Resources

FY 2016 General Fund revenues rose by only 1.7 percent, falling short of the official forecast of 3.2 percent growth by $268.9 million. Almost all of the shortfall was due to lower than expected withholding and sales tax collections, which are the two largest sources, and also those most closely tied to current economic conditions.

Subsequent to the FY 2016 revenue shortfall, the Governor undertook a Code-mandated reforecasting process and both the Joint Advisory Board of Economists (JABE) and the Governor's Advisory Commission on Revenues Estimates (GACRE) met over the summer to review the general fund revenue outlook. The Governor released an Interim Forecast for FY 2017 and FY 2018 at his presentation to the Joint Money Committees on August 26, 2016, which reduced revenues by $1.2 billion for the biennium compared to the forecast contained in Chapter 780 of the 2016 Acts of Assembly. When combined with the FY 2016 revenue shortfall, the assumed shortfall to be addressed in the FY 2016-18 biennium totaled $1.5 billion. That Interim Forecast predicted growth of 1.7 percent in FY 2017 and 3.6 percent in FY 2018.

After the release of the Interim Forecast, the standard Fall Reforecasting process occurred, with JABE and GACRE again meeting to review updated economic projections as well as actual fiscal year 2017 collections. While economic conditions appear to have remained fairly steady, year-to-date revenue collections are improving, especially in withholding tax collections, which make up roughly two-thirds of total revenues. Through the first five months of FY 2017, total revenues increased 5.4 percent, well ahead of the interim forecast of 1.7 percent growth. As a result, the December Forecast adds back $233.0 million when compared to the August Interim Forecast, $181.8 million of it in the current year, as a reflection of "cash in the bank." The December Forecast increases the assumed growth in FY 2017 to 2.7 percent, and reduces projected growth to 2.9 percent in FY 2018 compared to the Interim Forecast. The table on the next page details the respective impacts of the changes to the forecast that have occurred since Chapter 780 was adopted by the 2016 General Assembly.

In total, the proposed revisions to the FY 2016-18 resources contained in HB 1500/SB 900 include $303.6 million less in general fund resources than that assumed in Chapter 780. The resource adjustments reflect (1) a net balance reduction of $85.9 million; (2) an $819.6 million reduction in the general fund revenue forecast (after accounting for offsetting positive revenue impacts associated with $138.6 million of proposed tax policy changes); (3) transfer additions of $34.7 million; and (4) a withdrawal of $567.2 million from the Revenue Stabilization Fund.

As proposed, the amendments contained in HB 1500/SB 900 would leave an unappropriated balance of $16.1 million at the close of the FY 2018.

Change to General Fund Resources
Available for Appropriation
($ in millions)

	Chapter 780	HB 1500/SB 900	Difference
Unrestricted Balance (June 30, 2016)	$ 265.3	$ 623.4	$ 358.1
Balance Adjustments	680.4	236.4	(444.0)
Net Balance Reduction			($85.9)
Chapter 780 Revenue Estimate	$38,535.5		
August Interim Forecast		($1,197.1)	($1,197.1)
November GACRE Forecast Adjustment		233.0	233.0
Technical & Tax Policy Adjustments		144.5	144.5
HB 1500/SB 900 Revenues*		$37,715.9	($819.6)
Revenue Stabilization Fund	$ 0.0	$ 567.2	$ 567.2
Transfers	$ 1,174.5	$1,209.3	$ 34.7
Net Change to GF Resources			**($303.6)**

**Including proposed tax policy adjustments.*

Net Balance

A series of technical balance adjustments are required to align the Chapter 780 balance with the FY 2016 year-end Comptroller's report and to reflect agency savings plan actions and FY 2016 discretionary balances that are reverted in HB 1500/SB 900, as opposed to amounts estimated in Chapter 780 prior to the savings plans being finalized (see table at end of section).

Changes in Revenue

While improved over the growth assumptions released in August following the Interim Revenue Reforecast, the economic growth in HB 1500/SB 900 remains well below the assumptions contained in Chapter 780. Projected growth rates, before policy adjustments, now estimated at 2.7 percent in FY 2017 and 2.9 percent in FY 2018 in comparison to the growth rate assumptions of 3.2 percent and 3.9 percent, respectively, in Chapter 780.

Technical adjustments increase projected revenues by $5.9 million, including enhanced compliance of the consumer use tax and increases in assumed credit card rebates. In addition, the following tax policy proposals and other policy adjustments add $138.6 million to the revenue estimate over the two years. Both budget language and legislation will be proposed for different components of the tax policy package as detailed below.

1) **Tax Amnesty Program** – Includes budget language authorizing the Tax Commissioner to implement a tax amnesty program during the 2018 fiscal year. Under this proposal, qualifying payments made during the amnesty period would be exempt from penalties and half of the interest otherwise due. Qualifying participants who do not take part in the program would be subject to an additional 20 percent penalty. It is estimated that the program would generate a total of $71.5 million, of which $58.2 million would go to the general fund with the remainder flowing to transportation and the localities. It is anticipated that the Department would incur administrative costs of up to $5.5 million. Virginia previously implemented tax amnesty programs in 1989, 2003 and 2009. Companion legislation is anticipated to be introduced for this proposal (anticipated to generate $58.2 million GF in FY 2018).

2) **Deferred Phase-Out of Accelerated Sales Tax** – Retains the current $2.5 million taxable sales threshold for remittance of the June accelerated sales tax in FY 2017 and increases the threshold to $4.0 million in FY 2018. Chapter 780 assumed the threshold would increase to $10.0 million in June 2017 and to $25.0 million in June 2018 (retains $35.1 million in FY 2017 and $12.8 million in FY 2018).

3) **Tighten Sales Tax Nexus Definitions** – Includes budget language clarifying that the presence of inventory in Virginia gives rise to the Retail Sales and Use Tax nexus for out-of-state sellers who have sales to Virginia customers. As a result, out-of-state sellers who use Virginia warehouses and/or fulfillment centers will be required to register as dealers for the collection of retail sales and use tax. Virginia's nexus statute currently requires a dealer who maintains directly, or through an agent or subsidiary, an office, warehouse or place of business of any nature in Virginia to register. Current law is silent on whether owning inventory in Virginia creates nexus and Virginia's "Amazon" law does not cover dealers who keep their inventory in a fulfillment center or warehouse owned or operated by an unrelated third party. Companion legislation is anticipated to be introduced for this proposal (generates $11.1 million in FY 2018).

4) **Cap Maximum Individual Historic Rehabilitation Tax Credit** – Includes budget language prohibiting a taxpayer from claiming more than $5.0 million in Historic Rehabilitation Tax Credits for a single taxable year. Under current law, Virginia allows a credit equal to 25 percent of the eligible expenses incurred in the rehabilitation of a certified structure. The tax credit may not exceed a taxpayer's tax liability, and any unused credits may be carried forward for up to ten years. Over the last 19 years this credit has resulted in foregone revenue of the Commonwealth of more than $1.0 billion. The proposal would not limit the amount of credits that could be issued by the Department of Historic Resources; but, would impact the timing of when large credit

amounts could be claimed. Companion legislation is anticipated to be introduced for this proposal (increase revenues by $9.9 million in FY 2018).

5) **Retain $20,000 Limit on Land Preservation Tax Credit for TY 2017** – Includes budget language continuing the limit on the land preservation tax credit amount that can be claimed on each annual tax return to $20,000 for a single filer and $40,000 for joint filers, and extends the period for claiming unused credits from 10 years to 13 years for one additional year. The cap would be increased to $50,000 in tax year 2018. Companion legislation is anticipated to be introduced for this proposal (generates $6.1 million in FY 2018).

6) **Prevents Usage of Both Tax Credits and Deductions for Charitable Contributions through the NAP and EIS Tax Credit Programs** – Includes budget language prohibiting taxpayers from receiving a double state tax benefit for certain charitable donations as currently permitted by Virginia law. Under existing statute, Virginia allows businesses and individuals to receive a state income tax credit of up to 65 percent for the value of donations made under the Neighborhood Assistance Program or to a scholarship foundation under the Educational Improvement Scholarships Tax Credit Program. Donations to these organizations may also qualify for federal and state income tax deductions as charitable contributions. To prevent the double benefit, this proposal would eliminate the ability to claim both a tax credit and a deduction with respect to the same donation. Companion legislation is anticipated to be introduced for this proposal (generates $2.0 million in FY 2018).

7) **Increase Land Preservation Tax Credit Transfer Fee from 2 percent to 3 percent** – Includes budget language increasing the fee from 2 percent to 3 percent of the value of the donated interest attached to the transfer of land preservation tax credits on the secondary market. These fees are used to support the costs of administering the tax credit and auditing the value of appraised properties included in the program. Under provisions in the *Code of Virginia*, up to 50% of the revenues generated by the fees are used by the Department of Taxation and the Department of Conservation and Recreation for their costs in administering the tax credit program. The remainder is transferred to the Virginia Land Conservation Fund for distribution to the public or private conservation agencies or organizations that are responsible for enforcing the conservation and preservation purposes of the donated interests (generates $1.0 million in FY 2018).

8) **Notification of Payroll System Breaches** – Assumes passage of a legislative proposal which would require employers and payroll service companies to notify the Department of Taxation when they discover that the security of their payroll system has been breached. Prompt notification would permit the Department to provide extra scrutiny to

returns claiming withholding from these employers and avoid missing fraudulent refund claims generated by the data breaches (increases revenues by $0.8 million in FY 2018).

9) **VOSH Civil Penalties** – Reflects the assumed increase in civil penalties collected by the Department of Labor and Industry due to changes in federal penalty requirements that went into effect in August 2016. The penalties collected are deposited to the general fund under existing law. Separate legislation is anticipated to be introduced for this proposal (generates $0.7 million in FY 2018).

10) **Capture Unused Dam Safety Balances** – Includes budget language requiring the Virginia Resources Authority to pay to the general fund $544,711 from uncommitted balances in the Dam Safety, Flood Prevention and Protection Assistance Fund by June 30, 2017 (recovers $0.5 million in FY 2017).

11) **License Fees for Adult Services at DBHDS** – Proposes a new $100 annual license fee for adult mental service providers within the Department of Behavioral Health and Developmental Services (generates $0.1 million in FY 2017 and $0.2 million in FY 2018).

12) **Reflect Sunset of the Telework Tax Credit** – The existing telework tax credit is set to expire in tax year 2017. This proposal simply reflects revenue generated by the sunset of this credit (increases revenues $0.1 million in FY 2018).

When both proposed tax policy changes and technical adjustments are included, the projected revenue growth rates are 2.9 percent in FY 2017 and 3.2 percent in FY 2018.

Change in GF Taxes by Source Compared to Chapter 780
($ in millions)

	Estimated FY 2017	Annual Growth	Estimated FY 2018	Annual Growth
Net Individual	($316.3)	2.9%	($455.7)	3.6%
Corporate	29.0	3.8%	88.5	3.9%
Sales	(115.0)	2.7%	(189.5)	1.8%
Insurance	8.5	1.5%	14.5	6.0%
Recordation	9.2	5.5%	18.5	2.3%
All Other	39.5	0.7%	49.1	2.0%
Total GF Revenues	**($345.0)**	**2.9%**	**($474.5)**	**3.2%**

Changes in Transfers

Net transfer adjustments total $34.7 million in HB 1500/SB 900. The net changes include $79.0 million in increased transfers offset by forecast reductions for the 0.375 percent of sales tax transferred to the general fund of $44.3 million over the biennium. The largest increases in transfers derive from a $24.6 million biennial update to the ABC profits forecast, and $19.9 million generated by settlements with Volkswagen and Kia-Hyundai. Other substantial increases include $16.3 million in NGF cash transfers identified in the Governor's October 2016 savings plan and a proposal to transfer nongeneral funds from agencies to offset the VRS deferred contribution repayment which total $16.3 million and $15.5 million respectively. The remaining transfer items are outlined in the table below.

General Fund Resource Changes Compared to Chapter 780
($ in millions)

	2016-18
Unrestricted Balance:	
Unrestricted Fund Balance, Comptroller's August Report	$623.4
Balance Reflected in Chapter 780	265.3
Adjustment Needed to Restate Unrestricted Balance	**$358.1**
Adjustments to the Unreserved Balance:	
Chapter 780 Balances	$680.4
Re-appropriate Capital Projects	(141.9)
Virginia Health Care Fund (NGF)	(44.3)
Central Capital Planning Fund (NGF)	(10.3)
Local Communications Sales & Use Tax (NGF)	(35.9)
Commonwealth Development Opportunity Fund	(25.0)
Natural Disaster Sum Sufficient	(25.6)
Mandatory GF Reappropriations	(40.0)
Mandatory Higher Education Reappropriations	(18.7)
Virginia Water Quality Improvement Fund (NGF)	(15.8)
Economic and Technology Development - Committed	(45.3)
Health and Public Safety – Committed	(32.6)
Economic and Technology Development - Assigned	(7.3)
Environmental Quality and Natural Resource Preservation	(6.4)
Other Committed and Assigned NGF	(25.0)
Discretionary Re-appropriations Reverted to GF	(23.3)
Reverse Already Appropriated WQIF Assignment	(61.7)
Adjust for Delayed Sale Alexandria ABC	(11.1)
Adjust for 2016 Surplus Debt Service Funds	(3.0)
Miscellaneous Other Adjustments	0.4

General Fund Resource Changes Compared to Chapter 780

($ in millions)

Revert GF Capital Balances and Bond Capital Projects	128.5
Net Balance Adjustments	**$236.4**
Revenue Amendments:	
December Tax Re-forecast	($964.1)
Tax Policy Proposals/Legislation	138.6
Miscellaneous Technical	5.9
Total Revenue Adjustments	**($819.6)**
Transfers:	
ABC Profits	$24.6
Sales Tax Forecast Adjustment (0.375 cents for K-12)	(44.3)
Volkswagen and Kia Settlements from OAG	19.9
October Budget Reduction Plan	16.3
NGF Component VRS Expedited Repayment	15.5
Miscellaneous Other Transfers	2.7
Total Transfer Adjustments	**$34.7**