COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: April Revenue Report

Year-over-year, general fund revenues declined by 8.2 percent in April and are down 0.9 percent fiscal year-to-date. The decline was mainly due to a 9.4 percent drop in volatile non-withholding revenues that are associated with capital gains realizations. The April decline, however, was less than anticipated. Overall, in comparison to the updated December forecast ("the Forecast"), unadjusted general fund revenues are ahead of forecast by $497.4 million year-to-date, and ahead of revenues assumed in the amended 2022 Appropriation Act by $1.8 billion year-to-date. Throughout the remainder of this memorandum, all revenue comparisons will be with the updated Forecast.

Adjusting for policy actions and timing issues to better reflect underlying economic trends, general fund revenues were 2.7 percent higher in the first ten months of Fiscal Year 2023, compared to the same period of the previous year. For April, adjusted general fund revenues fell by 14.6 percent compared to April 2022.

April is the most significant revenue collection month in the fiscal year. In addition to the typical withholding and sales tax collections, final and estimated payments for individuals, insurance companies, and most corporations are remitted. April also marks the peak month for individual income tax refund processing. This year was also the first year of final collections for the new Pass-Through Entity Tax (PTET).

Revenues from non-withheld income are running well ahead of forecast. For April, non-withholding fell by a relatively small 9.4 percent. This was partly due to timing issues. Since the

PTET filing deadline of April 17 preceded the income tax filing deadline of May 1, some of the revenues that would typically have been received in May were shifted into April. Early indications are that May non-withholding collections, while lower than last year, are better than anticipated.

Offsetting some of the strength in non-withholding, refunds totaled $688 million in April, about $113 million higher than anticipated in the Forecast. Among other major sources, withholding revenue was somewhat lower than expected, while sales tax revenue continued to come in below expectations. As indicated in prior reports, shifting consumer patterns away from taxable goods, along with weaker overall consumption, have contributed to a larger than anticipated decline in this source of revenue. Overall collections from other sources of revenues generally exceeded the Forecast as discussed in more detail in the following sections.

Economic Review

- Real GDP growth slowed to 1.1 percent for the first quarter of the calendar year driven by large declines in inventory accumulation.

- Earlier estimates of an economic downturn and a reversal of recent interest rate hikes have generally been pushed out two to three quarters compared to the Forecast.

- Payroll gains in April exceeded expectations although the overall labor picture points to significant cooling. April job gains totaled 253,000 but the two prior months experienced substantial downward revisions. The three-month average of 222,000 for 2023 is considerably lower than the 284,000 three-month average for 2022.

- The CPI fell below 5.0 percent for the first time in two years. Some of the components of the CPI and the Fed’s preferred measure of inflation remain elevated.

- For the tenth consecutive meeting, the Fed opted to raise its target rate for fed funds rate, bringing the upper bound to 5.25 percent. The Fed’s May statement suggested that this could be the last increase during the current tightening cycle.

- The debt limit impasse is likely to come down to the wire with the outcome of negotiations highly uncertain.

- Bank lending standards have tightened considerably, with this level of tightening comparable to that seen during the 2001 recession.

- Virginia’s employment growth has slowed from 5 percent at the beginning of the year to a current rate of 2.7 percent.

April Revenue Collections

Through the first ten months of the fiscal year, adjusting for policy actions and timing issues, general fund revenues were up 2.7 percent. On an unadjusted basis, general fund revenues were down 0.9 percent versus the projected 8.8 percent decline assumed in the Forecast.

Net Individual Income Tax (67% of general fund revenues): After adjusting for policy and timing issues, on a fiscal-year-to-date basis, net individual income tax payments declined 14.6 percent. Unadjusted revenues fell by 13.4 percent on a monthly basis and were down 4.0 percent year-to-date. This was mainly due to the $1.06 billion in tax rebates issued this year along with the 9.4 percent decline in non-withholding. Performance in each component of individual income tax is as follows:

> ***Individual Income Tax Withholding (61% of general fund revenues)***: Collections of payroll withholding taxes were 2.5 percent higher for the month on an unadjusted basis. Fiscal-year-to-date, collections are 7.6 percent higher than the same period last year after adjustments, and 4.3 percent on an unadjusted basis. Through April, collections are trailing projections by $71.3 million. The slowdown that has occurred in withholding growth since the beginning of the year is slightly more pronounced than anticipated in our economic and revenue Forecast which calls for 4.8 percent growth in FY 2023 on an unadjusted basis. However, given the monthly volatility in this revenue source, the higher than anticipated decline is still within a margin of error to meet the year-end Forecast.
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> ***Individual Income Tax Non-withholding (19% of general fund revenues)***: April is a significant month for collections in this source as individuals and partnerships remit both their final and quarterly estimated payments. Non-withholding receipts surprised to the upside in April. PTET income tax returns were due on April 17 this year as opposed to the individual income tax filing deadline of May 1, pushing approximately $413 million into April that was received in May last year. After adjusting for the newly enacted PTET, collections are running 2.5 percent higher fiscal year-to-date. Fiscal year-to-date through April non-withholding collections are $602.1 million higher than projected.
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> ***Individual Income Tax Refunds (-13% of general fund revenues)***: Through April, the Department of Taxation has issued over $3.2 billion in refunds compared with $1.5 billion over the same period last year. Most of the increase is attributable to the $1.06 billion in taxpayer rebates along with the increased standard deduction, the expansion of the earned income tax credit (EITC) and the military retirement subtraction. Adjusting for these tax policy changes, income tax refunds increased 36.9 percent fiscal-year-to-date, $124.1 million higher than projected.

Sales Tax (19% of general fund revenues): Collections of sales and use taxes, reflecting March sales, increased by 1.5 percent in April and are up 4.0 percent year-to-date, after adjusting for the termination of the Accelerated Sales Tax (AST) program and the elimination of the State sales tax on grocery. Unadjusted sales tax collections are 7.2 percent higher year-to-date, trailing projections by $116.9 million. The continuing shift in consumption from taxable goods to non-taxable services is likely dampening sales tax revenue growth more than anticipated.

Corporate Income Tax (7% of general fund revenues): Corporate income tax collections surprised on the upside, growing 20.6 percent for the month of April. On a year-to-date basis, collections of corporate income taxes are 1.1 percent higher compared to the previous year, and ahead of projections by $103.8 million. There are no policy actions impacting revenue collections.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 42.0 percent lower in April compared to the previous year. On a fiscal-year-to-date basis, collections are down 35.3 percent as higher interest rates have sharply curtailed residential and commercial property sales and mortgage refinancing.

Insurance Premiums (2% of general fund revenues): Monthly collections of insurance company premiums were up 3.4 percent compared to the previous year. On a fiscal year-to-date basis, insurance company premiums are up 9.0 percent.

Other Revenue Sources

The following list provides growth data on collections through April for other revenue sources:

	Year-to-Date	Annual Estimate
Interest Income (0.8% GF revenues)	*285.1%*	*190.4%*
ABC Taxes (1% GF revenues)	*1.5%*	*3.6%*

Interest income has more than tripled through April compared to the previous year, totaling $310.5 million in the first ten months of the year compared to the full year Forecast of $222.6 million. Periodically, interest revenue is transferred to non-general fund agency accounts, which was the case in the month of April. These transfers resulted in an offset against general fund interest income for the month.

All Other Revenue (2% of general fund revenues): On a year-to-date basis, collections of All Other Revenue rose 20.6 percent to $422.2 million fiscal year-to-date compared with $350.1 million a year ago.

Summary

General Fund revenues declined year-over-year in April, but the decline was less than expected. Year-to-date collections are now running ahead of projections by $497.4 million, mainly due to higher than anticipated non-withholding revenue. Among other major sources, sales tax collections are trailing projections while it is still too early to tell whether withholding will meet the year-end Forecast. Revenues from all other sources generally exceed the Forecast. Additionally, there has also been a significant shift in income tax revenues due to the new optional PTET tax. Because this is the first year of implementation of this tax, the final liability will only be known in Fiscal Year 2024. Given the positive revenue impact of a stronger economy relative to the economic scenario included in the Forecast and positive non-withholding impact of timing issues associated with the implementation of PTET, it is anticipated that the year-to-date excess revenues may be largely offset by reductions to FY 2024 collections.