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 the entire 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 of 2016 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-to-date 2017 collections. While economic conditions remained fairly steady, year-to-date revenue collections improved, 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 added back \$233.0 million when compared to the August Interim Forecast, including \$181.8 million in the first year as a reflection of "cash in the bank." The December Forecast increased the assumed growth in FY 2017 to 2.7 percent, and reduced 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, and including policy adjustments, revisions to the FY 2016-18 resources contained in Chapter 836 of the 2017 Acts of Assembly (HB 1500) include \$178.1 million <u>less</u> in general fund resources than that assumed in Chapter 780. The resource adjustments reflect 1) a net balance reduction of \$81.2 million; 2) a \$780.0 million reduction in the general fund revenue forecast (after accounting for offsetting positive revenue impacts associated with \$184.1 million of technical and policy changes); 3) transfer additions of \$115.9 million; and 4) a withdrawal of \$567.2 million from the Revenue Stabilization Fund.

As enacted, the amendments contained to Chapter 836 leave an unappropriated balance of \$8.6 million at the close of the FY 2018.

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

	Chapter 780	Revised	<u>Difference</u>
Hamadriata I Balanca (Luca 20, 2016)	-	ф сээ 4	
Unrestricted Balance (June 30, 2016)	\$265.3	\$623.4	\$358.1
Balance Adjustments	680.4	241.1	<u>(439.3)</u>
Net Balance Reduction			(\$81.2)
Chapter 780 Revenue Estimate	\$38,535.5	\$38,535.5	
August Interim Forecast		(1,197.1)	(\$1,197.1)
November GACRE Forecast Adjustment		233.0	233.0
Technical Adjustments		6.1	6.1
Legislation and Tax Policy Adjustments		178.0	178.0
Chapter 836 Revenue Estimate*		\$37,755.5	(\$780.0)
Revenue Stabilization Fund		\$567.2	\$567.2
Transfers	1,174.5	<u>1,290.4</u>	115.9
Net Change to GF Resources	\$40,655.8	\$40,477.7	(\$178.1)
*Including 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. These also reflect agency savings plan actions and FY 2016 discretionary balances that are reverted in Chapter 836, 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 rates assumed in Chapter 836 remain well below the assumptions contained in Chapter 780. Projected growth rates, before policy adjustments are 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 \$6.1 million, including enhanced compliance of the consumer use tax and increases in assumed credit card rebates. In addition,

the following tax and other policy adjustments add \$178.0 million to the revenue estimate over the two years. Changes are detailed below.

Tax Policy and Revenue Amendments (\$ in millions)					
	<u>2016-18</u>				
Revenue Amendments:					
Tax Amnesty Program	\$89.5				
Defer Phase-Out of Accelerated Sales Tax	47.9				
Tighten Sales Tax Nexus	12.0				
Cap Individual Historic Rehabilitation Tax Credit	9.9				
Retain \$20,000 Limit on Land Preservation Tax Credit	6.1				
Notification of Payroll System Breaches	0.8				
VOSH Civil Penalties	0.7				
Capture Unused Dam Safety Balances	0.5				
Cigarette Sales Tax Enforcement	2.4				
ABC Excise Tax Collections	5.4				
Sale of Forestry Property	0.3				
DGIF Transfer	1.3				
State Police Background Checks	1.2				
Total Revenue Adjustments	\$178.0				

1) Tax Amnesty Program – Budget language authorizes the Tax Commissioner to implement a tax amnesty program during the 2018 fiscal year. Under this program, qualifying payments made during the amnesty period will be exempt from penalties and half of the interest otherwise due. Qualifying participants who do not take part in the program will be subject to an additional 20 percent penalty. It is estimated that the program will generate a total of \$105.0 million, of which \$89.5 million will go to the general fund with the remainder flowing to transportation and the localities. Estimated general fund collections from tax amnesty are \$31.3 million more than the \$58.2 million assumed in the introduced budget with any revenues above the original estimate appropriated to a Revenue Cash Reserve. It is anticipated that the Department will incur administrative costs of up to \$5.5 million. Virginia previously implemented tax amnesty programs in 1989, 2003 and 2009. Chapters 53 and 433 of the 2017 Acts of Assembly (HB 2246/SB 1438), codifies these provisions.

- 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).
- 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 (generates \$0.9 million in FY 2017 and \$11.1 million in FY 2018). Chapter 51 of the 2017 Acts of Assembly (HB 2058) codifies these provisions.
- 4) Cap Maximum Individual Historic Rehabilitation Tax Credit Chapters 717 and 721 of the 2017 Acts of Assembly (HB 2460/ SB 1034) prohibit a taxpayer from claiming more than \$5.0 million in Historic Rehabilitation Tax Credits for taxable years 2017 and 2018. 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. This language does not limit the amount of credits that could be issued by the Department of Historic Resources, but it does impact the timing of when large credit amounts could be claimed (generates \$9.9 million in FY 2018).
- 5) Retain \$20,000 Limit on Land Preservation Tax Credit for TY 2017 Chapter 424 of the 2017 Acts of Assembly (SB 963) continues 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 for tax year 2017. The cap will be increased to \$50,000 in tax year 2018 (generates \$6.1 million in FY 2018).
- 6) Notification of Payroll System Breaches Chapters 419 and 427 of the 2017 Acts of Assembly (HB 2113/SB 1033) 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 permits 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).
- 7) 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 of 2016. The penalties collected are deposited to the general fund and are expected to generate \$0.7 million in FY 2018.
- 8) 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.
- 9) Cigarette Sales Tax Enforcement Chapters 112 and 453 of the 2017 Acts of Assembly (HB 1913/SB 1390) create a new requirement that purchasers of cigarettes for resale must apply for a special cigarette exemption certificate from the Department of Taxation in order to not be liable for the payment of sales tax at the time of purchase. The bills also set forth numerous requirements that a taxpayer must meet in order to qualify for the exemption. These provisions are expected to decrease tax evasion resulting in additional general fund revenues of \$2.4 million in FY 2018.
- **ABC Excise Tax Collections** Adopted budget increases the estimated ABC excise tax collections of \$1.9 million in FY 2017 and \$3.5 million in FY 2018 to align with expected sales growth.
- **Sale of Forestry Property** Adopted budget authorizes the sale of five forestry tracts located in Amelia, Emporia, Kilmarnock, Lexington, and Floyd (estimated to generate \$340,000 in general fund revenue in FY 2018).
- **DGIF Transfer** Adopted budget reduces the transfer to the Department of Game and Inland Fisheries by \$650,000 each year.
- **State Police Background Checks** Reflects additional general fund revenues of \$609,748 each year from State Police criminal background checks related to firearms purchases and concealed carry permits.

When both adopted tax policy changes and technical adjustments are included, the projected revenue growth rates are 2.9 percent in FY 2017 and 3.4 percent in FY 2018.

Adopted Change in GF Taxes by Source Compared to Chapter 780

(\$ in millions)

	Estimated FY 2017	Annual <u>Growth</u>	Estimated FY 2018	Annual <u>Growth</u>
Net Individual	(\$316.3)	2.9%	(\$445.9)	3.7%
Corporate	29.0	3.8%	104.2	5.8%
Sales	(114.1)	2.8%	(184.4)	1.9%
Insurance	8.5	1.5%	14.5	6.0%
Recordation	9.2	8.0%	18.5	2.3%
All Other	42.8	1.2%	54.0	2.2%
Total GF Revenues	(\$340.8)	2.9%	(\$439.1)	3.4%

Changes in Transfers

Net transfer adjustments total \$115.9 million in Chapter 836. The net changes include \$159.9 million in increased transfers offset by forecast reductions for the 0.375 percent of sales tax transferred to the general fund of \$44.0 million over the biennium. The largest increases in transfers include a transfer of nongeneral funds from agencies to offset the VRS deferred contribution repayment which totals \$58.9 million, a \$39.6 million transfer of ABC profits, and \$19.9 million generated by settlements with Volkswagen and Kia-Hyundai. The remaining transfer items are outlined in the table below.

General Fund Resource Changes Compared to Chapter 780 (\$ in millions)				
	<u>2016-18</u>			
Unrestricted Balance:				
Unrestricted Fund Balance, Comptroller's August Report	\$623.4			
Balance Reflected in Chapter 780	<u>265.3</u>			
Adjustment Needed to Restate Unrestricted Balance	\$358.1			
Adjustments to the Unreserved Balance:				
Chapter 780 Balances	\$680.4			
Re-appropriate Capital Projects	(141.9)			
Reverse Already Appropriated WQIF Assignment	(61.7)			
Economic and Technology Development - Committed	(45.3)			
Virginia Health Care Fund (NGF)	(44.3)			

General Fund Resource Changes Compared to Chapter 780 (\$ in millions) Mandatory GF Reappropriations (40.0)Local Communications Sales & Use Tax (NGF) (35.9)Health and Public Safety - Committed (32.6)Natural Disaster Sum Sufficient (25.6)Commonwealth Development Opportunity Fund (25.0)Other Committed and Assigned NGF (25.0)Discretionary Re-appropriations Reverted to GF (23.3)Mandatory Higher Education Reappropriations (18.7)Virginia Water Quality Improvement Fund (NGF) (15.8)Adjust for Delayed Sale Alexandria ABC (11.1)Central Capital Planning Fund (NGF) (10.3)Economic and Technology Development - Assigned (7.3)Environmental Quality and Natural Resource Preservation (6.4)Adjust for 2016 Surplus Debt Service Funds (3.0)Balance from Richmond Tourism Project 1.5 Miscellaneous Other Adjustments 3.9 Revert GF Capital Balances and Bond Capital Projects 128.5 **Net Balance Adjustments** \$241.1 **Revenue Amendments:** December Tax Re-forecast (\$964.1)Tax Policy Changes/Legislation 178.0 6.1 Miscellaneous Technical **Total Revenue Adjustments** (\$780.0) **Transfers: ABC Profits** \$39.6 Sales Tax Forecast Adjustment (0.375 cents for K-12) (44.0)NGF Component VRS Expedited Repayment* 58.9 Volkswagen and Kia Settlements from OAG 19.9 October Budget Reduction Plan 16.3 Special Emergency Medical Services Fund Transfer 5.9 **Revert Capital Planning Funds** 5.0 Trauma Center Fund Transfer 3.9 Aerospace Supplier Cluster Grant Fund Balance 2.5 Office of Attorney General Consumer Fund Reversion 1.9 Small Business Grant Fund Balances 1.6 Miscellaneous Other Transfers 4.4 **Total Transfer Adjustments** \$115.9 * Includes \$43.4 million nongeneral fund recovery from higher education.