COUNCIL ON REVENUES

Princess Ruth Keelikolani Building
DLIR Conference Rooms Third Floor
Rooms 310-313
Honolulu, Hawaii 96813

Wednesday, January 4, 2017
1:00 p.m.

PRESENT:

Council Members:
Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham, Ed Case, Jack P. Suyderhoud, and Kristi L. Maynard

Staff Members:
Department of Taxation (DOTAX): Seth Colby, J. Guitguiten and, Yvonne Chow

Department of Budget and Finance (B&F): Neal Miyahira, Terri Ohta, Gregg Hirohata-Goto, Donovan Chun and, Kenneth Shirokane

Others:
Damien Elefante, Deputy Director of Taxation
Maria Zielinski, Director of Taxation
Jonathan White, Department of Taxation
Sharon Kotaka, Budget & Finance
Nathan Eagle, Civil Beat
Kevin Dayton, Star Advertiser

EXCUSED:
Christopher Grandy, Member

CALL TO ORDER:

Chair Kawafuchi called the meeting to order at 1p.m. A quorum was present.

Chair Kawafuchi announced the newest member of the Council, Mr. Ed Case (to serve the remainder of Ms. Elizabeth Cambra's term) and the new Tax Research & Planning Officer, Dr. Seth Colby.

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

Chair Kawafuchi asked if there were public comments or communications to the Council on Revenues (Council). There were no other comments or communications to the Council.

MINUTES OF THE MEETING OF OCTOBER 31, 2016:

Chair Kawafuchi called for a motion to approve the minutes for the meeting of October 31.

Ms. Maynard moved to approve the minutes. Dr. Suyderhoud seconded the motion. Mr. Case and Ms. Niwao voted to abstain due to they were not present at that meeting.

It was moved by Ms. Maynard and seconded by Dr. Suyderhoud that the minutes of the October 31st meeting be approved. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**Abstain**
Jack P. Suyderhoud	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Excused**
Ed Case	**Abstain**
Kristi L. Maynard	**Yes**

GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2017:

Next, the Council discussed the current year forecast for fiscal year 2017. Chair Kawafuchi asked Dr. Colby if he wanted to start the discussion in terms of the models provided to the Council. Dr. Colby said that considering he just started a week ago, he probably doesn't have much to offer as he will in the next meeting. He said according to the department's models, we're predicting a 5.5% revenue increase (the latest forecast). Dr. Colby said the two models are showing 5.3% and 5.8%. Chair Kawafuchi said the first 5 months of the year is positive .7% (general fund). Chair Kawafuchi asked Dr. Colby if he was able to prepare some scenarios as to what the Council will need to hit for the last 7 months in order to hit 5.5%. Dr. Colby said our staff prepared this for the Council. Chair Kawafuchi asked questions about the different scenarios presented by the report.

Dr. Bonham said when he got this table (sent by email from the tax department) it caused him to think a little bit. He said we've had basically the first 5 months of the fiscal year were a surprise. Dr. Bonham said he didn't think most of us would have expected that. Ms. Maynard agreed. Dr. Bonham said given that we've got 4 to 4.5% income growth; visitor spending growing at about 4%; consumer prices growing at about 2.5, 3%; jobs between 1.5 and 2%--it's just completely an anomaly.

Dr. Bonham said if they happen to be in the first half of the year doesn't necessarily mean they're going to be in the second half.

Ms. Niwao added that last year the State received $39 million settlement from the Expedia lawsuits ($29,381,790 million was received September 2015) and $9,999,910 million was received February 2016. Ms. Niwao said when she ran some numbers for the GET growth, it was quite low, and factoring in the higher base figures for last year, the adjusted growth rate for GET was approximately 3%.

Ms. Niwao asked if Dr. Bonham or Dr. Suyderhoud still believed that Hawaii's long-term growth rate is around 6% even though the population growth rate has dropped substantially from previous estimates. She said the reason she asked was because of an article in the Hawaii News Now about the out-migration of people moving to the mainland over the number of people moving to Hawaii which exceeded 10,000 this last year, according to the Census report. She explained that the population growth rate when combining all population changes was only .2% from 2015 to 2016. She said DBEDT (Department of Business, Economic Development & Tourism) has been forecasting a .8% population growth rate over the long-term. She said it could be that the decrease in the population growth rate was due to those leaving due to the high cost of living in Hawaii, those leaving due to military transfers, or those who moved due to health care needs. She said whatever the reasons, we are now not having a higher population growth rate that was previously forecast.

Dr. Bonham said the forecast that UHERO (UH Economic Research Organization) uses and that he uses for the tax forecast for 2016 is .5%. He said the Census data came in at 0.2% and UHERO's long-run forecast is probably 20 maybe 30 bases points lower than the ones that DBEDT (Department of Business, Economic Development & Tourism) uses.

Ms. Niwao said she's also concerned about the federal funds flow to Hawaii now with the political changes that have occurred and how Hawaii is going to be affected by those changes with respect to federal funding for military and federal grants, etc. Ms. Niwao said she thought that Hawaii already loses out because of the Affordable Care Act (ACA) provisions since Hawaii employers already are required to pay for employee health insurance, and most taxpayers in Hawaii do not take advantage of the Federal ACA tax credits.

Ms. Niwao asked former U.S. Representative Case as to his thoughts as to what changes, if any, would there be with a new President and a Republican Congress in terms of federal spending in Hawaii. Mr. Case said he expects military spending and the U.S. tax structure to remain the same for at least the next couple of years. His concern was what the Trump administration would mean for Hawaii's visitor industry because of President Trump's protectionist views. He felt that there may be a future negative impact on tourism if trade was curtailed with certain countries or travel by foreigners was restricted.

Dr. Suyderhoud said the underlying economy is strong but the GET is reflecting really low growth other than these one-time base effects that we're talking about earlier. He asked the Tax department if there were any trends that are happening and why people are not paying GE. He said there's spending going on and there's income. Chair Kawafuchi added that there's the new system (roll-out) within the Tax department in August (2016).

Dr. Colby said 5.1% is pretty close to our estimate of 5.5% (both adjustments). Ms. Maynard said still we're down to a .7 growth rate at the end of November. Dr. Bonham said yes, but that adjustment is as if we got the settlement another time. Dr. Colby said if we didn't get the settlement last year and basically that's a truer trend. Dr. Bonham said yes, comparing to economic data.

Dr. Colby said the $35 million is a one-time event. Dr. Bonham said part of it is a one-time but the $35 million is not recurring. Chair Kawafuchi asked Dr. Colby to further explain the circumstances of the $35 million. Dr. Colby referred the question to Director Zielinski for further clarification. Director Zielinski said that she believed it was just one particular taxpayer where it was booked as GE which should have been applied to TAT. She said it was an accounting entry that had to be made to move the moneys from GE to TAT. Director Zielinski said it was a reclassification, one-time.

Ms. Maynard suggested the Council should probably be adjusting for that in some way. Dr. Bonham agreed and said the Council should've adjusted for the one-time event during the Council's last forecast.

Ms. Niwao said other than demographic changes (aging of Hawaii's population) she has talked about in the past, she is concerned that Hawaii is not collecting taxes on online retail sales. According to reports, the growth rate of retail sales at regular stores like brick and mortar stores was roughly 3% versus approximately a 17% growth in online retail sales, where state taxes are not collected, for the most part. For example, she said Hawaii is not capturing sales/use tax from Amazon sales to Hawaii residents, whereas Amazon already collects sales taxes for 26 other states. She said there probably needs to be Hawaii nexus or other state tax legislation to capture online retail sales/use taxes so Hawaii's tax growth can grow according to the underlying base economy.

Ms. Niwao said she's in agreement that the economy looks fairly strong, and aside from the fact that she hears that some construction contractors have delayed projects due to insufficient buyers for condos, and, aside from the fact that Maui has just lost its HC&S sugar cane business, the rest of the economy appears fairly healthy.

Dr. Suyderhoud said he wanted to caution the Council that they ought to be careful about what they conclude in speculating about long-term trends, military, online sales. He strongly advised that they have absolutely no information about this.

Ms. Niwao said her other concern was tax rates. She provided handouts. Ms. Niwao referenced the Model's below-the-line adjustments ($57.5 million) and mentioned a change in tax laws and higher tax rates that expired in 2016 ~~on~~ for individual income taxes. Chair Kawafuchi reiterated what Ms. Niwao was saying that in calendar year 2016 the rates dropped (highest rates in the non-corporate dropped from 11% to 8.25%). He added that the non-corporate rate applied also to trusts and estates.

Ms. Niwao said in looking at the individual income tax 2015 tax rate schedule, the higher income bracket in 2016 dropped from 11% to 8.25% (the top marginal rate for most taxpayers). Also included in the below-the-line tax adjustment forecast by the State is the lifting of the limitation for itemized deductions. She said she also wanted to share with the Council that the 2016 withholding tables for the State taxes was the same table used for prior years - the withholding tax rates were not changed, and employers kept withholding at the same rates as in the past.

In addition, taxpayers would be calculating and paying in 2016 estimated taxes using the prior year (2015) taxes paid in order to avoid possible underpayment tax penalties. Tax software programs are designed so that estimated taxes are automatically calculated using prior year tax liability in order to avoid these penalties, unless there is an override. Therefore, there would be more refunds being paid out around April 15th for the higher income taxpayers that would reflect the difference between 2016 and 2015 state tax rates. Dr. Bonham stated that perhaps some taxpayers adjusted their 2016 state estimated taxes in anticipation of the lower 2016 state tax rates. Ms. Niwao said that was very unlikely because, except for year-end tax planning with a sudden bump in income, tax practitioners would not adjust 2016 state estimated tax calculations for lower tax rates. They would instead rely on the prior year taxes paid exception calculated by the computer rather than spend the extra time to calculate hypothetical state estimated taxes on estimated 2016 income.

Mr. Case said there just weren't any huge disruptions in the economy in those 5 months that led to a lower actual revenue collection. He said the tourism industry was fairly constant; for construction there weren't any huge failures; there was no crash in the world economy; there was nothing to explain that short 0.8.

Director Zielinski said the department's revenue accounting staff conducted some analysis early on during the revenue report for the month (and year-to-date) and one of the things we saw that we were concerned is that the refunds are significantly higher both for corporate as well as individual and fiduciary. Director Zielinski provided the Council with a schedule. She said just for the month of November we're up refunds almost $27 million (corporate refunds up $7.3 million; individual/fiduciary up almost $19.6 million). Year-to-date the total refunds are up $49.4 million of which almost $22 million relates to corporate and $27.4 million relates to individual and fiduciary.

Dr. Bonham said he would be very comfortable assuming that the next 7 months of the fiscal year is going to grow at the same rate they thought they were going to grow at. He said maybe something a little bit less than that because their original growth forecast was polluted by a higher base. Ms. Niwao said she was looking at a 1.5% growth rate at the lower end (for the revenues for the fiscal year). She said we have not only changes of the tax rates, but the effect of another installment of the online travel companies coming through in February of 2016 of about $10 million. She said that would mean the base rate that we have to jump through in February 2017 is going to be even higher to get us to the 5.5% growth rate. Chair Kawafuchi asked if there were any events going on during the current year. He said besides the rental companies, are there any other initiatives affecting the revenue base (large settlements) coming through, nothing that would impact 1 point or greater. Deputy Director Elefante said no.

Ms. Niwao said that part of the higher 2016 estimated taxes paid in would have been paid in the first 6 months (January to June), which would have been reflected in the prior fiscal year. The second half of the 2016 estimated taxes would be paid in the current fiscal year, and the refunds for the excess taxes paid would be paid in 2017. In addition, the 2017 estimated taxes would be based upon the 2016 tax liability, which may be lower than what was paid in the first half of 2016.

Dr. Bonham said he moves to adopt a 5% growth rate for the last 7 months of this fiscal year and do the calculation and come up with a forecast. Mr. Case seconded the motion. Dr. Suyderhoud said and that's going to result in a total growth rate of 3.2% at the end of the fiscal year.

Ms. Niwao said the problem with the analysis is that we have collected money in advance for estimated taxes that will have to be refunded. Dr. Suyderhoud said what we think is that the economic growth is going to show up in the other tax collections and offset that so that overall revenue growth for the fiscal year will be 3.2%.

Ms. Niwao said there's another $10 million hurdle to go over in February (about $30 million collected in September 2015 and $10 million collected in February 2016), and the February base would be higher. Dr. Bonham said so you're talking about less than 1/10 of 1% ($10 million) of total general fund. Ms. Niwao stated that the actual tax collections for the 5 months also showed a growth rate of .7%, and she was uncomfortable to be so far off from the actual tax collections.

Ms. Niwao said she thought 3.5% is too high. Dr. Suyderhoud said no one said 3.5. Dr. Bonham said to think about it this way that the Council's previous forecast which looks to be way too high—5.5% that's below-the-line.

Dr. Suyderhoud asked if there could be a straw vote because we've got two pretty much opposing views on what we think the rest of the fiscal year is going to look like. A sub-set of us believe that 5% resulting in 3.2% or 3.1% or maybe 3% is one scenario. Chair Kawafuchi said he didn't think that there's a majority to carry it at this point. He said there are three in favor (takes 4 to carry). Ms. Maynard said she would be comfortable with a 3% number. Chair Kawafuchi thought so as well.

Dr. Suyderhoud asked Dr. Bonham if he would go with 3%. Dr. Bonham said yes, and that there's not enough difference. Dr. Suyderhoud said two that made the motion are willing to change to 3. Chair Kawafuchi asked Dr. Bonham if he wanted to amend the motion. Dr. Bonham said yes. Mr. Case seconded.

Chair Kawafuchi said the motion is for 3% growth rate for the current fiscal year. Ms. Maynard said that Ms. Niwao is still feeling uncomfortable because that's too high.

Dr. Suyderhoud called to question. Chair Kawafuchi said to Ms. Niwao that he thought the rest of the Council is comfortable with 3%. Ms. Niwao said that's fine and that she'll abstain from the vote. Dr. Suyderhoud suggested to Ms. Niwao to vote no if she disagreed, rather than abstain. Chair Kawafuchi said just to have it on record and asked who votes for 3.0% below-the-line forecast.

<u>It was moved by Dr. Bonham that the general fund tax revenues growth rate be 3.0% for FY 2017 (below-the-line). Mr. Case seconded. The Chair called for the vote, and the motion passed with the following votes:</u>

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**No**
Jack P. Suyderhoud	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Excused**
Ed Case	**Yes**

Kristi L. Maynard	**Yes**

GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2018 THROUGH 2023:

Next the Council discussed the general fund revenue forecast for the out years. Chair Kawafuchi asked for the Council's projections for the out years (table 1, page 1). He said 5% (FY 2018); 4.4% (FYs 2019 through 2023).

Chair Kawafuchi said we haven't taken a vote on the out years. Dr. Suyderhoud said the motion is to keep the same growth rates but apply to the lower base. That's the motion. Ms. Maynard said she seconded.

A motion was made by Ms. Niwao that the general fund revenue forecast remain at 5.0% (2018); 4.4% (2019); 4.4% (2020); 4.4% (2021); 4.4% (2022); 4.4% (2023). Ms. Maynard seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**Yes**
Jack P. Suyderhoud	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Excused**
Ed Case	**Yes**
Kristi L. Maynard	**Yes**

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:
Significant Changes from September 2016 Report

Mr. Chun provided the Council members with Budget & Finance's report of revised projections of general fund non-tax revenues and non-general fund tax and non-tax revenues since the September 2016 meeting. Mr. Chun said the report includes a brief summary of significant changes and that there are several significant changes highlighted:

General Fund Non-Tax Revenues

Non-Revenue Receipts – the increase in FY 17 reflects the proceeds from premiums on bonds sold (B&F). ($73,199,534)

Other Than Special Fund Non-Tax Revenues

Federal Grants – The net increases in FYs 17-23 reflect an increase in anticipated federal funds for the federal medical assistance program at DHS (FY 18 - $108.4M, FY 19 – FY 23 - $66.1M)

Non-Revenue Receipts – The net increases in FY 17 reflect additional OPEB contributions in FY 17. ($119.3M)

Ms. Maynard moved to accept the B&F report as submitted and Dr. Suyderhoud seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**Yes**
Jack P. Suyderhoud	**Yes**
Carl S. Bonham	**Yes**
Christopher Grandy	**Excused**
Ed Case	**Yes**
Kristi L. Maynard	**Yes**

NEXT MEETING:

The Council tentatively agreed to meet on Monday, March 13, 2017 at 2 p.m.; however, the date and time will be confirmed by e-mail. The Council staff will attempt to secure the DLIR Conference Rooms 310-313.

The Chair adjourned the meeting.

ADJOURNMENT:

The meeting adjourned at 2:56 p.m.