The Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: the general fund, and nongeneral funds. Over half of state revenues are "nongeneral funds," or funds earmarked by law for specific purposes. For example, motor vehicle and gasoline taxes are earmarked by law for transportation programs, student tuition and 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 are derived primarily from five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are public service gross receipts/consumption taxes, corporate income taxes, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

Broad-based strength in fiscal year 2004 revenue collections

In fiscal year 2004, total general fund revenues rose by 9.7 percent to $11,917.9 million. Growth surged above projected levels in the fourth quarter, growing at almost double the pace of the first three quarters.

The strength in revenue collections was broad-based. All five major sources exceeded their respective forecasts and collectively ended the year with a surplus of $270.4 million.

Miscellaneous taxes and other revenues ended the year $53.4 million above the estimate. The bulk of the surplus was due to higher-than-expected collections of wills, suits, deeds and contract fees, which are primarily recordation taxes, and estate taxes.

General fund revenue forecast reflects continuing expansion and tax reform package

The general fund revenue forecast for the 2004-2006 biennium reflects both the economic expansion in Virginia and the impacts of the recently enacted tax reform package.

In December 2003, Governor Warner announced his proposed tax reform legislation. After many months of debate during the 2004 regular and special sessions of the General Assembly, House Bill 5018 was passed by the General Assembly and signed by Governor Warner. This bill substantively changed Virginia's income, sales, corporate, tobacco, and recordation tax laws.

Throughout this explanation of the general fund revenue forecast, monetary changes and growth rates are presented both pre- and post-tax reform. As such, the revenue forecast can be examined on the basis of changes strictly to the baseline (mainly economic-based) and the separate impact of tax reform.

Baseline general fund tax revenues are expected to increase by 5.9 percent in fiscal year 2005 and 5.2 percent in fiscal year 2006. Adjusting for tax reform, general fund revenues are expected to increase 8.2 percent in fiscal year 2005 and 4.3 percent in fiscal year 2006.

Forecast for the major general fund revenue sources

For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2004 and the forecast for the next two fiscal years:

The general fund forecast for the 2004-2006 biennium

	Fiscal Year 2004	2004-2006 biennium	
	Actual	*Forecast*	*Forecast*
	2004	**2005**	**2006**
Major tax sources			
Corporate income	$425.7	$479.0	$497.2
Individual income	7,384.9	7,867.7	8,319.0
Insurance premiums	351.3	381.0	413.7
Public utility	86.9	87.4	88.6
State sales & use	2,562.3	2,938.0	3,021.2
Miscellaneous	1,106.8	1,140.1	1,102.1
Total revenues	11,917.9	12,893.2	13,441.8
Transfers			
ABC Profits	16.8	15.1	19.8
Lottery Profits	407.8	423.5	441.8
Transfers per the Appropriation Act	588.2	297.5	378.4
Total general fund	**$12,930.7**	**$13,629.3**	**$ 14,281.8**

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

Individual income taxes

Net individual income tax receipts of $7,384.9 million exceeded the official estimate by $149.5 million in fiscal year 2004. Individual income tax receipts increased by 9.0 percent over the previous year.

The upswing in job growth and a surge in nonwithholding payments drove the strong growth in this source.

Over the forecast horizon, withholding is expected to grow at rates consistent with an expanding economy. In addition, a generally stronger business environment should lead to gains in nonwithholding collections.

Baseline growth in individual is expected to be 6.3 percent in fiscal year 2005 and 6.4 percent in fiscal year 2006. Adjusting for tax reform, growth is projected to be 6.5 percent and 5.7 percent in fiscal years 2005 and 2006 respectively.

Sales and use taxes

Sales and use tax collections increased by 9.7 percent in fiscal year 2004, $55.1 million ahead of the forecast. Removing the effects of the accelerated collections, growth in sales and use tax collections was 10.1 percent, the fastest annual growth in this source since fiscal year 1985.

Tax reform will affect collections from this source in several ways. The sales tax on non-food items increased one-half percent effective September 1, 2004. Half of this increase will be deposited into a special fund and half will be deposited to the general fund. The additional general fund revenues from this increase, along with the additional revenue generated by the repeal of the sales tax exemption for public service corporations, will offset a one and one-half percent reduction in the sales tax on food that will be phased in over three years. Baseline growth in sales tax collections is expected to be 6.0 percent in fiscal year 2005 and 5.5 percent in fiscal year 2006. Adjusted for tax reform, collections of sales and use taxes are expected to increase by 14.7 percent in fiscal year 2005 and 2.8 percent in fiscal year 2006.

Corporate income taxes

The corporate income tax is the most volatile of Virginia's revenue sources and tends to be even more sensitive to the business cycle than personal income taxes.

Corporate income tax collections have been difficult to forecast due to: (1) the tenuous link between profits and tax liability, (2) Virginia's profit/loss carry-forward, carry-back provisions, and (3) the varying time lag between the booking of profits and the payment of taxes. In addition, large fluctuations are often caused by payments from, or refunds to, a few large corporations.

Corporate income tax collections were $425.7 million in fiscal year 2004.

Corporate income tax receipts were much stronger than anticipated in fiscal year 2004 and collections through the first quarter of fiscal year 2005 are up about 8 percent. Estimated payments are higher than the same period last year, and refunds are lower. The markedly improved business climate should support higher growth in this source. The forecast changes baseline growth in corporate receipts to a 4.5 percent in fiscal year 2005. Growth in fiscal year 2006 was raised from 4.1 percent to 6.7 percent.

General fund revenues show typical recovery

Percent change over previous year

Data for 2005 and 2006 are forecasts. Source: Department of Taxation

Tax reform will also affect collections in this source. The closing of corporate loopholes regarding intangible and interest expenses is expected to increase revenue by about $30 million a year. Adjusting for tax reform, growth in corporate income tax collections is expected to be 12.5 percent in fiscal year 2005 and 3.8 percent in fiscal year 2006.

Public service gross receipts / consumption taxes

Collections from this source are expected to be relatively flat over the forecast horizon, assuming somewhat normal weather patterns.

Insurance company premiums taxes

Tax collections on insurance company premiums exceeded the forecast by $3.5 million in fiscal year 2004. Increasing home values buoyed collections in this source.

Collections of insurance premiums taxes are anticipated to be 8.5 percent in fiscal year 2005 and 8.6 percent in fiscal year 2006.

Miscellaneous taxes and other revenue

Miscellaneous taxes and other revenues exceeded projections by $53.4 million in fiscal year 2004. Most of the surplus was the result of higher-than-anticipated collections of fees on wills, suits, deeds and contracts (mainly the recordation fee charged on home financing activities) and estate tax collections.

Tax reform included an increase in the recordation tax rate to 25 cents (up from 15 cents) per hundred dollars of value of the instrument recorded, effective September 1, 2004. This is expected to raise revenue in this source by about $150 million a year, making this the fourth largest revenue source.

Over half of state revenue is non-general fund revenue

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

Nongeneral fund revenue is expected to increase by 13.4 percent in 2005, and by 4.3 percent in 2006. Nongeneral funds will comprise about 56.0 percent of total state revenue during the 2004-2006 biennium.

Federal grants

Federal grants are the largest source of nongeneral fund revenue, comprising more than 40 percent of the total.

Frequently federal 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 2004, federal grants and contracts totaled $5.9 billion. This source is projected to increase by 9.5 percent to $6.5 billion in 2005, and by 8.4 percent to $7.0 billion in 2006. About one-third of all federal revenue is attributed to the Medicaid program.

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. In 2004, institutional revenue collections were $3.3 billion, about 23 percent of all nongeneral fund revenue. Institutional revenues are projected to grow by 13.0 percent to $3.8 billion in 2005 and then decline by 2.5 percent in 2006. These growth rates are affected by the expected receipt of one-time funding in 2005 for capital projects.

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.

Commonwealth transportation revenues from state taxes and fees amounted to $2.1 billion in 2004, an increase of $133.2 million over the prior year. Total collections ended $75.9 million, or 3.7 percent above the official forecast.

The nongeneral fund forecast for the 2004-2006 biennium*

	Actual 2004	Forecast 2005	Forecast 2006
Motor vehicle fuel tax	$908.8	$935.8	$957.1
Unemployment compensation payroll tax	362.1	522.7	581.8
Special highway tax from sales tax	415.0	437.6	463.4
Motor vehicle sales and use tax	597.2	613.1	625.1
Other taxes	90.4	81.0	81.6
Rights and privileges	674.9	760.0	769.1
Sales of property and commodities	449.3	469.8	498.9
Institutional revenue	3,342.1	3,777.5	3,683.9
Interest dividends and rents	50.5	54.8	67.2
Federal grants and contracts	5,925.0	6,485.7	7,029.8
Master Tobacco Settlement Agreement Funds	77.0	126.2	127.8
Public Ed. SOQ/Local Real Estate Property Tax Relief Fund	0.0	158.1	221.3
Taxes on Tobacco Products	0.0	113.0	210.5
Other revenue	1,595.8	1,889.5	1,805.9
Total	**$14,488.0**	**$16,424.9**	**$17,123.4**

*Based on December 2004 forecast. Dollars in millions. Figures may not add due to rounding. Total excludes balances and bond proceeds available for appropriation, as well as Lottery, Literary, and internal service funds.

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

Fiscal year 2004 growth of 6.7 percent in Commonwealth Transportation Fund (CTF) revenues was the highest growth rate in the CTF since fiscal year 1994 and more than double the average growth rate of 3.3 percent for the previous fifteen years. The official forecast was based on an economic scenario of gradually accelerating growth. Despite the continued sluggishness in national employment growth, the job market in Virginia surged over the second half of fiscal year 2004. The flurry of economic activity in the Commonwealth resulted in stronger than anticipated growth in motor fuel consumption, vehicle sales, and retail sales.

For fiscal years 2005 and 2006, total fund revenues from state sources are expected to be about $2.2 billion per year. These amounts are equal to annual growth of 2.8 percent and 2.6 percent respectively.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be higher each year of the biennium, reflecting higher wage and employment growth and continuation of the existing fund balance factor (solvency level) that governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2005, unemployment tax collections are expected to increase to $522.7 million from actual collections of $362.1 million in 2004. For 2006, revenues are anticipated to increase to $581.8 million, an increase of 11.3 percent over 2005.

Master Tobacco Settlement Agreement Funds

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 46 states, the District of Columbia, and 5 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 60 percent of the 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 Virginia Tobacco Settlement Fund receives the next 10 percent of the MSA allocation for the purposes of discouraging, eliminating, or preventing the use of tobacco products by minors and for health care. Programs targeted at minors include but are not limited to educational and awareness programs on the health effects of tobacco and on laws restricting the distribution of tobacco products to minors.

For fiscal years 2005 and 2006, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive $63.1 million and $63.9 million, respectively. The Virginia Tobacco Settlement Fund will take in $12.6 million and $12.8 million over the same period.

The remaining 40 percent share of the MSA funds had been deposited to the general fund of the state treasury. Beginning in 2005, this 40 percent share will be deposited to the newly created Virginia Health Care Fund, which will be used to fund the Medicaid program in the 2004-2006 biennium. Collections are anticipated to be $50.5 million for 2005 and $51.1 million for 2006.

Virginia Health Care Fund

In addition to 40 percent of the MSA funding, the Virginia Health Care Fund will receive revenue from the taxation of tobacco products and Medicaid cost recovery settlements. Taxes on tobacco products are expected to generate $113.0 million in 2005 and $221.3 million in 2006. This revenue source was increased by the tax reform legislation passed by the 2004 General Assembly and it was earmarked for the Health Care Fund. Previously, the tax on cigarettes was deposited to the general fund of the Commonwealth.

Public Education Standards of Quality/Local Real Estate Property Tax Relief Fund

The sales and use tax on non-food items was increased by one-half percent effective September 1, 2004. Half of this increase is being deposited to a newly created nongeneral fund account (Public Education SOQ / Local Real Estate Property Tax Relief Fund) to help pay for public education in the Commonwealth and relieve the real property tax burden at the local government level. For 2005, this source is projected to amount to $158.1 million. For 2006, it is expected to raise $210.5 million.