

Resources

FY 2018 General Fund revenues rose by 6.3 percent, well ahead of the official forecast of 3.4 percent growth, resulting in a revenue surplus of \$555.5 million (including transfers). The gain in net individual income tax and sales tax, about \$618.0 million, was somewhat offset by shortfalls in all other revenue sources. As a result of the higher than anticipated base, FY 2019 tax collections have to grow only 1.5 percent to meet the revenue assumptions included in Chapter 2 of the 2018 Acts of Assembly, Special Session I.

The Joint Advisory Board of Economists (JABE) and the Governor's Advisory Council on Revenue Estimates (GACRE) met as part of the standard Fall Reforecasting process to review updated economic projections as well as actual fiscal year 2018 collections. Consistent with their assessments, year-to-date revenue collections have continued to show strength. Through the first five months of FY 2019, total revenues had increased 3.4 percent, well ahead of the forecast of 1.5 percent growth. As a result, the December Forecast added \$548.2 million over the biennium, \$296.4 million of it in the current year, as a reflection of "cash in the bank." The December Forecast increased the assumed economic growth in FY 2019 to 3 percent, and reduces projected growth to 3.7 percent in FY 2020.

In addition to economic adjustments to the forecast, the adopted budget includes a net total of \$387.3 million associated with enacted legislation, tax relief and other tax policy and technical adjustments. Conformity with the federal Tax Cuts and Jobs Act (TCJA) provides an additional \$1.2 billion in anticipated revenues over the biennium. The majority of this revenue results from limitations on itemized deductions and the increase in the standard deduction at the federal level which will induce more taxpayers to claim the standard deduction on their state returns. To offset the additional anticipated revenues from the TCJA, the General Assembly enacted tax relief legislation which returns to taxpayers approximately \$976.0 million. These actions, when combined with the economic-based revisions to the collection forecast, result in overall projected revenue growth of 3.3 percent in FY 2019 and 5 percent in FY 2020.

In total, adopted amendments to the FY 2018-20 resources contained in Chapter 854 of the 2019 Acts of Assembly (HB 1700) include \$1.57 billion more in general fund resources than that assumed in Chapter 2. The resource adjustments reflect (1) a net balance adjustment of \$609.2 million; (2) a \$935.5 million increase in the general fund revenue forecast; and (3) transfer additions of \$22.9 million.

As adopted, the amendments contained in Chapter 854 leave an unappropriated balance of \$7.6 million at the close of the FY 2020.

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

| | <u>Chapter 2</u> | <u>Revised</u> | <u>Difference</u> |
|--|-------------------|------------------|-------------------|
| Unrestricted Balance (June 30, 2018) | \$212.2 | \$1,229.9 | \$1,017.8 |
| Balance Adjustments | 21.5 | (387.1) | <u>(408.6)</u> |
| Net Adjustments to Available Balance | | | \$609.2 |
| Chapter 2 Revenue Estimate | \$41,149.8 | | |
| GACRE/Economic Forecast Adjustments | | 548.2 | 548.2 |
| Legislation and Tax Policy Adjustments | | 390.1 | 390.1 |
| Technical Adjustments | | <u>(2.8)</u> | <u>(2.8)</u> |
| Chapter 854 Revenue Estimate* | | \$42,085.3 | \$935.5 |
| Transfers | <u>\$ 1,252.0</u> | <u>\$1,274.9</u> | <u>\$ 22.9</u> |
| Net Change to GF Resources | | | \$1,567.6 |

*Including tax policy adjustments.

Net Balance

A series of technical balance adjustments are required to align the Chapter 854 balance with the FY 2018 year-end Comptroller's report. These also reflect restricted balances made available for appropriation to the Revenue Cash Reserve, Revenue Stabilization Fund and the Water Quality Improvement Fund, as well as FY 2018 discretionary balances that are reverted to the general fund in Chapter 854 (see table at end of section).

Changes in Revenue

The economic growth in the adopted budget assumes personal income, wage and salary income growing at about a 4 percent to 4.5 percent pace over the forecasted horizon, while employment is forecast to increase 1.7 percent in FY 2019 – faster than the 1.4 percent increase in FY 2018. Overall, Virginia's economy is expected to mirror national trends in job growth and have slightly softer growth in wages. Projected growth rates, before policy adjustments, are now estimated at 3 percent in FY 2019 and 3.7 percent in FY 2020 in comparison to the growth rate assumptions of 3.7 percent and 3.9 percent, respectively, in Chapter 2.

Economic Variables Assumed In Forecast
Percent Growth Over Prior Year
(December Forecast)

| | <u>FY 2019</u> | | <u>FY 2020</u> | |
|------------------|----------------|-------------|----------------|-------------|
| | <u>VA</u> | <u>U.S.</u> | <u>VA</u> | <u>U.S.</u> |
| Employment | 1.7% | 1.6% | 1.1% | 1.3% |
| Personal Income | 4.1% | 4.4% | 4.8% | 4.9% |
| Wages & Salaries | 4.3% | 4.6% | 4.2% | 4.8% |

Tax Policy Changes Assumed in Revenue Forecast

Embedded in the budget are revenues associated with a number of tax policy changes adopted by the General Assembly. It assumes \$1.2 billion in additional revenues from conformity with the federal Tax Cut and Jobs Act of 2017 (TCJA). These revenues are offset by a reduction in revenues of \$976.0 million GF resulting from tax relief legislation enacted during the 2019 General Assembly Session. Also embedded in the revenue estimate is \$107.5 million GF from reinstating the Pease Limitation in taxable year 2019, \$82.5 million GF from legislation authorizing collection of additional sales tax from internet retailers, and a one-time cost of \$27.2 million to increase the threshold for retailers required to participate in the Accelerated Sales Tax (AST) collection program to \$10.0 million in FY 2020. In total, including technical adjustments, tax policy changes increase anticipated revenues by \$390.1 million. Changes are detailed below.

Tax Policy and Revenue Amendments

(\$ in millions)

| | <u>2018-20</u> |
|---|----------------|
| Revenue Amendments: | |
| Conformity with Federal Tax Cuts and Jobs Act | \$1,205.3 |
| Tax Relief Legislation | (976.0) |
| Deconform from Pease Limitation | 107.5 |
| Wayfair Internet Sales Tax | 82.5 |
| Increase AST Threshold to \$10 million | (27.2) |
| Reduced Tax Rate on Personal Hygiene Products (HB 2540) | (1.6) |
| Transferability of Port Tax Credits (SB 1652) | (0.5) |
| Sunset Telework Tax Credit (HB 2065) | <u>0.1</u> |
| Total Revenue Adjustments | \$390.1 |

Conformity with Federal Tax Cut and Jobs Act (TCJA) of 2017. The TCJA is assumed to generate a total of \$1.2 billion in additional revenues over the biennium. This includes ongoing revenues of \$76.9 million in FY 2019 and \$177.5 million in FY 2020 from portions of the Act which are permanent – primarily those relating to changes to business and international tax provisions. Also included is \$517.3 million in FY 2019 and \$433.6 million in FY 2020 relating to adjustments to personal income tax provisions which are set to expire after TY 2025 under the TCJA. Most Virginians will see either a net decrease or no change in their combined federal and state tax liability as a result of the federal Tax Cuts and Jobs Act (TCJA). However, many taxpayers who save on federal taxes may owe more on their state returns. This is primarily because of limitations on itemized deductions and the increase in the standard deduction at the federal level will induce more taxpayers to claim the standard deduction on their state returns. Under Virginia law, taxpayers are required to claim the same type of deduction (standard or itemized) on their Virginia returns.

Income Tax Relief. In response to the anticipated increase in revenues attributable to the TCJA, the General Assembly enacted income tax relief legislation in Chapters 17 and 18 of the 2019 Acts of Assembly (HB 2529/SB 1372) that reduces expected general fund revenues by \$976.0 million. The package of tax reforms provide for an individual income tax refund, not to exceed a taxpayer's tax liability of up to \$110 for individuals and \$220 for married persons filing a joint return. The refund will be issued in October 2019 and will be available for a taxpayer filing a final return by July 2019. The legislation also provides individual income tax relief by raising the Virginia standard deduction from \$3,000 to \$4,500 for single filers and from \$6,000 to \$9,000 for married/joint filers and by deconforming from the \$10,000 limitation on state and local tax deductions imposed at the federal level. Both of these provisions are effective with taxable year

2019. In addition, business taxpayers will benefit from provisions in the legislation that (i) provide a deduction for 20 percent of net interest expenses that are newly disallowed under the TCJA, and (ii) provide a deduction for the new classification of foreign income defined in the TCJA as global intangible low-taxed income (“GILTI”).

Pease Limitation. In addition to the provisions of Chapters 17 and 18 outlined above, the reduction in revenues is partially offset by imposing an overall limitation on the amount of itemized deductions that high-income taxpayers may claim on their Virginia tax returns. The provision known as the Pease limitation existed in federal tax law until suspended by the TCJA beginning in tax year 2018. By deconforming with this provision of federal law, Virginia will reinstate the limitation beginning in tax year 2019 resulting in a positive revenue impact of \$107.5 million in fiscal year 2020. Budget language directs this additional revenue to be deposited to the Revenue Cash Reserve Fund to be used for additional future tax relief.

“Wayfair” Internet Sales Tax Collections. The adopted budget includes a total of \$82.5 million in general fund revenues over the biennium as a result of enacted legislation, Chapters 815 and 816 of the 2019 Acts of Assembly (HB 1722/SB 1083), expanding the remote seller sales tax nexus provisions. A decision by the Supreme Court in the case *Wayfair v. South Dakota* released this past year authorizes states to require retailers to collect sales taxes owed even when the retailer has no physical presence in that jurisdiction. In total, authorizing this change in Virginia is anticipated to generate \$155.0 million in FY 2020. Of that amount, \$82.5 million will accrue to the general fund – inclusive of both the unrestricted amount and the share dedicated to K-12 pursuant to the *Code of Virginia* – and the remainder will be distributed under the existing sales tax distribution requirements to transportation, localities, and the regional transportation authorities. This legislation also repeals provisions of Chapter 766 of the 2013 Acts of Assembly which would dedicate these internet sales tax revenues to transportation.

Increase Accelerated Sales Tax Threshold. Chapter 854 retains the current \$4.0 million taxable sales threshold for remittance of the June accelerated sales tax in FY 2019 and increases the threshold to \$10.0 million in FY 2020. This is expected to remove 1,800 businesses from the AST requirement and result in a one-time revenue reduction of \$27.2 million in the second year. The language authorizing the change to the provisions is included in Part 3 of the adopted budget.

Finally, technical adjustments reduce projected revenues by \$2.8 million, including a reduction of \$3.4 million by eliminating the revenues assumed to accrue to the Commonwealth from the utility rate credit, offset by an assumed revenue increase of \$617,000 generated by increasing tobacco staffing in Northern and Southwest Virginia.

Overall Changes in GF Revenues by Source

When adopted tax policy changes and technical adjustments are added to the economic forecast revisions, the projected revenue growth rates are 3.3 percent in FY 2019 and 5 percent in FY 2020.

| Change in GF Taxes by Source Compared to Chapter 2 | | | | |
|---|-------------------------|----------------------|-------------------------|----------------------|
| (\$ in millions) | | | | |
| | <u>Estimated</u> | <u>Annual</u> | <u>Estimated</u> | <u>Annual</u> |
| | <u>FY 2019</u> | <u>Growth</u> | <u>FY 2020</u> | <u>Growth</u> |
| Net Individual | \$237.8 | 2.2% | \$406.3 | 5.8% |
| Corporate | 100.2 | 17.4% | 104.4 | 1.8% |
| Sales | 43.8 | 3.7% | 104.3 | 3.9% |
| Insurance | 18.7 | 17.0% | 12.7 | 3.8% |
| Recordation | (38.6) | (6.7%) | (38.6) | 0.0% |
| All Other | <u>(6.9)</u> | <u>3.0%</u> | <u>(8.6)</u> | <u>2.0%</u> |
| Total GF Revenues | \$355.0 | 3.3% | \$580.5 | 5.0% |

Changes in Transfers and Balance Adjustments

A series of technical balance adjustments are required to align the Chapter 2 balance with the FY 2018 year-end Comptroller’s report. Adjustments to the beginning balance reflect year-end assets, including the larger than anticipated FY 2018 revenues and agency balances, and then withdraw funds pending distribution and redeposit restricted funds, like the Revenue Stabilization and Lottery Proceeds funds. Adjustments to the balance reflect the commitment of general funds with mandatory carry-forwards, like the Water Quality Improvement Fund and the Revenue Cash Reserve. Also included is \$262.9 million for the FY 2020 Revenue Stabilization Fund reserve, \$235.2 for the FY 2019 Cash Reserve deposit, and \$73.8 million for the FY 2020 WQIF deposit. It also reflects \$76.8 million FY 2018 discretionary balances, 16.6 million in balances set aside for Hurricane Florence, and other carryforwards that are reverted in the adopted budget.

Net transfer adjustments total \$22.9 million in Chapter 854 and includes \$44.0 million in increased transfers offset by transfer reductions of \$21.1 million over the biennium. The largest increases derive from adjustments to the sales tax forecast for the 0.375 percent of sales tax transferred to the general fund for K-12. This includes an adjustment of \$7.0 million to the base sales tax forecast as well as \$10.3 million attributable to the adoption of legislation authorizing expanded collection of sales tax from internet retailers. Notable downward adjustments relate to decreases intended to backfill revenues lost from legislation to be proposed to the 2019 General

Assembly relating to driver’s license reinstatement fees totaling \$9.0 million over the biennium as well as adjustments to assumed revenues generated from court debt collections (reduction of \$2.2 million), unrefunded marine fuels (\$5.2 million), and the Integrated Drug Enforcement (IDEA) Fund (\$3.0 million). The remaining transfer and balance adjustment items are outlined in the table below.

| Changes to Transfers and Balances Compared to Chapter 2 | |
|--|------------------|
| (\$ in millions) | |
| | <u>2018-20</u> |
| Unrestricted Balance: | |
| Unrestricted Fund Balance, Comptroller’s August Report | \$1,229.9 |
| Balance Reflected in Chapter 2 | <u>212.2</u> |
| Adjustment Needed to Restate Unrestricted Balance | \$1,017.8 |
| Adjustments to the Unreserved Balance: | |
| Chapter 2 Balances | \$21.5 |
| Revenue Cash Reserve | (390.8) |
| Re-appropriate Capital Projects | (7.2) |
| Virginia Health Care Fund (NGF) | (30.2) |
| Central Capital Planning Fund (NGF) | (2.8) |
| Local Communications Sales & Use Tax (NGF) | (34.0) |
| Commonwealth Development Opportunity Fund | (27.4) |
| Natural Disaster Sum Sufficient | (81.8) |
| Mandatory GF Reappropriation | (77.0) |
| Virginia Water Quality Improvement Fund (NGF) | (93.1) |
| Economic and Technology Development | (78.7) |
| Health and Public Safety | (57.1) |
| Environmental Quality and Natural Resource Preservation | (17.5) |
| Other Committed and Assigned | (18.1) |
| Discretionary Re-appropriations | (163.9) |
| Miscellaneous Other Adjustments | (2.5) |
| Appropriate 2019 Revenue Reserve | 235.2 |
| Appropriate 2020 Rainy Day Fund Reserve | 262.9 |
| Appropriate 2020 WQIF Part A and B Deposits | 73.8 |
| Add Reverted Discretionary Balances | 76.8 |
| Hurricane Florence Set Aside | 20.3 |
| DMAS Carryforward | <u>4.6</u> |
| Net Balance Adjustments | (\$387.1) |
| Transfers: | |
| OAG Transfer Wells Fargo and Uber Settlements | \$14.0 |
| ABC Profits | 10.3 |

Changes to Transfers and Balances Compared to Chapter 2
(\$ in millions)

| | <u>2018-20</u> |
|--|----------------|
| Wayfair Sales Tax Forecast Adjustment (0.375 cents for K-12) | 10.3 |
| Base Sales Tax Forecast Adjustment (0.375 cents for K-12) | 7.0 |
| ABC Sunday Operating Hours | 0.9 |
| Court Debt Collection | (2.2) |
| Unrefunded Marine Fuels | (5.2) |
| NGF Indirect Costs | (2.8) |
| IDEA Fund Transfer | (3.0) |
| Trauma Center Fund Transfer | (6.2) |
| Reduce OAG Revolving Trust Transfer to GF | (1.0) |
| Increase ABC Distiller Commission | (0.7) |
| Miscellaneous Other Transfers | <u>1.5</u> |
| Total Transfer Adjustments | \$22.9 |