COUNCIL ON REVENUES

Office on Aging Conference Room
No. 1 Capitol District Building
250 S. Hotel Street
Fourth Floor, Room 410
Honolulu, HI 96813

Thursday, January 5, 2012
10:00 a.m.

PRESENT:

Council Members:
Richard F. Kahle, Jr. (Chair), Jack P. Suyderhoud (Vice-Chair), Avery K. Aoki, Carl S. Bonham, Christopher Grandy, Ronald K. Migita and Marilyn M. Niwao

Staff Members:
Department of Taxation: Donald Rousslang, Hamid Jahanmir and Jacquelyn Guitguiten
Department of Budget and Finance: Terri Ohta, Keith Shimada and Gregg Hirohata-Goto

Others:
Neal Miyahira, Budget and Finance
Sharon Kotaka, Budget and Finance
Lowell L. Kalapa, Tax Foundation of Hawaii
Allison Murakawa, DHRD
Eric Nitta, DHRD
Roderick Becker, Senate Ways and Means
Susan Hirai, Senate Ways and Means
Wayne Yoshioka, KHPR
Johnnel Nakamura, Department of Taxation
Titin Sakata, Department of Taxation

CALL TO ORDER:

The Chair called the meeting to order at 10:00 a.m. with a quorum present.

COMMUNICATIONS TO THE COUNCIL:

Chair Kahle asked if there were any communications to the Council. Dr. Rousslang told the Council that there is a very preliminary December figure of $399 million for General Fund revenues. The Chair commented that the general excise tax (GET) is looking pretty good; better than it has. He asked Mr. Aoki how the hotels were doing now that APEC is over. Mr. Aoki said that from what was reported by the media, hotels and restaurants did well, although spending might not be as robust as people had expected, particularly for retail shops.

MINUTES OF THE MEETING OF NOVEMBER 3, 2011:

The Chair asked the members for comments on the minutes of the November 3rd meeting. There were no comments. The Chair called for a motion to approve the minutes.

It was moved by Ms. Niwao and seconded by Dr. Suyderhoud that the minutes of November 3, 2011 meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	**Yes**
Jack P. Suyderhoud	**Yes**
Avery A. Aoki	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Yes**
Ronald K. Migita	**Yes**
Marilyn M. Niwao	**Yes**

GENERAL FUND REVENUE FORECAST:

Next, the Council discussed the General Fund revenue forecast for FY 2012. Ms. Niwao referred to the COR Workbook and suggested that the model the Council looks at should be revised periodically, not only for 1) changes in economic growth, but also for 2) tax law changes, and 3) Tax Department administrative procedure changes and collection efforts. She said it is difficult to estimate revenue growth because the State is on the cash basis of recognizing revenue. The November 2011 preliminary General Fund collections were showing 10.1% growth, whereas Table 2b (in the Workbook prepared for the Council members), showed collections is coming in at 3.9% less than the Council's forecast of 14.5% made in September. Ms. Niwao had a number of comments, saying she wondered whether the model should consider the federal funds flowing into Hawaii and the impact of the $2.2 billion in stimulus funds ($1.9 billion of which was spent as of September 30, 2011), and the effect of the loss of those funds. She asked, what would be the impact on the forecast? In reference to a Chart she provided to the Council, she said some other States are predicting no growth from their federal stimulus funds and that was something the Council should probably consider. Secondly, the November preliminary statement showed cumulative negative collections for the corporate income tax of $21,410,000, whereas in the prior year cumulative collections had been $7,536,000. She said she thought the collections were probably negative, because of net operating loss carrybacks from C corporations. The State allows C corporations to carryback net operating losses for 2 years and recover taxes paid in prior years. Ms. Niwao pointed out that although there appears to be increased business activity, the bottom line profits are not there. For the net income tax collections, refunds paid out to the corporations on 2010 returns probably were paid out in October or November of 2011, so that although the GET collections are monthly and reflect current business activity, for the net income taxes from corporations, you are looking at what happened to net income in the prior year. It means also that corporations are hurting and that although GET collections are the main revenue source, the net income figure is important because it reflects the health of businesses and that if a business stops operating, we will lose its GET collections.

Ms. Niwao told the Council that another thing to look at was receivables. And, when we look at the growth in State tax collections, we are looking at it on a cash basis (as the money being collected from taxpayers). She said that many businesses and individual taxpayers were hurting for cash. She displayed a Chart showing that as of fiscal year June 30, 2011, the receivable balances were quite high (approximately $40 - $50 million more in receivables compared to the prior years), and that although that might be due partly to the Tax Department cutting back on the number of tax collectors, it was also consistent with the fact that many businesses have a lot of receivables on their books. For example, construction contractors might have big accounts receivables if they are on an accrual method of accounting, but they might not be very healthy businesses because people have not paid them. They may be reporting income but have not received the cash if their customers cannot pay. When the receivables become bad debt resulting in losses, they can carryback the losses to prior years.

The receivables on the Department's books were an indication that taxpayers may not be doing well (referring to the Chart). She said that businesses on a cash basis look at their accounts receivable and at payment lags by their customers--not reporting their income until they actually collect the revenues.

Dr. Grandy asked Ms. Niwao if she thought that these effects were substantially different in recent years from prior years. Ms. Niwao said in her 33 years of public accounting, she has never seen the economy this bad. Dr. Grandy repeated his question asking whether there was something unusual in recent years in Hawaii, compared to the past. Ms. Niwao said usually when the economy turns down, you start seeing businesses carryback net operating losses. In the present instance, businesses are still trying to stay in business and one of the ways that they are allowed to stay in business for a little longer is to get State tax refunds from the net operating loss carrybacks. Dr. Grandy agreed but asked whether similar practices would have happened in the early 2000s, through mid-1990s and the early 1980s as well. He said while he agreed about the effect on immediate collections, looking at things from a long-term perspective, those structural elements would be embedded in Hawaii's collections data and so would be incorporated in the forecast. Ms. Niwao said it is a question of how negative all the businesses are collectively and for how long, and she thought that it is the worst she has seen over the years, as far as how businesses are doing. Banks have gotten much more reluctant to loan money, because the cash flows and health of the businesses are much worse than before.

Mr. Aoki asked about the current DOTax collections and the Council's past forecast of 14.5%.

Dr. Rousslang said that without the refund delay of 4.3%, the growth would be about 5.8%. He said adding 4.3% plus 5.8% gives 10.1% growth.

Dr. Bonham asked Dr. Rousslang if he could explain what the last column in Table 2b of the Workbook says. Dr. Rousslang said the top portion is actual collections. Dr. Suyderhoud asked if the Council could focus on the last column (General Fund). Dr. Rousslang said the column showed actual collections for the General Fund. He said the next section showed the forecast if there were no legislative changes. Dr. Bonham asked whether the annual growth rate was applied to each month. Dr. Rousslang said yes, and explained that the last section of Table 2, which accounts for the effects of legislative changes, also takes into account of the fact that some of the tax law changes are not expected to show up in collections until later in the fiscal year. The section shows what we should expect if collections were coming in according to the Council's forecast.

Dr. Suyderhoud said several things were going on: the refund delay, tax law changes, and economic growth. Mr. Aoki said there was 4.3% for the income tax refunds; 5.2% from economic growth; and, 5% from tax law changes. That is how the Council got the 14.5% growth forecast.

Dr. Grandy said the problem was that an annual forecast was being applied on a monthly basis. He said he was not sure that was appropriate, especially if some effects are not distributed evenly over the year. Dr. Bonham agreed. Dr. Rousslang said he tried to account for those effects.

Ms. Niwao said she thought Dr. Rousslang was saying that he was not seeing the overall increase that the Council expected. Dr. Suyderhoud said that could be because the revenue estimate for the Act 105 was highly uncertain. Dr. Rousslang said the Council had cut that estimate from $170 million roughly to $50 million. And, that he was tracking the monthly data in an effort to see how far off the $50 million revenue estimate had been. Dr. Suyderhoud asked if the $50 million is what the Council had in the forecast. Dr. Rousslang said yes.

Dr. Suyderhoud asked if there was reason to believe that the $50 million estimate should be adjusted downward. Dr. Rousslang said the GET is coming in at about 6% or 2.3% lower than the expectation. He said either the Act 105 number is still too high or the economic forecast is too high.

Dr. Suyderhoud said perhaps the revenues were not coming in as quickly as the Council had thought and that he thought that Ms. Niwao believed that this was due to carryback losses, to delinquencies, and to people hoarding cash instead of paying their tax bills. He said Dr. Rousslang had mentioned another reason is that the impact of the tax law changes may not be as robust as expected. Ms. Niwao agreed.

Providing another Chart to the Council, Ms. Niwao said another thing that she was concerned about (besides the fact that we are not collecting the amount of revenues that we expected and that the tax law changes may not be bringing as much as we expected), is the Tax Department had changed its administrative procedures. She said last April 2011, the Tax Department changed the way it was depositing checks, and that the checks are now being deposited within 4 days as opposed to several weeks delay. In the past when people sent their checks for tax payments, often the checks were not cashed for a month. And, that procedure was changed because the Tax Department put priority on processing returns with payments rather than returns with refunds. She added that the Tax Director discussed this effect at the Council's May 2011 meeting, and the minutes of the meeting indicated that the effect of that was expected to be reversed in June, because by the end of the fiscal year the returns with refunds would be paid. She noted, however, that would not take into account the GET collections.

Ms. Niwao said her Chart shows how much revenue had been collected. She said approximately $100 million more was collected in April 2011, but the expectation was that it would reverse by the end of June 2011. However, earlier collections of GET will not reverse because it is just an earlier collection of tax money. She suggested that there is possibly $100 million in revenue collection in the prior fiscal year that would not be collected this year. She is concerned, because in April of this next year (while we would get the increase of tax collected with the tax law changes), we would not get the money collected from the change of administrative procedures that we had in April 2011. Dr. Bonham asked if Ms. Niwao was suggesting that the increase is from the GET. Ms. Niwao said yes. In addition, the increase could have been a one-time event from high-income taxpayers making a one-time conversion from their IRAs and taxable pensions to Roth IRAs. Many high-income taxpayers made the decision to recognize income and convert IRAs and taxable pensions to Roth IRAs in 2010, which would amount to a one-time recognition of State taxes. This ability of high income taxpayers to rollover IRAs and pensions to Roth IRAs occurred due to a federal tax law change effective in 2010.

Dr. Suyderhoud said in terms of the impact on the forecast, what it means is that 2011 should be about $100 million better than anticipated. Ms. Niwao said that is correct. She said she was concerned that the base the Council used for last year is higher than expected. Dr. Bonham said he understood, but that the GET could not come to $100 million, because it is a month of income tax collections. The Chair agreed. Dr. Bonham said he does not dispute the gap, but that he has no idea how big it is. Ms. Niwao said she had no idea either.

Dr. Bonham said in the first half of this fiscal year the economy performed less well than anticipated, but only if you look at aggregate job growth. Looking at visitors' spending, it has performed better than anybody thought it would. He said he does not know whether that was due to tax effects or the economy. He suggested that if you take out the tax law changes and look just at the economic effects, you would get about 9% growth for the whole fiscal year.

Dr. Bonham said he was trying to estimate what revenue growth would be for the rest of the year. He said growth of 5.8% seems a little high. If the economy grows by 5.8% for the next 6 months you would get around a 9% for the total revenue growth without taking into account tax law changes. Ms. Niwao said some of the effects of the tax law changes are already reflected in the 5 months of collections. Mr. Aoki said he thought the effect of tax law changes would be "back loaded", but the percentage was unknown.

Dr. Suyderhoud asked Ms. Niwao what she thought would be the overall General Fund revenue growth rate for fiscal year 2012. Ms. Niwao said she would estimate it to be about 10%.

Dr. Bonham suggested 5.8% for the whole year, plus the refunds. Ms. Niwao said the 5.8% figure already includes the tax law changes, so adding another 2.5 would double-up on the tax law changes. The 5.8% already reflects the (suspension of) GET tax exemptions and other changes. The other question that she had was what effect the loss of the federal stimulus funds would have. Dr. Bonham said that it is already built into the assumptions in the models. He said it was not assumed to last forever. Ms. Niwao asked about the European problem. Dr. Bonham said that is why the forecast is so pessimistic.

Dr. Suyderhoud said that when he was putting together his forecast assumptions, he considered Europe. He said he assumed that Europe would muddle along. Dr. Bonham said there is a positive probability that something would go badly wrong in Europe or Iran. Dr. Grandy said there is also a positive probability that it would not. Dr. Bonham agreed.

Dr. Grandy said you do not make a forecast just on the basis of the negative probabilities. He said when he came into the meeting; he was going to suggest that the Council maintain the existing forecast, except that it might consider dropping slightly the forecasts for 2014 and 2016 in light of the effects of tax law changes in future years shown in the Tax Department's model. He said the discussion, he could see that they might reduce the forecast for 2012 slightly, but that the basic forecast still seemed reasonable.

Dr. Suyderhoud asked the Council what kind of lower bound they felt comfortable with for 2012, and that the lower bounds he had heard were 10% or 11.5%. He asked if any members wanted to suggest a number. Mr. Migita said he thought that it would be in the mid- 9%'s, but he could accept 10%. He said if he was to use a single number, it would be around 9.5% or 9.7%. He added that while the economy is growing, some businesses are doing poorly. Tourism numbers are positive, but talking to businesses and friends in construction, they were not doing well. He said he had never been comfortable with the current forecast of 14.5%. Ms. Niwao told Mr. Migita that she could almost agree with him about 9.5%, because she sees people on the verge of going out of business.

Dr. Bonham said he is certain that Ms. Niwao is right and that many businesses are not doing well, and that some may not be able to hold on any longer. Ms. Niwao added that it would cause GET revenue to be lost. Dr. Bonham said he does not agree with that, because someone else will sell the products to the people. When a contractor goes out of business, it does not mean that the GET necessarily goes away. He said that total jobs; total income; total visitors; total visitors' spending; and, tax collections were all growing. And, in some cases like visitor expenditures, they were growing at high rates. He said that some of what Ms. Niwao was seeing was backward-looking, such as contracting, which has not recovered yet. And, the question is whether we are about to see growth in construction jobs statewide, something not seen in 4 years. Ms. Niwao said she has seen her clients' income and what they were planning, and does not see many new businesses being started to replace the old businesses. She believes that when an old business goes out of business, a new business does not replace that business for quite a while. In addition to the capital needs (in an environment when banks are not lending), the younger generation doesn’t seem as willing to take on the risk of starting a new business, contrary to what occurred in the past. Dr. Bonham asked who hired the 1.5% people who got jobs this year. Someone hired them, though it may not have been new businesses.

Ms. Niwao said there are other aspects of the economy that are really hurting besides construction and real estate. She said the regular working people were hurting. Dr. Suyderhoud said that the regular working people also include people working in hotels, and from the story that Mr. Aoki told, the news there is not particularly bad. Mr. Aoki said it is not robust, but it is steady--there is improving profitability yet there is a ways to go toward the peak years from 2006 and 2007. Ms. Niwao agreed, but said other segments of the economy are not doing as well. She said that although the visitor industry is doing well, other segments have companies going out of business and that these businesses would not be replaced quickly.

After further discussion about the economy, Dr. Bonham moved that the Council adopt 11.5% as the revenue growth forecast for 2012. Dr. Suyderhoud seconded the motion. The Chair asked for discussion. There was none. The Chair asked for all in favor of accepting 11.5% growth as the forecast for fiscal year 2012.

Dr. Bonham made a motion to forecast the general fund tax revenues growth rate for the remainder of FY2012 at 11.5%. Dr. Suyderhoud seconded the motion. The Chair called for the vote, and the motion passed with a 5 to 2 vote:

Richard F. Kahle, Jr.	**Yes**
Jack P. Suyderhoud	**Yes**
Avery A. Aoki	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Yes**
Ronald K. Migita	**No**
Marilyn M. Niwao	**No**

Dr. Suyderhoud asked Ms. Niwao and Mr. Migita if they opposed the motion. Both said they did.

Mr. Migita said things are improving, like employment, but the improvement is slow. He did not want to give an impression that the world is falling apart, because it is not. Ms. Niwao expressed her concerns about external factors and how they might affect Hawaii's economy.

Next, the Council discussed the out years from fiscal years 2013 through 2018. Dr. Suyderhoud asked what the Council's current forecasts were. The Chair said 6.5%, 3.0%, 5.0%, 5.0%, and 5.0%. Dr. Suyderhoud said that since the Council lowered the 2012 growth rate, the numbers going forward would be lower, even with no changes in the growth rates. Dr. Grandy mentioned that the ending of the tax law changes in 2017 and 2018 were not fully reflected in the Council's forecast.

Dr. Bonham asked Dr. Rousslang if in the future he could average the forecasts across different models and give the Council an average forecast. Dr. Rousslang said yes.

Dr. Grandy moved that the out years 2013 through 2018 be as follows: FY 2013 at 6.5%; FY2014 at 3%; FY2015 at 5%; FY 2016 at 3%; FY 2017 at 5% and FY 2018 at 5%. Mr. Migita seconded the motion. The Chair asked if there was any discussion. There was none.

It was moved by Dr. Grandy and seconded by Mr. Migita to forecast the growth rate of general fund tax revenues at 6.5% for FY 2013; 3.0% for FY 2014; 5.0% for FY 2015; 3.0% for FY 2016; and 5.0% for FYs 2017 and 2018. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	**Yes**
Jack P. Suyderhoud	**Yes**
Avery A. Aoki	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Yes**
Ronald K. Migita	**Yes**
Marilyn M. Niwao	**Yes**

Next, the Council heard the report by Budget and Finance.

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:

Ms. Ohta reported the changes for the General Fund Non-Tax Revenues and for Special Tax Revenues since the September 2011 meeting.

Special Fund Non-Tax Revenues reflect the following significant changes: decreases in Airport Improvement Program discretionary funds for the Department of Transportation's Airports Division (DOT - Airports), increases in assessments from insurance carriers and self-insured employers (Department of Labor and Industrial Relations), as well as lower rental payments due to lowered expense growth rates that are the result of bond refinancing and restructuring (DOT - Airports).

Other than Special Fund Non-Tax Revenues reflect increases in federal grants available to: maintain National Guard Facilities (Department of Defense); fund public assistance for the Lower Income Housing Program (Hawaii Housing Authority); and fund the Maternal, Infant, Early Childhood Home Visiting Program (Department of Health). There were also increases to reflect reporting errors for the Department of Human Services' public assistance grant. Changes in FYs 14 and 15 are due to forecasted loan repayments being revised from FY 14 to FY 15 in the Hawaii Housing Finance and Development Corporation (Department of Business, Economic Development and Tourism).

Dr. Suyderhoud moved a motion to accept the report. Mr.Migita seconded the motion. The Chair asked for all in favor.

It was moved by Dr. Suyderhoud and, seconded by Mr. Migita to accept the B&F report as submitted. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	**Yes**
Jack P. Suyderhoud	**Yes**
Avery A. Aoki	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Yes**
Ronald K. Migita	**Yes**
Marilyn M. Niwao	**Yes**

The Department of Taxation's Tax Research & Planning Office will prepare a table with detailed line-item estimates for the Governor, along with the Council's forecast as submitted.

NEXT MEETING:

The next COR meeting is tentatively scheduled for Wednesday, March 7, 2012 at 10:00 am; however, the date and time will be confirmed by e-mail. The Council staff will attempt to secure the Office on Aging Conference Room 410 for the meeting.

ADJOURNMENT:

The meeting adjourned at 11:34 a.m.