

COUNCIL ON REVENUES

Third Floor Conference Rooms
Princess Ruth Keelikolani Building
Rooms 310 & 313

Monday, May 21, 2007
12:00 P.M.

PRESENT:

Council Members:

Jack Suyderhoud (Vice-Chair), Carl Bonham, Vito Galati, Michael Hirai, and
Pearl Imada Iboshi

Staff Members:

Department of Taxation: Tu Duc Pham, Yvonne Chow, Glenn Ifuku, Donald
Rousslang, and Cathleen Tokishi

Department of Budget and Finance: Keith Shimada, Karen Matsunaga, and Terri
Ohta

Others:

Gordon Arakaki, Senate Committee on Ways and Means
Huong Bassford, Department of Budget and Finance
Nandana Kalupahana, House Committee on Finance
Richard F. Kahle, Jr., Senate Majority Office
Kurt Kawafuchi, Department of Taxation
Titin Liem, Department of Taxation
Neal Miyahira, Department of Budget and Finance
B. J. Reyes, Honolulu Star-Bulletin

ABSENT:

Council Members:

Paul Brewbaker (Chair) and Eric Yeaman

CALL TO ORDER:

The Vice Chair called the meeting to order at 12:10 P.M. with a quorum present.

COMMUNICATIONS TO THE COUNCIL:

There were no communications to the Council.

INTRODUCTION OF NEW APPOINTEES TO THE COUNCIL:

The Vice Chair introduced Former Tax Director, Richard F. Kahle, Jr., who would be joining the Council effective July 1, 2007. In response to a question from the Vice Chair, Ms. Tokishi stated that Mr. Albert Yamada of First Hawaiian Bank and Mr. Dean Hirata of Central Pacific Bank would be joining Dr. Bonham, Dr. Brewbaker, Dr. Suyderhoud, and Dr. Imada Iboshi, who were reappointed. The Vice Chair then thanked outgoing member, Mr. Galati, for his service.

ELECTION OF CHAIR AND VICE CHAIR:

Pursuant to internal rules adopted by the Council, the current Council members are to choose the Chair and Vice Chair for the new term beginning on July 1, 2007. The Council determined that the current Chair and Vice Chair could be re-elected and that Dr. Brewbaker could be re-elected in absentia.

It was moved by Dr. Imada Iboshi and seconded by Mr. Galati, that Dr. Brewbaker and Dr. Suyderhoud be re-elected as Chair and Vice Chair, respectively. The Vice Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Absent
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Absent
Pearl Imada Iboshi	Yes
Eric Yeaman	Absent

MINUTES OF THE MEETING OF MARCH 13, 2007:

The Vice Chair asked if there were any corrections to or comments about the minutes of the March 13, 2007, meeting. There were none, so the Vice Chair called for a vote and the minutes were approved unanimously.

At this time, Mr. Hirai arrived and was recognized for his service on the Council.

The Vice Chair then asked the Department of Budget and Finance representatives to present their report on other revenues.

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES

Ms. Matsunaga reported the significant changes from their March 2007, report.

General Fund Non-Tax Revenues: In the category, Charges for Current Services, the decreases in FYs 2007-2013 reflect the net impact of decreases due to a correction in the reporting of revenues from ambulance service fees, partially offset by changes in the estimates of reimbursements for the employer's share of health insurance premiums.

In the category, Non-Revenue Receipts, the increase in FY 2007 reflects increases due to the transfer of excess funds from the Parking Control Revolving Fund and to premiums received from the sale of bonds.

Special Fund Tax Revenues: Increases for FYs 2007-2013 in both the Motor Vehicle Weight Tax and Vehicle Registration Fee Tax categories reflect revisions based on actual fiscal year-to-date collections for FY 2007.

Special Fund Non-Tax Revenues: In the category, Use of Money and Property, the increases in FYs 2007-2013 reflect revisions based on actual fiscal year-to-date interest earnings for FY 2007.

In the Federal category, the increases in FYs 2007-2013 reflect projected federal grants for the Department of Transportation, Airports Division.

In the category, Charges for Current Services – Others, the increase for FY 2007 reflects a "catch-up" reimbursement for Medicaid fee-for-service costs.

Other than Special Fund Non-Tax Revenues: In the category, Use of Money and Property, the changes for FYs 2006-2013 are due to an increase in collections of tenant rent for public dwellings by the Department of Human Services. This increase is offset by a decrease in general lease and sublease revenues for the Department of Hawaiian Home Lands to correct a reporting error.

In the category, Federal Grants, changes for FYs 2006-2013 reflect increases in federal grants to operate Army National Guard facilities (Department of Defense), for the medical assistance program, and for subsidies for affordable housing rentals (Department of Human Services). The increases are offset by a decrease in funding for rehabilitation and modernization of federally aided low-income housing projects (Department of Human Services).

In the category, Non-Revenue Receipts, changes for FYs 2006-2013 reflect increases to the employee contribution for health benefit cost plans (Department of Budget and Finance) and increases in funds collected on general home loans (Department of Hawaiian Home Lands). The increases are offset by a decrease in the employer contribution for health benefit cost plans due to an HMSA/Medicare rate decrease for retirees 65 years of age and over.

The Vice Chair called for a motion to approve the report.

It was moved by Dr. Bonham and seconded by Mr. Hirai, that the report of the Department of Budget and Finance be accepted. The Vice Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Absent
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Absent

GENERAL FUND TAX REVENUE WORKSHOP AND FORECAST:

The Council decided to forego the workshop.

Dr. Pham stated that two Council members submitted new data, which was input into econometric models that were almost the same as before (Tables 3A and 3B on pages 5 and 6 of the workbook).

The general excise tax is more than projected, but the net income tax is down 4.5%, and the General Fund increase overall is down to only 2.9% based on preliminary income through April 2007. The scenarios in Tables 10A-10C on pages 34-36 reflect the effect of assumed revenue growth rates of 3.0%, 6.0%, and 9.0%, respectively, for the remaining two months of the fiscal year on the estimated FY 2007 General Fund revenue. The results are summarized in Table 11 on page 37.

Dr. Pham stated that a partial explanation for the 2.9% rate is that envelopes containing estimated income tax payments were opened earlier last year than they were this year, such that more were opened in May this year rather than in April. There was a weekend effect in April 2006 with the amounts usually paid in April being paid in May 2006, but the fact that 2007 estimated tax payments were pushed to May 2007 instead of April offset about \$27 million of the \$30 million difference caused by the April 2006 weekend effect.

There will be another weekend effect for June 2007, pushing revenue normally paid in June 2007 into July 2007. However, this \$30 million weekend effect should be totally offset by a decrease in refunds paid during the remainder of this fiscal year compared to 2006, because the Department is processing refunds at a faster rate this year than last. Faster refund processing means that more refunds have already been processed, leaving fewer outstanding refunds to process in May and June 2007 than in May and June 2006.

The models show that, assuming an average growth rate for May and June of 3.0%, the estimated revenue growth rate for FY 2007 is 2.8%. If the average growth rate is a higher 6.0%, which they had been forecasting, then the estimated revenue growth rate is 3.5%. If the average growth rate is an even higher 9.0%, then the estimated revenue growth rate is 4.1%. The Council's current FY 2007 forecast is 6.0%.

Although 9.0% is just an assumption, the Vice Chair asked Dr. Pham what could lead to an accelerated 9.0% average growth rate for May and June 2007, particularly since the May and June 2006 collections were huge. The State would need to collect 9.0% more than it did in May and June 2006, which would be a significant amount. He asked if the Department expected an end of the fiscal year bump in delinquent collections as had occurred in recent years.

Both Dr. Bonham and Dr. Imada Iboshi stated that the cause of a 9.0% growth rate would not be economic.

Dr. Imada Iboshi asked if estimated tax payments were all made by check rather than by electronic payment. Director Kawafuchi stated that some estimated tax payments might be paid electronically, but that the vast majority is paid by check.

The Council asked Director Kawafuchi how FY 2007 delinquent collections were compared to last year, as the year-end collections had in recent years resulted in higher actual collections for the fiscal year than what the Council had forecast. Director Kawafuchi stated that delinquent collections were slightly ahead of last year. He added that May and June have historically been strong, primarily because all the restaurants and bars have to obtain tax clearances by the end of June.

Dr. Bonham asked about contractors needing tax clearances to renew their licenses. Director Kawafuchi stated that contractors got their tax clearances October 1, 2006.

In summary, the Vice Chair noted that actual collections were running at about 3.0%. Dr. Pham directed the Council to Tables 4A and 4B and Tables 5A and 5B, which showed the model's results at 3.0% and 4.0%, respectively, over May and June 2006.

The Vice Chair asked the Council if they should revise their current 6.0% forecast downward. Dr. Bonham stated that he didn't think that they had much choice but to do so. A 9.0% rate for May and June was conceivable if there was a huge bump in delinquent tax collections, although even that would result in only a 4.1% growth rate. Both Dr. Bonham and Dr. Imada Iboshi noted that they had lowered their forecasts the last two years only to be "blindsided" by phenomenal May and June numbers.

Dr. Bonham stated that he was comfortable with a 5.5% to 6.5% nominal (including inflation) growth rate of the economy for May and June but was unsure of how that might translate into tax

revenues. Table 11 indicates that a 6.0% growth rate would result in an estimated general fund growth rate for FY 2007 of 3.5%.

Dr. Pham suggested another option. Rather than concentrating on the actual figure for this year, the Council could instead forecast FY 2008 and FY 2009, and when the actual 2007 revenue is received, apply the growth rate to the actual collections for FY 2008 and FY 2009.

Dr. Bonham stated that regardless of how it would be done, the current 6.0% rate had to be reduced. He asked that Dr. Pham review Table 11, which Dr. Pham did.

Dr. Imada Iboshi asked Dr. Pham to review Table 10A on page 34, which shows an increase in actual cumulative income of 2.9%, but 5.5% after adjustments. Dr. Pham did, noting that September's \$40 million income tax adjustment is for a large, one-time, lump sum corporation income tax payment, and that from January on, there is a \$3 million per month adjustment, which is his estimate of the impact of tax law changes such as the change in the standard deduction and the expansion of the income tax brackets.

Mr. Galati asked how May collections were doing. Dr. Pham stated that May is \$16 million ahead so far; Director Kawafuchi concurred and added that the \$16 million was as of Wednesday, May 16, 2007. The Vice Chair asked for a guess of the total May collections, because it was \$522 million last year, and May 2007 is \$16 million ahead of that pace at this point. Director Kawafuchi stated that, in his experience, the daily totals are very volatile and hard to project out. Halfway through May 2007, estimated income taxes are about \$29.4 million ahead of May 2006 due to the priority currently being put on the processing of estimated tax payments.

In response to a comment by the Vice Chair, Dr. Bonham pointed out that, even if the collections were the same for May and June of last year, the 6.0% overall growth rate would not be achieved. He noted that the 6.0% growth rate reflected a 6.0% growth over May and June of 2006 and would only produce a 3.5% overall growth rate for FY 2007, and that even a 9.0% growth rate for May and June would only produce a 4.1% growth rate for FY 2007.

Dr. Bonham stated that he didn't see how they could forecast anything higher than 4.0%, and that they would be lucky to get 4.0%. All year, they had been suggesting that the fundamentals were growing at 6.0%, but that they didn't have a good grasp of the impact of processing and tax law changes on forecasting two months of data. The Vice Chair noted, however, that the revenue growth had always fluctuated around the fundamental economic growth.

The Vice Chair asked if anyone wanted to reduce the forecast to 4.0%. Dr. Imada Iboshi commented that she felt even 4.0% would be difficult. The Vice Chair then asked if anyone thought it would be above 4.0%.

In response to Dr. Bonham, Ms. Liem stated that the May tax collections were currently \$16.7 million ahead of last year with 12 of 22 working days completed, which Director Kawafuchi noted was about 6.0% over last year.

The Vice Chair again asked if anyone thought it would be above 4.0%, and none did. He then asked if anyone thought it would be more than 3.0%; Dr. Imada Iboshi said that it was possible. Dr. Bonham added that 4.0% was possible although it would require a strong June.

The hesitation in proposing a reduction in their forecast to 4.0% was, for Mr. Galati, because that it was such a large drop. Dr. Bonham added that it is hard to understand since the economy was continuing to grow at 6.0%. Dr. Pham noted that the growth rate of the general excise tax usually corresponds to the economy. The Vice Chair pointed out that the general excise tax growth rate was 10.0%, and Dr. Bonham added that the general excise tax is growing faster than the economy.

At this time, the Vice Chair called for a motion on the 2007 forecast.

It was moved by Dr. Bonham and seconded by Mr. Galati, to change the forecast for the 2007 fiscal year to 4.0%. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Absent
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Absent

The discussion then turned to the 2008-2013 forecasts, currently 6.0% for 2008, 4.1% for 2009, 4.6% for 2010, 4.5% for 2011, 4.9% for 2012, and 5.6% for 2013.

Dr. Pham stated that Tables 5A and 5B anticipated a revision for 2007 to 4.0%. In response to a question from the Vice Chair, Dr. Pham clarified that the forecasts were based on the revised input from two of the Council members and the old input from the others.

Tables 5A and 5B reflect a 6.2% growth rate for 2008, which the Vice Chair noted was close to the Council's nominal underlying growth number.

The Vice Chair asked if there were any significant tax law changes that would impact the 2008 forecast. Dr. Pham noted that many of the tax-related bills from the 2007 Legislative session had not yet been signed. Director Kawafuchi noted that there was a constitutionally mandated income tax refund would have a one-time \$26 million revenue impact,¹ and a food tax credit² that would

¹ Recorder's Note: S.B. 148, S.D. 2, H.D. 1, C.D. 2, enacted as Act 210, Session Laws of Hawaii 2007.

² Recorder's Note: S.B. 1882, S.D. 2, H.D. 1, C.D. 1, enacted as Act 211, Session Laws of Hawaii 2007.

begin in 2008 and impact returns filed in 2009 at a cost of almost \$25 million per year. There are no pending bills that would impact the standard deduction. There also is a bill that would exempt ethanol-blended fuel from the general excise tax³ beginning July 1, 2007, and ending June 30, 2009, which would cost approximately \$36 million per year.

Dr. Imada Iboshi stated that the 6.2% rate for FY 2008 was close to her 6.1% below-the-line number. The Vice Chair stated that his number is 5.8%. Dr. Bonham initially said that he would lower their current 6.0% forecast if it was his forecast, because his income forecast is about 25 to 50 basis points lower in real terms than it was, their construction completed forecast is lower, and their general excise tax forecast shows that growth rate slowing pretty significantly. However, that was when he was comparing his current numbers against his older numbers. Using his current numbers, he is coming in at 6.1%. The consensus was that they should keep the 6.0% rate on the lower 2007 base.

The Vice Chair then called for a motion on the 2008-2013 forecasts.

It was moved by Dr. Imada Iboshi and seconded by Mr. Hirai, that the 2008 through 2013 growth rates of 6.0%, 4.1%, 4.6%, 4.5%, 4.9%, and 5.6%, respectively, be retained and applied to the smaller FY 2007 base reflecting the 4.0% growth rate. The Vice Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Absent
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Absent

NEXT MEETING:

Ms. Chow stated that the next meeting is to forecast Total Personal Income, which is due on Sunday, August 5.

The next meeting will be held on Friday, August 3, 2007, at 2:00 P.M. in the Office of Aging Conference Room.⁴

³ Recorder's Note: H.B. 1757, H.D. 1, S.D. 3, C.D. 2, enacted as Act 209, Session Laws of Hawaii 2007.

⁴ Recorder's Note: Due to a scheduling conflict, the next meeting was subsequently rescheduled for 2:00 P.M., Thursday, July 26, 2007, and will be held in the Leiopapa A. Kamehameha Building, Land Use Commission Conference Room 405.

ADJOURNMENT:

The meeting adjourned at 1:12 P.M.