9	\$2,522.7	\$3,159.6	\$3,297.4
Institutional revenue**	\$2,849.7	\$9,703.2	\$10,717.5	\$11,292.3
Interest dividends and rents	\$310.0	\$274.6	\$269.9	\$276.0
Federal grants and contracts	\$22,048.6	\$19,881.2	\$22,274.6	\$23,332.1
Master Tobacco Settlement Agreement Funds	\$68.7	\$90.3	\$97.8	\$97.8
Other Revenue	\$3,628.5	\$3,297.3	\$3,584.1	\$3,336.5
Total	\$42,819.9	\$47,197.6	\$51,285.7	\$53,117.9

*Based on December 2023 forecast. Dollars in millions. Figures may not add due to rounding. Total excludes balances and bond proceeds available for appropriation, as well as Literary Fund transactions, and internal service funds.

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

**Per the Management Agreement between the tier 3 schools and the Commonwealth as set forth in Chapters 933 and 943 of the 2006 Acts of Assembly, the tier 3 schools are not required to report actual revenue collections in the Cardinal financial system. However, these institutions participate in the nongeneral fund revenue estimation process.