

GENERAL FUND REVENUE

FY 2024

FY 2024 Baseline General Fund revenues are projected to be \$16.92 billion. This is a decrease of \$(907.9) million compared to the original revenue estimate included in the FY 2024 budget enacted in May 2023.

The reduced revenue amount is the result of:

- A decrease of \$(891.6) million in net revenues due to lower levels of collections than originally projected.
- The cost of the individual income tax rebate program being \$(13.1) million higher than assumed in the enacted budget.
- A \$(3.2) million decrease in the balance forward from FY 2023. The original budget assumed an ending balance of \$2.530 billion for FY 2023 while the actual balance carried forward was \$2.527 billion.

The starting point for developing the Baseline net revenue forecast for the current fiscal year and the next 3 fiscal years is a consensus forecasting process known as the "4-sector" approach. Under this approach, the projected Baseline growth rates for the "Big 3" revenue categories of sales, individual income, and corporate income taxes are produced by averaging the results of the following 4 forecasts:

- Finance Advisory Committee panel forecast of January 2024. Consisting of 11 public and private sector economists, this independent panel usually meets 3 times a year to provide the Legislature with guidance on the status of the Arizona economy.
- The University of Arizona Economic and Business Research (EBR) General Fund Baseline model. The model is a simultaneous-equation model consisting of more than 100 equations that are updated on a regular basis to reflect changes in the economy. The model uses more than 200 variables related to Arizona's economy and is updated quarterly.
- EBR's more cautious forecast model, and
- JLBC Staff projections.

The projected net revenue growth rates from each sector of the forecast for FY 2024 through FY 2027 are displayed in *Table 1*.

"Net Revenue" includes the impact of the phase-in of the 2.5% single individual income tax rate along with other previously enacted tax legislation but excludes Urban Revenue Sharing and one-time revenue adjustments.

Year to date through December, net General Fund revenue is down by (8.5)% compared to the same period in FY 2023 and is \$(488) million below the enacted budget forecast.

Under the 4-sector average forecast, net revenue is projected to decline by (1.8)% for all of FY 2024, as shown in *Table 1*. In dollar terms, a (1.8)% decline would result in a FY 2024 revenue loss of \$(622) million relative to the enacted budget. This means that since the year-to-date forecast loss through December is \$(488) million, the 4-sector forecast could only withstand an additional forecast loss of \$(134) million over the next 6 months of FY 2024.

Compared to the 4-sector, the JLBC-only sector has a (3.4)% revenue decline in FY 2024 (*see Table 1*). Under this forecast, net revenue would decrease by \$(905) million relative to the enacted budget. In developing the January Baseline, we have used the JLBC sector in FY 2024 to provide a greater "margin of error."

FY 2025 and Beyond

While the JLBC Staff forecast was used to develop the FY 2024 Baseline forecast, the FY 2025 to FY 2027 projected revenue levels were based on the average forecast of the 4 sectors.

As previously noted, under the January Baseline, total net General Fund revenue, which includes the impact of previously enacted tax legislation, Urban Revenue Sharing, one-time revenue adjustments and the beginning balance, is projected to be \$16.92 billion in FY 2024. The corresponding amount under the Baseline's FY 2025 forecast is \$15.39 billion, which is (9.0)%, or \$(1.53) billion, below the level in FY 2024. Net ongoing revenue, which excludes Urban Revenue Sharing, one-time revenue adjustments, and the beginning balance, is projected to grow by 2.6% under the January Baseline forecast relative to the FY 2024 level.

The FY 2025 Baseline also incorporates revenue planning estimates for FY 2026 and FY 2027, which are shown in *Table 4*. Under the January Baseline, net ongoing revenue would increase by 4.1% in FY 2026 and 4.7% in FY 2027.

The FY 2025 through FY 2027 growth rates from each of the 4 sectors of the forecast are listed in *Table 1* shown on the following page.

Table 1

**4-Sector Estimates
Forecast Percentages (FY 2024 - FY 2027)
Net Revenue ^{1/}**

	FY 2024					FY 2025				
	<u>JLBC</u> ^{2/}	<u>UA</u> <u>Low</u>	<u>UA</u> <u>Base</u>	<u>FAC</u>	<u>Avg</u>	<u>JLBC</u>	<u>UA</u> <u>Low</u>	<u>UA</u> <u>Base</u>	<u>FAC</u>	<u>Avg</u>
Sales Tax	2.7%	1.3%	2.8%	3.3%	2.5%	4.8%	2.2%	4.0%	3.6%	3.7%
Individual Income Tax	(10.5)%	(8.1)%	(6.0)%	(9.8)%	(8.6)%	5.0%	6.8%	7.3%	4.6%	6.0%
Corporate Income Tax	(8.5)%	6.2%	8.7%	3.2%	2.4%	0.0%	1.7%	2.4%	(0.7)%	0.9%
Overall ^{3/}	(3.4)%	(1.7)%	(0.1)%	(1.7)%	(1.8)%	2.8%	2.3%	3.4%	2.1%	2.6%
	FY 2026					FY 2027				
	<u>JLBC</u>	<u>UA</u> <u>Low</u>	<u>UA</u> <u>Base</u>	<u>FAC</u>	<u>Avg</u>	<u>JLBC</u>	<u>UA</u> <u>Low</u>	<u>UA</u> <u>Base</u>	<u>FAC</u>	<u>Avg</u>
Sales Tax	4.6%	4.4%	5.0%	4.8%	4.7%	4.9%	4.6%	4.9%	5.3%	4.9%
Individual Income Tax	4.9%	5.6%	6.2%	5.5%	5.6%	5.4%	5.7%	6.2%	5.3%	5.7%
Corporate Income Tax	3.0%	2.6%	3.6%	6.8%	4.0%	4.5%	3.0%	4.3%	6.2%	4.5%
Overall ^{3/}	3.8%	3.8%	4.4%	4.5%	4.1%	4.6%	4.4%	4.9%	5.0%	4.7%

^{1/} Includes impact of previously enacted tax legislation.

^{2/} Baseline revenue forecast for FY 2024 is solely based on the JLBC Staff sector forecast.

^{3/} The growth rates for each sector represent the weighted average of Big-3 revenue estimates plus JLBC Staff estimates of other revenue categories.

Risks to the Revenue Forecast

While the U.S. economy has proven more resilient than most economists predicted a year ago, there are still several factors that pose risks to the forecast, including potential problems in the banking sector, which first came to light in the spring of 2023, as well as the potential impact of ongoing conflicts in Ukraine and the Middle East on energy prices.

Over a few weeks in the spring of 2023, several relatively well-known regional banks collapsed, including Silicon Valley Bank, Signature Bank and First Republic Bank, resulting in the most significant systemwide banking stress since the Great Recession. Other risks to the banking sector are related to the commercial real estate market. Due to higher interest rates and more vacant office buildings (resulting from more people working from home than previously), there is an increased risk of defaults on loans made by banks to owners of commercial real estate. A wave of defaults could lead financial institutions to severely tighten their lending standards, which would curtail credit expansion. As a result, credit-dependent spending by households and small businesses

could be significantly reduced, which would have an adverse impact on economic activity.

Another risk to the U.S. and global economy is related to current conflicts in Ukraine and the Middle East. If those conflicts worsen, there could be a sharp increase in energy prices, which would have a dampening effect on both consumer spending and business investments.

Revenue Adjustments

Table 2 provides an overview of ongoing net revenue and total revenue growth for FY 2024 and FY 2025. Ongoing net General Fund revenue includes the impact of previously enacted tax legislation, such as the phase-in of the 2.5% single individual income tax rate, but excludes Urban Revenue Sharing, and one-time financing sources. As shown in Table 2, under the January Baseline, ongoing net revenue is projected to decline by (3.4)% in FY 2024,

Table 2				
General Fund Revenue Baseline For FY 2024 and FY 2025 Budget (\$ in Millions)				
	<u>FY 2024</u>	<u>%</u>	<u>FY 2025</u>	<u>%</u>
Net Revenue ^{1/}	\$16,231.5	(3.4)%	\$16,660.7	2.6%
Urban Revenue Sharing	(1,564.8)		(1,268.3)	
One-Time Financing Sources:				
Balance Forward	2,527.2		0.0	
One-Time Income Tax Rebate	<u>(272.9)</u>		<u>0.0</u>	
Subtotal	2,254.3		0.0	
Total Revenue	<u>\$16,921.0</u>	(7.0)%	<u>\$15,392.4</u>	(9.0)%

^{1/} Net revenue represents ongoing General Fund revenue after the impact of previously enacted tax legislation.

followed by an increase of 2.6% in FY 2025. Total revenue, which represents all net General Fund revenue, including Urban Revenue Sharing and one-time financing sources, is estimated to decrease by (7.0)% in FY 2024 and (9.0)% in FY 2025.

Budget Legislation

Each year there are statutory tax law and other revenue changes that affect the state's net revenue collections. These may include tax rate or tax exemption changes, state conformity to federal tax law changes, or the implementation of programs that affect revenue collections.

As noted earlier, the Baseline revenue forecast was prepared on a net revenue basis, which means that the projected revenue levels already reflect the impact of prior tax laws, such as the phase-in of the 2.5% single tax rate. For more details on previously enacted tax legislation, see page 432 in the *FY 2024 Appropriations Report*.

Urban Revenue Sharing

The Urban Revenue Sharing (URS) program provides that a percentage of state income tax revenues (including both individual and corporate income tax) be shared with incorporated cities and towns within the state. Through FY 2023, the amount distributed to cities and towns was 15% of net income tax collections from 2 years prior. Laws 2021, Chapter 412 increases the URS distribution from 15% to 18%, beginning in FY 2024.

As indicated in *Table 3*, total URS distributions will decrease from \$1.56 billion in FY 2024 to \$1.27 billion in FY 2025. As noted above, starting in FY 2024, URS distributions are calculated based on 18% of total net (individual plus corporate) income tax collections from 2 years prior. Therefore, the reason that URS distributions

decreased by (19)% from FY 2024 to FY 2025 is that net income tax collections declined by the same percentage from FY 2022 to FY 2023.

One-Time Financing

As shown in *Table 3*, the FY 2024 budget adopted in May 2023 includes the following one-time financing sources:

FY 2024

One-Time Income Tax Rebate

Laws 2023, Chapter 147 (Taxation Budget Reconciliation Bill) provides a one-time individual income tax rebate to an Arizona taxpayer who: (1) filed a full-year resident tax return for TY 2021, (2) claimed a dependent tax credit on the TY 2021 tax return, and (3) had a tax liability of at least \$1 in TY 2019, TY 2020, or TY 2021. The rebate is \$250 for each dependent tax credit claimed on the taxpayer's TY 2021 tax return for a dependent who was under age 17 at the end of 2021 and \$100 for each dependent who was at least 17 years old at the end of 2021. The maximum rebate that can be claimed is for 3 dependents. To be eligible for the dependent tax credit, a taxpayer's federal adjusted gross income cannot exceed \$219,000, or \$419,000 in the case of married couples filing jointly. DOR is required to issue the tax rebates between October 15, 2023 and November 15, 2023. A taxpayer who does not receive the rebate by November 15, 2024 can claim the rebate by filing an online form with DOR. The budget enacted in May 2023 assumed that the cost of the one-time rebate program would be \$(259.8) million in FY 2024. Based on currently available data from the Department of Revenue, the cost is now estimated to be \$(272.9) million.

Balance Forward

The FY 2023 General Fund ending balance carried into FY 2024 was \$2.527 billion.

FY 2025 – FY 2027

The Baseline assumes no one-time revenue sources in FY 2025 through FY 2027.

Table 3

GENERAL FUND REVENUE - FY 2023 - FY 2025

FORECAST REVENUE GROWTH								
(\$ in Thousands)								
	ACTUAL FY 2023	% CHANGE PRIOR YR	FORECAST FY 2024	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR	FORECAST FY 2025	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR
Sales and Use	7,677,789.3	6.5%	7,885,089.6	2.7%	207,300.3	8,173,718.4	3.7%	288,628.8
Income - Individual	5,239,552.9	-30.4%	4,689,399.8	-10.5%	(550,153.1)	4,967,499.1	5.9%	278,099.3
- Corporate	1,806,311.4	55.3%	1,652,774.9	-8.5%	(153,536.5)	1,666,740.6	0.8%	13,965.7
Property	22,208.0	-17.1%	21,763.9	-2.0%	(444.2)	21,328.6	-2.0%	(435.3)
Luxury - Tobacco	18,686.8	-10.5%	19,220.7	2.9%	533.8	19,028.5	-1.0%	(192.2)
- Liquor	45,379.8	4.1%	46,875.2	3.3%	1,495.4	49,500.2	5.6%	2,625.0
Insurance Premium	761,342.0	7.6%	769,716.8	1.1%	8,374.8	797,426.6	3.6%	27,709.8
Other Taxes	18,354.0	12.6%	19,730.6	7.5%	1,376.6	21,170.9	7.3%	1,440.3
Subtotal - Taxes	15,589,624.2	-6.7%	15,104,571.4	-3.1%	(485,052.8)	15,716,412.9	4.1%	611,841.5
Other Non-Tax Revenues:								
Lottery	175,812.0	-4.3%	222,285.2	26.4%	46,473.2	234,637.8	5.6%	12,352.6
Gaming Revenue	49,377.2	373.1%	36,590.0	-25.9%	(12,787.2)	39,157.0	7.0%	2,567.0
Licenses, Fees and Permits	42,181.8	3.9%	45,050.1	6.8%	2,868.4	46,942.2	4.2%	1,892.1
Interest	366,763.2	690.7%	360,000.0	-1.8%	(6,763.2)	240,000.0	-33.3%	(120,000.0)
Sales and Services	33,156.3	9.2%	34,482.5	4.0%	1,326.3	35,861.8	4.0%	1,379.3
Other Miscellaneous	178,644.0	14.7%	185,789.8	4.0%	7,145.8	193,221.4	4.0%	7,431.6
Transfers and Reimbursements	275,596.9	64.7%	166,909.0	-39.4%	(108,687.8)	80,301.0	-51.9%	(86,608.0)
Disproportionate Share Revenue	98,139.0	11.7%	75,853.5	-22.7%	(22,285.5)	74,162.9	-2.2%	(1,690.6)
Subtotal - Other Non-Tax	1,219,670.3	68.8%	1,126,960.2	-7.6%	(92,710.1)	944,284.1	-16.2%	(182,676.0)
Net Ongoing Revenue	16,809,294.5	-3.6%	16,231,531.6	-3.4%	(577,762.9)	16,660,697.0	2.6%	429,165.5
Urban Revenue Sharing (URS)	(1,106,958.7)	N/A	(1,564,826.3)	N/A	(457,867.7)	(1,268,255.6)	N/A	296,570.8
Net Ongoing Revenue w/ URS	15,702,335.8	-5.9%	14,666,705.3	-6.6%	(1,035,630.6)	15,392,441.4	4.9%	725,736.3
One-Time Financing Sources:								
Attorney General Settlement	75,462.1	N/A	0.0	-100.0%	(75,462.1)	0.0	N/A	0.0
TPT Diversions	(2,287,489.6)	N/A	0.0	N/A	2,287,489.6	0.0	N/A	0.0
One-Time Income Tax Rebate	0.0	N/A	(272,956.4)	N/A	(272,956.4)	0.0	N/A	272,956.4
Subtotal - One-Time Financing Sources	(2,212,027.5)	N/A	(272,956.4)	N/A	1,939,071.2	0.0	N/A	272,956.4
Subtotal - Revenues	13,490,308.3	-19.2%	14,393,748.9	6.7%	903,440.6	15,392,441.4	6.9%	998,692.7
Balance Forward	4,709,446.0	426.4%	2,527,233.0	-46.3%	(2,182,213.0)	0.0	-100.0%	(2,527,233.0)
Total - Resources	18,199,754.3	3.4%	16,920,981.9	-7.0%	(1,278,772.4)	15,392,441.4	-9.0%	(1,528,540.4)

Table 4

GENERAL FUND REVENUE - FY 2026 - FY 2027

FORECAST REVENUE GROWTH						
(\$ in Thousands)						
	FORECAST FY 2026	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR	FORECAST FY 2027	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR
Sales and Use	8,557,678.1	4.7%	383,959.7	8,979,299.8	4.9%	421,621.7
Income - Individual	5,243,240.4	5.6%	275,741.2	5,539,962.4	5.7%	296,722.0
- Corporate	1,733,167.0	4.0%	66,426.4	1,811,385.3	4.5%	78,218.3
Property	20,902.0	-2.0%	(426.6)	20,484.0	-2.0%	(418.0)
Luxury - Tobacco	18,838.2	-1.0%	(190.3)	18,649.8	-1.0%	(188.4)
- Liquor	52,272.2	5.6%	2,772.0	55,199.5	5.6%	2,927.2
Insurance Premium	830,121.0	4.1%	32,694.5	864,156.0	4.1%	34,035.0
Other Taxes	22,652.9	7.0%	1,482.0	24,238.6	7.0%	1,585.7
Subtotal - Taxes	16,478,871.8	4.9%	762,458.9	17,313,375.3	5.1%	834,503.5
Other Non-Tax Revenues:						
Lottery	250,185.7	6.6%	15,547.9	266,504.7	6.5%	16,319.0
Gaming Revenue	41,010.9	4.7%	1,853.9	42,955.0	4.7%	1,944.1
Licenses, Fees and Permits	48,913.8	4.2%	1,971.6	50,968.2	4.2%	2,054.4
Interest	135,000.0	-43.8%	(105,000.0)	87,000.0	-35.6%	(48,000.0)
Sales and Services	37,296.3	4.0%	1,434.5	38,788.1	4.0%	1,491.9
Other Miscellaneous	200,950.2	4.0%	7,728.9	208,988.3	4.0%	8,038.0
Transfers and Reimbursements	80,859.5	0.7%	558.5	81,437.6	0.7%	578.1
Disproportionate Share Revenue	74,428.5	0.4%	265.6	74,452.7	0.0%	24.2
Subtotal - Other Non-Tax	868,644.9	-8.0%	(75,639.2)	851,094.5	-2.0%	(17,550.5)
Net Ongoing Revenue	17,347,516.7	4.1%	686,819.7	18,164,469.8	4.7%	816,953.1
Urban Revenue Sharing (URS)	(1,141,591.4)	N/A	126,664.1	(1,194,163.2)	N/A	(52,571.7)
Net Ongoing Revenue w/ URS	16,205,925.3	5.3%	813,483.8	16,970,306.6	4.7%	764,381.4
One-Time Financing Sources:						
Attorney General Settlement	0.0	N/A	0.0	0.0	N/A	0.0
TPT Public Infrastructure	0.0	N/A	0.0	0.0	N/A	0.0
One-Time Income Tax Rebate	0.0	N/A	0.0	0.0	N/A	0.0
Subtotal - One-Time Financing Sources	0.0	N/A	0.0	0.0	N/A	0.0
Subtotal - Revenues	16,205,925.3	5.3%	813,483.8	16,970,306.6	4.7%	764,381.4
Balance Forward	0.0	N/A	0.0	0.0	N/A	0.0
Total - Resources	16,205,925.3	5.3%	813,483.8	16,970,306.6	4.7%	764,381.4