

Revenue

The budget, as introduced, includes a net reduction of \$440.2 million in general fund resources available for appropriation during the 2002-04 biennium.

This net decline results from a shortfall in the unreserved fiscal year 2002 balance forward and a \$1.3 billion reduction in “economic-based” revenue projections. The reduction is partially offset by revenue proposals to increase collections by roughly \$95 million, withdrawals from the “Rainy Day” Fund, and proposed transfer and balance actions described below.

| General Fund Resources Available for Appropriation | | | |
|---|---------------------------|-----------------------------|----------------------|
| (2002-04 biennium, \$ in millions) | | | |
| | <u>Chapter 899</u> | <u>HB1400/SB 700</u> | <u>Change</u> |
| Available Balances | \$151.0 | \$109.1 | (\$41.9) |
| Revenue Estimate | 23,306.2 | 22,118.7 | (1,187.5)* |
| Transfers (Includes Lottery) | 1,290.6 | 1,705.4 | 414.8 |
| Revenue Stabilization Fund | 0.0 | 374.4 | 374.4 |
| Total GF Resources Available | \$24,747.8 | \$24,307.6 | (\$440.2) |
| * (Net effect of economics and proposed revenue actions). | | | |

Available Balances

Balance adjustments include transactions related to the fiscal year 2002 close along with \$80.4 million from bonding capital projects previously funded with cash (an additional \$5.6 million of bonded projects is included as a transfer); and \$10.6 million from capital balances and the reversion of capital outlay funds as part of agency budget reductions.

Proposed Adjustments to Balances

(\$ in millions)

| | |
|--|-----------------|
| Fiscal Year 2002 Close & Other Technical Adjustments | (\$128.6) |
| Bond GF Capital Projects | 80.4 |
| GF & NGF Capital Outlay Reversions & Balances | 10.6 |
| Federal Audit of Internal Service Funds | (0.5) |
| Additional Natural Disaster Allocations | <u>(3.8)</u> |
| Total Balance Adjustments | (\$41.9) |

Estimated Revenues

The introduced budget includes a downward revision of \$1,282.4 million in GF tax revenues to reflect the current expectation that economic weakness will continue through fiscal year 2003, and an appreciable rebound will not occur until fiscal year 2004. The revised forecast assumes economic growth rates of 0.8 percent in fiscal year 2003 and 4.6 percent in fiscal year 2004. (Revenue declined by 3.8 percent in fiscal year 2002).

Changes in Major Tax Sources

(November Forecast)

(\$ in millions)

| | <u>FY 2003</u> | <u>FY 2004</u> |
|--------------------------------------|-----------------------|-----------------------|
| Income Tax Withholding | (\$253.7) | (\$287.0) |
| Income Tax Nonwithholding | (210.8) | (238.9) |
| Tax Refunds | (79.3) | (82.5) |
| Corporate | (7.2) | (28.5) |
| Sales Tax | (30.7) | (80.5) |
| Other Revenue | <u>58.5</u> | <u>(41.8)</u> |
| Total Economic Driven Changes | (523.2) | (759.2) |

Changes from the August Interim Forecast include a further downward revision to income tax withholding of \$92.5 million based on performance year-to-date, and a downward revision in tax dues (final payments) of \$45.6 million to reflect the national projected decline in capital gains of 25 percent. These amounts are offset by positive adjustments in corporate collections and in recordation taxes from refinancing activity.

Key assumptions underlying the revised forecast are (1) that Virginia's 16-month run of negative job growth is nearing an end and the roughly 40,000 jobs lost in fiscal years 2002 and 2003 will be regained in fiscal year 2004, and (2) wage and salary growth will experience a healthy rebound in fiscal year 2004.

| Economic Variables Assumed in Forecast (November Forecast) | | | |
|---|---------------------|---------------------|---------------------|
| Percent Growth Over Prior Year | | | |
| | <u>FY 02</u> | <u>FY 03</u> | <u>FY 04</u> |
| Virginia Employment | (0.8) | (0.4) | 1.9 |
| Virginia Wages & Salaries | 1.8 | 3.2 | 5.9 |
| Virginia Personal Income | 3.1 | 5.4 | 4.9 |

Beyond the economics, a number of proposed revenue actions would increase general fund collections by \$94.8 million over the biennium, resulting in a net forecast reduction of \$1,187.5 million.

- Revenue Actions.** Included in the proposed revenue actions beyond the economic forecast is \$34.0 million from retaining fourth quarter interest earned by nongeneral fund accounts; \$11.3 million from conforming with all federal tax changes adopted last year except for bonus depreciation and carry back of net operating losses; \$18.4 million from enhanced tax compliance (budget proposes adding 83 audit positions at a cost of \$11.4 million for the biennium); \$3.3 million from the general fund by requiring vendors doing business with the Commonwealth to collect sales tax on all sales to Virginia residents; \$2.8 million from participating in a federal debt setoff for delinquent taxpayers; \$2.5 million from imposing a \$100 fee for DUI convictions; and \$21.7 million from retaining DMV's share of the automobile rental tax as part of the agency's budget reduction.

The following table details all proposed adjustments, which would take the revenue growth rates to 1.0 percent in fiscal year 2003 and 5.2 percent in fiscal year 2004. Selected actions are explained in greater detail below.

| Proposed Revenue Adjustments Beyond the Economic Forecast | |
|---|---------------|
| (\$ in millions) | |
| Medicaid Recoveries | \$ 4.2 |
| MCI Revenue-Prison Phone System | 1.5 |
| Master Tobacco Settlement Agreement | 2.5 |
| Revised estimate-DOC surplus property sales | (6.6) |
| Wine & Spirit Tax, ABC average price (Funds are recouped through transfer action) | (11.8) |
| Impose \$100 DUI Fee | 2.5 |
| Merrill Lynch Settlement | 1.0 |
| Retain 4 th quarter interest-NGF accounts | 34.0 |
| DMV Auto Rental Tax | 21.7 |
| Selective Deconformity with 2002 Federal Changes | 11.3 |
| IRS Debt Setoff | 2.8 |
| Tax Compliance | 18.4 |
| Required Collection of Sales Tax from Vendors | 3.3 |
| Doing Business with Commonwealth | |
| Sale of DOC houses and DMV assets | 5.9 |
| Miscellaneous other | <u>4.1</u> |
| Total Proposed Adjustments | \$94.8 |

- **Selective Deconformity.** In 2002, Congress adopted tax policy changes just prior to the end of the General Assembly session that would have reduced state general fund revenues by about \$310

million through fiscal year 2004. In response, the Governor proposed and the General Assembly adopted fixed date conformity with federal tax law at December 31, 2001. The introduced budget assumes passage of legislation that will be submitted by the Governor moving the conformity date to December 31, 2002, for all actions except bonus depreciation and carry back of net operating losses (actions that would have created a large negative revenue impact). The result would be an increase of \$11.3 million in general fund revenue from other features of the federal tax policy changes enacted last year.

- **Tax Compliance.** The introduced budget includes funds for 83 additional tax audit and collections staff with a corresponding projected increase in compliance collections of \$2.0 million in FY 2003 and \$16.4 million in FY 2004.
- **Vendor Collection of Sales Tax.** Currently, vendors that do not have a physical presence in the state (nexus) do not have to collect and remit sales taxes for products sold to Virginia residents. The Governor will propose legislation that requires vendors, as a condition of doing business with the state, to collect the sales tax from Virginia residents, with a projected increase in general fund revenue of \$3.3 million in FY 2004. The proposal is modeled after a North Carolina statute.

Transfers/Deposits to General Fund

The introduced budget increases proposed transfers/deposits to the general fund (including Lottery profits) by \$414.8 million. Lottery profits available to public education would increase by \$72.8 million over the biennium (plus an additional \$2.3 million would be available from budget savings). Additional funds of \$35.6 million from ABC operations and wine/spirit tax receipts (including an average 2.6 percent average price increase effective February 1, 2003), are transferred for substance abuse services. A resulting decrease in ABC profits, two thirds of which would apply to localities, is proposed as part of the aid to localities contribution to the budget reduction plan.

Other major transfer proposals include \$174.1 million in targeted cuts and balances at nongeneral fund agencies, a portion of which was included in the October Budget Reduction Plan, with savings being transferred to the general fund to help offset the revenue shortfall; \$39.3 million from a tax amnesty program which would waive penalties and half of the accrued interest for voluntary compliance; \$14.9 million from the Tax Department's Public/Private Technology Partnership Fund; \$19.4 million from projected nongeneral fund

savings related to consolidation of information technology activities into a new state agency; \$5.7 million from bonding prior year capital expenditures; and \$8.5 million from the State Corporation Commission energy deregulation education program.

The following table details all additional transfers proposed in the introduced budget. Selected proposals are explained in greater detail below.

| Additional Transfers in HB 1400/SB 700 | |
|---|----------------|
| (\$ in millions) | |
| Lottery profits | \$72.8 |
| ABC/Wine & Spirit Tax to Dept. of Mental Health, Mental Retardation & SAS (Includes increase in ABC prices) | 35.6 |
| Reduction of ABC Profits Transfer | (8.4) |
| NGF Budget Cuts | 174.1 |
| Reduced sales tax transfers to Game Protection Fund | 4.1 |
| Increased premium taxes-Children’s Health Security Program | (2.9) |
| Executive Management Savings – VRS & Lottery | 4.7 |
| \$1 increase in IDEA Fee | 1.7 |
| Tax Public/Private Technology Partnership Fund | 14.9 |
| SCC Deregulation Education Program | 8.5 |
| Tax Amnesty Program | 39.3 |
| NGF Savings – Centralize IT Operations | 19.4 |
| Crime Victim’s Compensation Fund for Line of Duty Act | .5 |
| Bond prior year capital expenditures | 5.7 |
| Internal Building Operations Service Fund Efficiencies | 1.1 |
| General Liability Insurance Fund | 5.0 |
| Miscellaneous Other | (2.0) |
| Sale of Housing Partnership Loan Fund Portfolio to VHDA | <u>40.8</u> |
| Total | \$414.8 |

- **ABC/Wine Tax Transfers for Substance Abuse Services.** The introduced budget proposes additional transfers from gross ABC receipts and a new

transfer related to wine tax receipts. Specifically, the transfer would capture all of the proceeds from a 2.6 percent average increase in the price of distilled spirits (current average mark-up is 52 percent); additional collections from a revised estimate of sales volume; and a portion of wine taxes previously distributed to localities.

Currently, 88 percent of wine taxes are deposited to the general fund and half of this amount is returned to localities (the remaining 12 percent is deposited to the ABC Fund). Roughly \$20 million in wine tax receipts are collected per year. The introduced budget transfers \$4.9 million of gross wine taxes in the first year and \$9.9 million in the second year to DMHMRSAS for substance abuse services, thereby reducing the amount that would be shared with localities. This action is proposed as part of the local aid contribution to the budget shortfall.

- **Tax Amnesty.** The Governor will propose legislation to create a 60-day tax amnesty program in fiscal year 2004 to encourage payment of taxes due. Penalties and half of interest will be waived for voluntary compliance. The last tax amnesty program occurred in 1990, and estimated collections totaled \$32.2 million. The current proposal anticipates \$39.3 million in GF collections.
- **SCC Education Program.** The introduced budget proposes to defer a consumer education program on electricity deregulation since competition has yet to materialize, and transfers funds for the education program from the State Corporation Commission to the general fund. The transfer would total \$2.0 million in fiscal year 2003 and \$6.8 million in fiscal year 2004.
- **Sale of Housing Partnership Loan Portfolio.** The introduced budget directs the sale of the Housing Partnership Revolving Loan Fund portfolio of outstanding loans and other assets to the Virginia Housing Development Authority and requires that \$40.8 million in proceeds be paid to the general fund. A third party valuation of the portfolio is required, with all proceeds initially deposited to the Partnership Loan Fund.
- **NGF Budget Cuts.** Proposed reductions of \$174.1 million for nongeneral fund agencies include \$24.4 million of FY 2002 unspent balances in various nongeneral fund accounts. Included in this amount is \$4.4 million from the Motor Vehicle Dealer Board Transaction Recovery Fund. The Governor will propose legislation increasing the bonding requirement for licensed dealers to cover losses from fraudulent practices.

The remaining reductions of \$149.7 million include actions as specified in the October Budget Reduction Plan with the exception that DMV savings from that plan were reduced by \$29 million and partially replaced by DMV's share of the automobile rental tax revenues (\$21.7 million reflected under Revenue Adjustments). Also, targeted reductions of \$52.3 million were identified subsequent to the October Budget Reduction Plan including \$4.8 million in NGF balances at the State Police, \$4.1 million in additional savings from Technology Planning beyond the \$11.6 million identified in October and \$32.0 million from the Virginia Department of Transportation NGF savings beyond the \$31.8 million identified in October.

Revenue Stabilization Fund Withdrawal

The introduced budget includes withdrawals from the "Rainy Day" Fund totaling \$374.4 million for the biennium (one half of the fund balance in each year). At the end of the biennium, roughly \$129 million will remain in the Fund. The Governor has indicated that he will offer proposals to enhance future deposits.