

Hawaii
The Aloha State



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MID-PROJECT UPDATE

Hawai‘i Tax Review Commission Study of the Hawaii Tax System

June 21, 2012

THE PFM GROUP

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Today's Agenda

- Introductions
- Project Status
- Benchmarking and Ranking Metrics
- Financial Model: Baseline and Key Assumptions
- Key Issues
- High Level Findings
- Possible Revenue Approaches
- Questions and Discussion



Project Status

- ✓ Phase I – Project Planning: Completed
- ✓ Phase 2 – Information Gathering: Mostly Completed
- Phase 3 – Evaluation: In-Progress
- Phase 4 – Recommendations: August and September

Activities	February	March	April	May	June	July	August	September																									
	13	20	27	5	12	19	26	2	9	16	23	30	7	14	21	28	4	11	18	25	2	9	16	23	30	6	13	20	27	3	10	17	24
Phase 1 - Project Planning/Management																																	
Submit detailed information request	X																																
Provide a comprehensive detailed project plan	X																																
Provide a prototype project management report	X																																
Schedule kick-off meeting and initial interviews	Y	X																															
Prepare an engagement letter for project kick-off		Y	X																														
Provide written discussion topics for interviewees		Y	X																														
Identify peer states for benchmarking		Y	X																														
Provide written monthly project reports			X																														
Phase 2 - Information Gathering																																	
Hold project kick-off and first round of on-site interviews			X																														
Prepare and submit electronic benchmarking survey			Y	X																													
Follow-up on information request outstanding data			Y	X																													
Drop dead date for receiving data for models				X																													
Follow-up on interviews - additional questions/information				Y	X																												
Follow-up on survey with benchmark states					Y	X																											
Develop and populate financial models						Y	X																										
Drop dead date benchmarking surveys							X																										
Review model assumptions with state SMEs							Y	X																									
Phase 3 - Evaluation																																	
Finalize model baseline - revenue/expenditure																																	
Conduct tax and revenue best practices research																																	
Analyze benchmarking survey data/responses																																	
Identify and analyze revenue policy alternatives																																	
Develop project high level findings																																	
Evaluate the need for alternate revenue structure report																																	
Mid-project milestone to communicate project progress																				X													
Phase 4 - Recommendation																																	
Finalize annotated report outlines																																	
Finalize all models and outputs																																	
Draft report(s)																																	
Communicate/discuss/review as appropriate																																	
Draft and submit final report(s)																																	
Communicate project findings																																	

*Colored boxes indicate level of work intensity (yellow = low; orange = medium;
X indicates the submission of a deliverable to client



Project Status

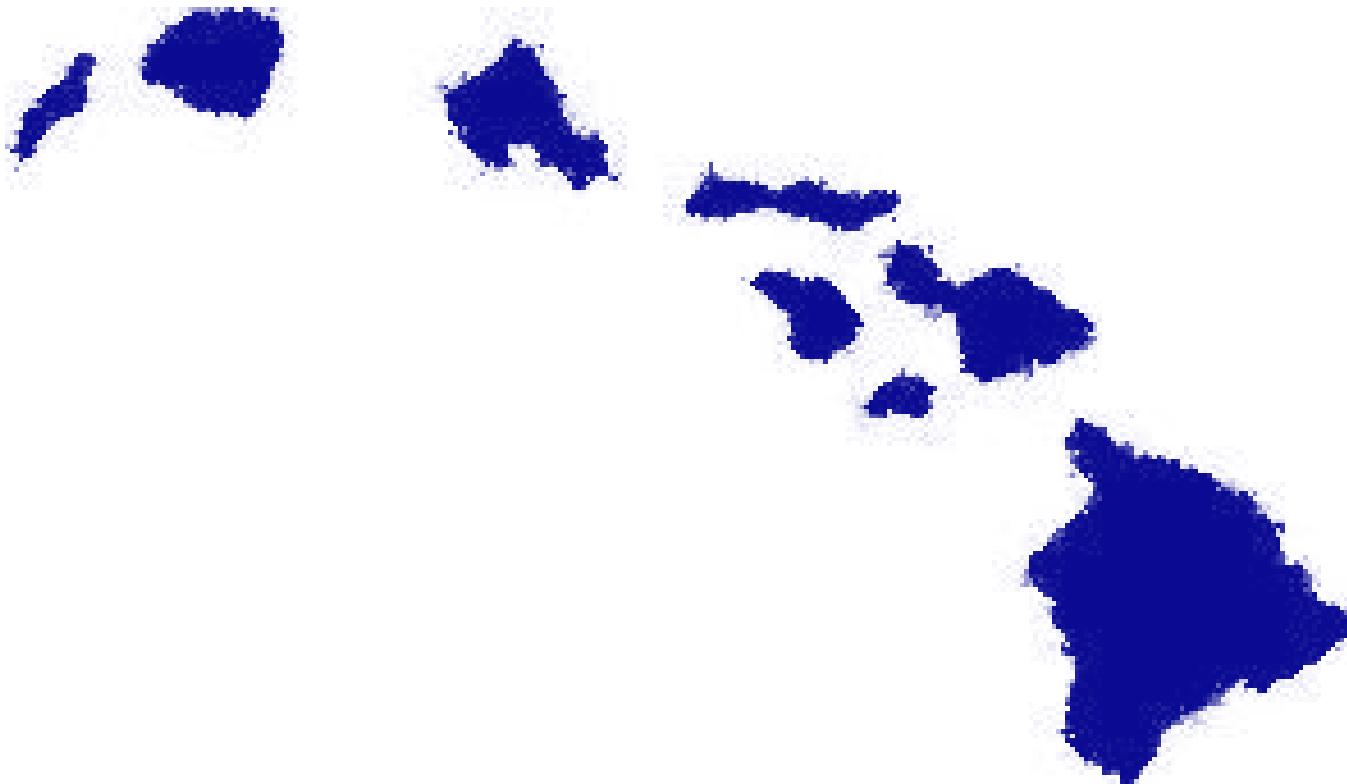
- Expenditure data issues have slowed the timeline for analysis
- As was noted at the beginning of the project, there was some ‘room’ on the timeline to accommodate this without jeopardizing timely completion of the project deliverables
- The Project Team is confident that we can stay on course and on schedule for remaining project activities and deliverables



Mid-Project Milestone

- Goal for today is to provide a high level update on project approach and direction
- An opportunity for two-way communication as the Project Team moves toward more concrete conclusions
- This is an inflection point, not an end point, for the project
 - While the PFM models include data and assumptions for baseline and trend line analysis, they are not ‘set in stone’
 - The project team will continue to refine its assumptions and analysis and vet them with appropriate subject matter experts

Distinctly Hawai‘i





Characteristics Unique to Hawai‘i

- More so than most states, Hawai‘i has historically had a predominant single economic driver – which can be both a strength and a weakness
- As tourism has ascended to the top as the State economic driver, it is important to ascertain whether its role in the economy is likely to be constant or also change over the timeframe analyzed for this report
- The multi-cultural heritage of Hawai‘i must also be considered in the analysis of likely budgetary drivers, both on the expenditure and revenue sides of the equation



Economy: Tourism

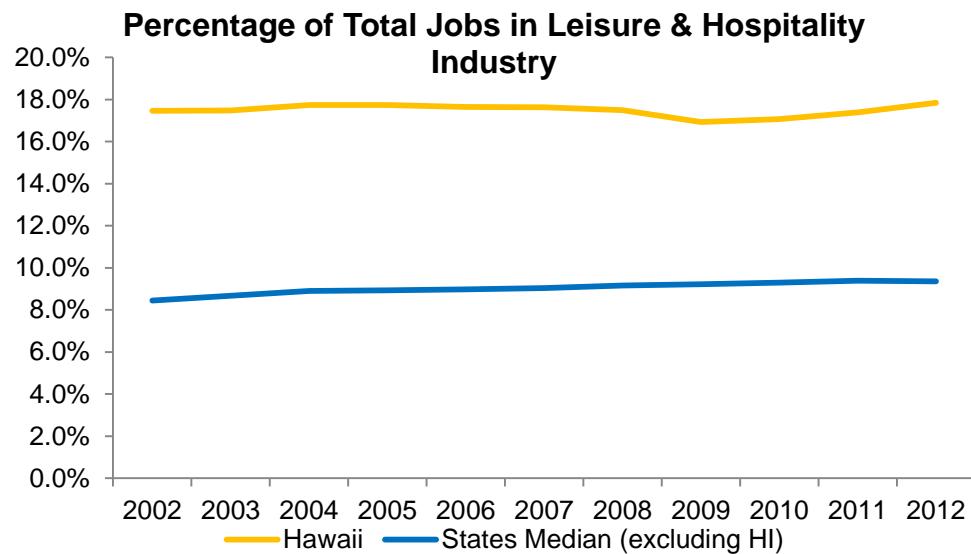
- A 2009 study suggested that 24 percent of Hawai‘i non-farm jobs are created by tourism (over 141,000 jobs)
- The study indicated that travelers spent over \$14 billion in the Hawaiian economy in 2009 and the tourism industry had a payroll of over \$4 billion
- A 2011 study suggested that tourism directly contributed over \$8 billion to Hawai‘i’s GDP – with an additional \$3 billion of indirect contributions to GDP
 - Taken together the \$11 billion comprised over 16 percent of total GDP; if including induced effects, the percentage increases to 22 percent

Source: U.S. Travel Association – *Why Travel Matters to Hawaii*; UHERO – *The Direct and Indirect Contributions of Tourism to Regional GDP: Hawaii* (2011)



Economy: Leisure & Hospitality Industry

- This industry in Hawai‘i employs approximately 105,000 individuals as of Jan 2012 – approximately 18 percent of total jobs in the State
 - Only Nevada has a greater share of its total jobs in this industry
- Nationally, leisure and hospitality employment has maintained or grown its share of total employment from 2002-2012



Source: BLS – CES Data – January 2002 – January 2012 Not Seasonally Adjusted



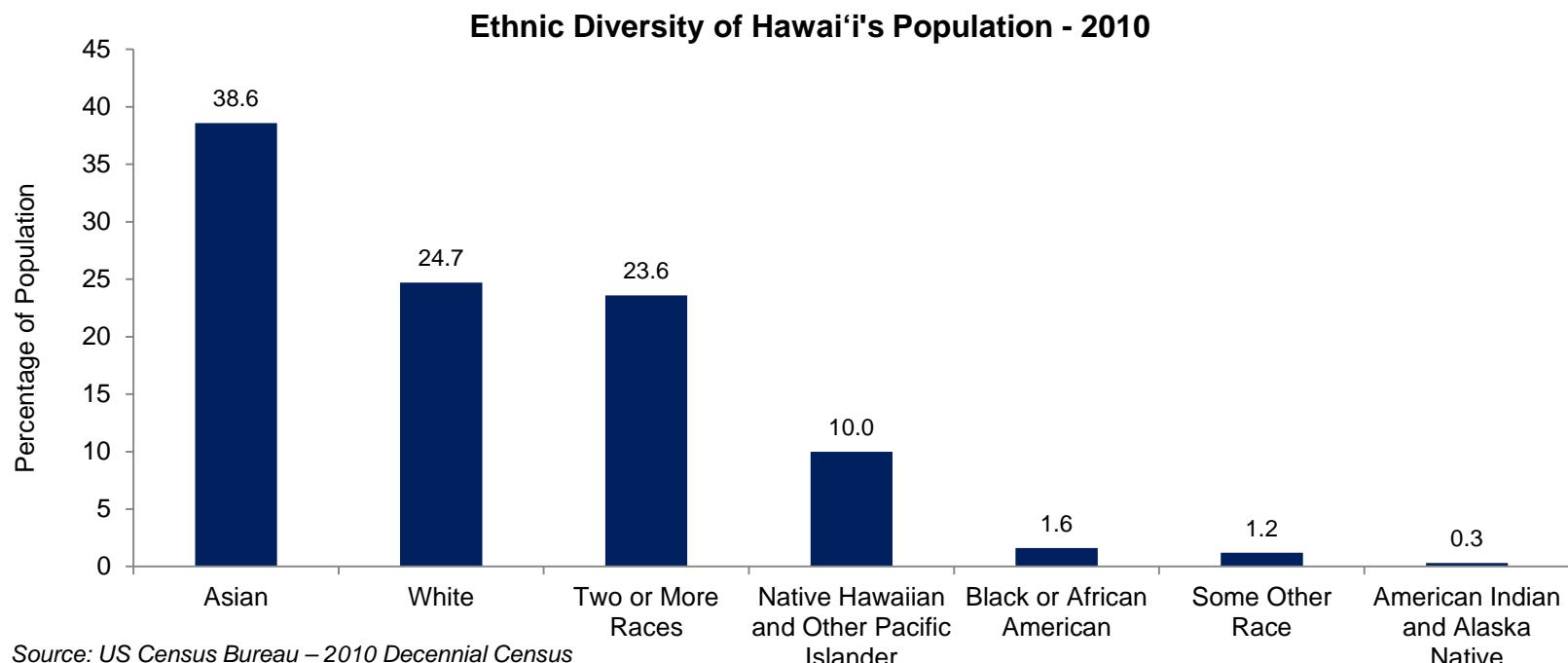
Economy: Leisure & Hospitality Industry

- In 2012, Leisure/Tourism jobs as a percentage of total jobs is smaller in only 5 states than in 2000 (MN, MS, ND, UT, WY)
- Among states that experienced growth in the share of leisure and hospitality jobs during this time period, Hawai‘i's 0.4 percent growth was 35th out of 45. CA led with 1.5 percent growth, followed by NC (1.5), NY (1.4), WV (1.3), and DE (1.3)



Population Profile: Ethnic Diversity

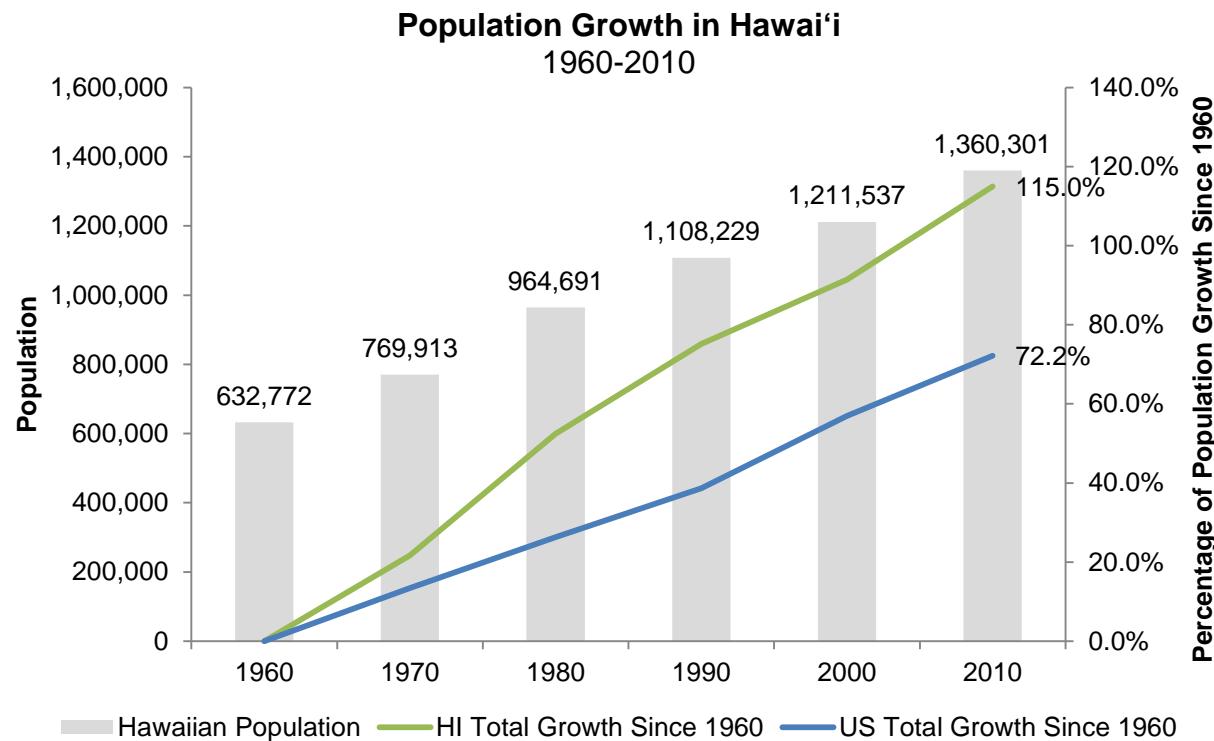
- Hawai‘i is among the most diverse states – with the greatest percentage of residents in any state identifying as ‘Asian’ (39 percent) and ‘two or more races’ (24 percent)
- The percentage of citizens who identify as ‘white’ is the lowest among the 50 states at 25 percent





Population Growth Exceeds Nation

- Hawai‘i ranks 40th among states in population with 1.36 million residents
- Hawai‘i more than doubled in population between 1960 and 2010 – growing at a much faster rate than total US population





Hawai‘i: A High Income State

■ Per Capita Income

- Ranks among the top one-third of all states in the US and 16th overall at \$28,417
- Over \$3,000 greater than the median of all other states and almost \$1,500 greater than the per capita income of the US as a whole

■ Median Household Income

- Ranks 5th among all 50 states at \$66,201
- Over \$17,000 greater than the median among the other 49 states and almost \$15,000 greater than the US median household income

	PER CAPITA INCOME	MEDIAN HOUSEHOLD INCOME
HAWAI‘I	\$28,417	\$66,201
RANK AMONG STATES	16	5
VARIANCE FROM US (\$)	\$1,475	\$14,979
VARIANCE FROM US (%)	5.5%	29.2%

Source: US Census Bureau 2010 ACS 3-year estimates



Hawai‘i: High Median Home Value

- Hawai‘i has the highest median home value among all states at \$534,900
 - Median home value among those with a mortgage and those without a mortgage is very similar (\$535,300 w/ a mortgage; \$533,900 w/o a mortgage) – both are highest among all states
- Among those earning \$50,000 to \$74,999 (HI median income: \$66,201), 84.9 percent of homes are valued at \$250,000 or more
 - Approximately 40.5 percent are valued between \$250,000-\$499,999; 44.4 percent are valued at \$500,000 or more
- Property owners in Hawai‘i pay a proportionally smaller percentage of property taxes compared to property value than many states
 - Hawai‘i ranks 33rd in median real estate taxes paid at \$1,377 per year

Note: HI Constitution reserves property tax for local governments

Source: US Census Bureau 2010 ACS 3-year estimates



Hawai‘i: High Educational Attainment

- Generally well-educated compared to the other 49 states
 - Ranks 9th among states in percentage of population with a high school diploma or higher (90 percent) and 16th in percentage of population with a bachelor's degree or higher (29 percent)
 - Comparatively, Hawai‘i has a relatively low percentage of its population who have not achieved at least a high school diploma (10 percent) and ranks above average for median earnings for this cohort

	Less than High School Diploma	High School Diploma	Some College (no degree) / Assoc. Degree	Bachelor's Degree	Graduate or Professional Degree
HAWAI‘I	9.9%	28.9%	32.0%	19.5%	9.7%
Rank	41	27	15	12	21
Median Earnings	\$20,275	\$28,993	\$34,694	\$45,269	\$61,052
Rank	17	13	14	23	22

Source: US Census Bureau 2010 ACS 3-year estimates



Ranking: Low Poverty

- Hawai'i has among the smallest percentage of its population living in poverty (10 percent) and ranks 45th out of the 50 states in this percentage
 - The percentage of Hawai'i residents under age 18 and age 65 and above who live in poverty is among the lowest of all 50 states
 - 13 percent for those under age 18 – ranking 47th
 - 7 percent for those age 65 and above – ranking 46th

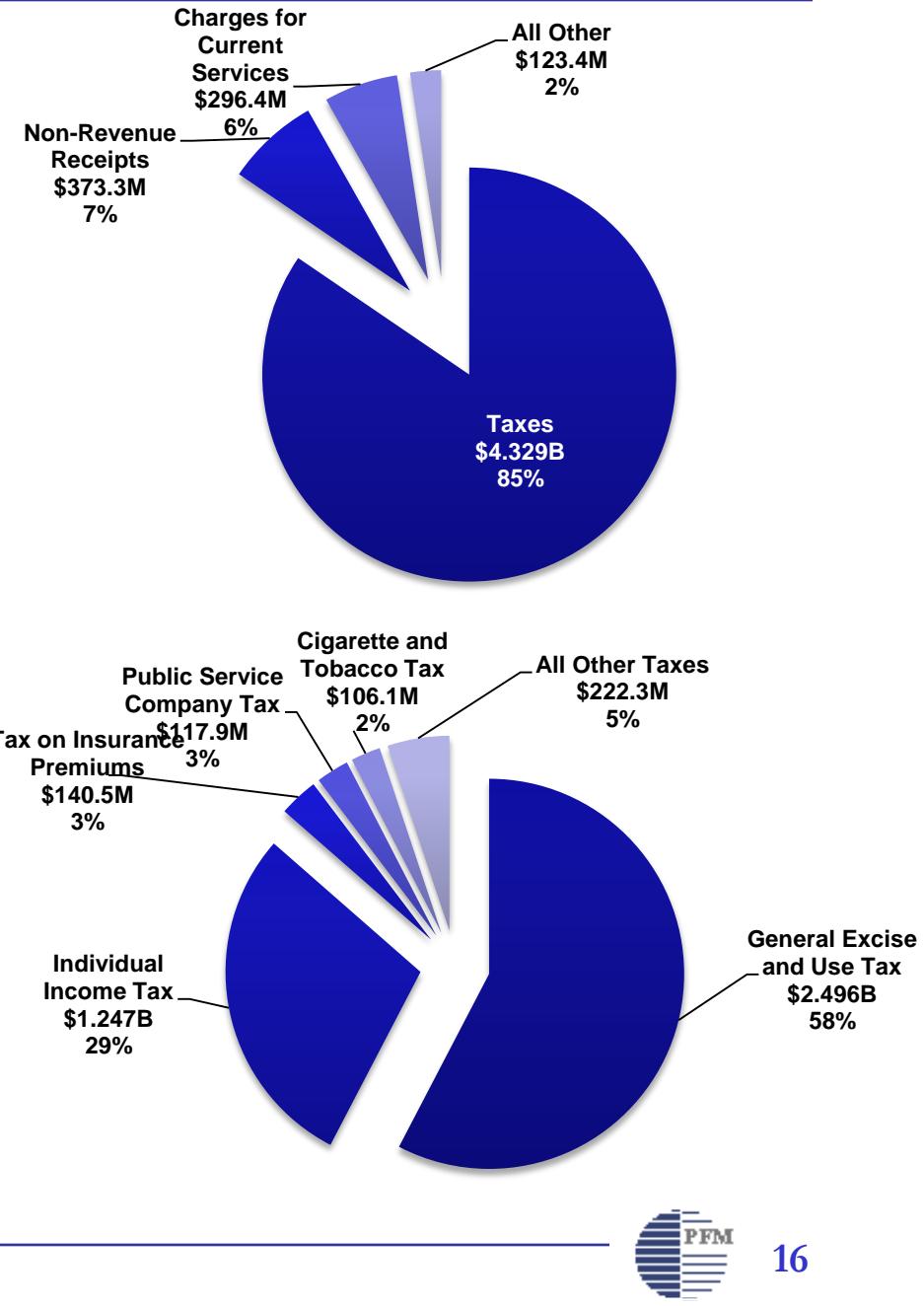
	Percentage of Total Population Living in Poverty	Percentage of Children Living in Poverty	Percentage of Seniors Living in Poverty
HAWAII	10.0%	12.7%	6.9%
HI Rank	45	47	46
US	14.4%	20.1%	9.4%

Source: US Census Bureau 2010 ACS 3-year estimates



Key Revenues: Taxes, Taxes, Taxes

- The 2010 US Census Survey of the States shows that Hawai‘i derives 50 percent of general revenue from taxes, in comparison to 45 percent nationally
- Hawai‘i’s GF is even more reliant on taxes - \$4.3 billion in FY 2011 or 85 percent of total GF revenue
- The largest GF tax revenue source is the General Excise Tax (GET), accounting for \$2.5 billion or 58 percent of total tax revenue collected in FY 2011
 - Nationally, **individual income tax** is the largest contributor, accounting for 33.6 percent of total general revenue derived from taxes (US Census)





Benchmarking: GET/Sales Taxes

- Hawai‘i’s GET rate of 4.0 percent is among the lower rates of sales-like taxes in states; however, it applies to more goods and services than most other states
 - For example, Hawai‘i taxes food, but allows income tax offsets to compensate low income households
 - According to an FTA study of the most common 168 services, Hawai‘i GET applies to 160 of the services – ranking 1st among all states
- Hawai‘i’s GET is responsible for providing approximately 51.4 percent of the state’s total tax revenue – ranking 5th among the 50 states in sales/gross receipts tax revenues as a percentage of total tax revenue (trailing WA, FL, SD, TN)
- Hawai‘i is the only state that broadly taxes goods and services that also has a broad-based income tax

Source: Federation of Tax Administrators (FTA) – 2012 Data; FTA 2007 Tax Survey;
US Census Bureau 2011 State Government Tax Collections Data





Benchmarking: Personal Income Tax

- Hawai'i income tax burden is shouldered by residents
 - Hawai'i personal income tax yielded approximately 95 percent of all income taxes collected (CNIT yields remaining 5 percent) – the 2nd highest proportion of personal income tax revenue to total income tax revenue among states (trailing only OH)
- In 2010, Hawai'i median household income of \$63,030 would have been taxed (assuming joint filing) at a rate of 7.6 percent prior to deductions
 - Using median household incomes, Hawai'i's joint filing income tax rate is the 4th highest among the 50 states (trailing only OR, ME, IA)

Hawai'i Personal Income Tax Details – 2000-2011

Year	Marginal Rates (range)	# of Brackets	Lowest Bracket (under)	Highest Bracket (over)
2000	1.6-8.75%	9	\$2,000	\$40,000
2001	1.6-8.75%	9	\$2,000	\$40,000
2002	1.5-8.5%	9	\$2,000	\$40,000
2003	1.4-8.25%	9	\$2,000	\$40,000
2004	1.4-8.25%	9	\$2,000	\$40,000
2005	1.4-8.25%	9	\$2,000	\$40,000
2006	1.4-8.25%	9	\$2,000	\$40,000
2007	1.4-8.25%	9	\$2,000	\$40,000
2008	1.4-8.25%	9	\$2,400	\$48,000
2009	1.4-11%	12	\$2,400	\$200,000
2010	1.4-11%	12	\$2,400	\$200,000
2011	1.4-11%	12	\$2,400	\$200,000

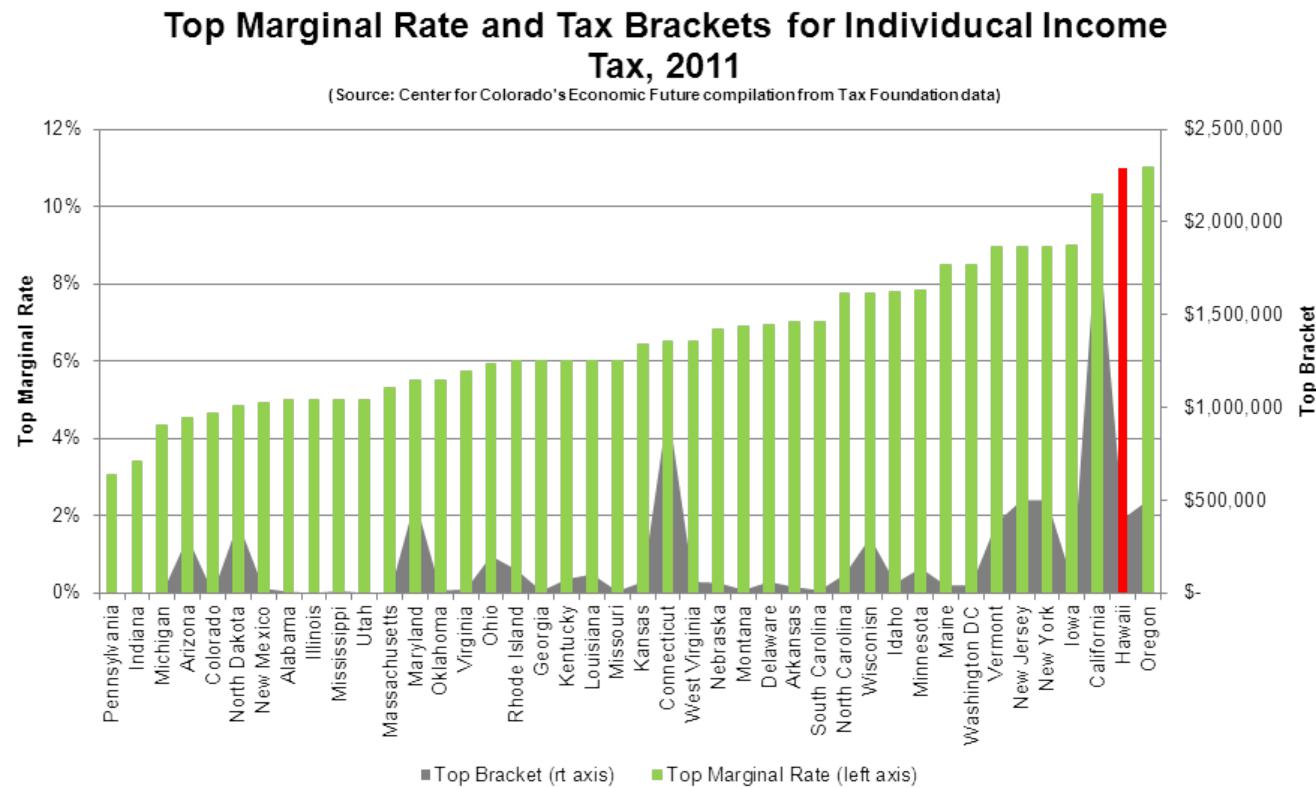
Source: Federation of Tax Administrators (FTA) – 2012 Data; US Census Bureau 2011 State Government Tax Collections Data; Tax Foundation 2011 Data





Benchmarking: Personal Income Tax

- In 2011, Hawai‘i had the highest top marginal tax rate among states (tied with Oregon) at 11 percent
 - The top bracket includes those with taxable income of at least \$200,000 (individual) or \$400,000 (joint)

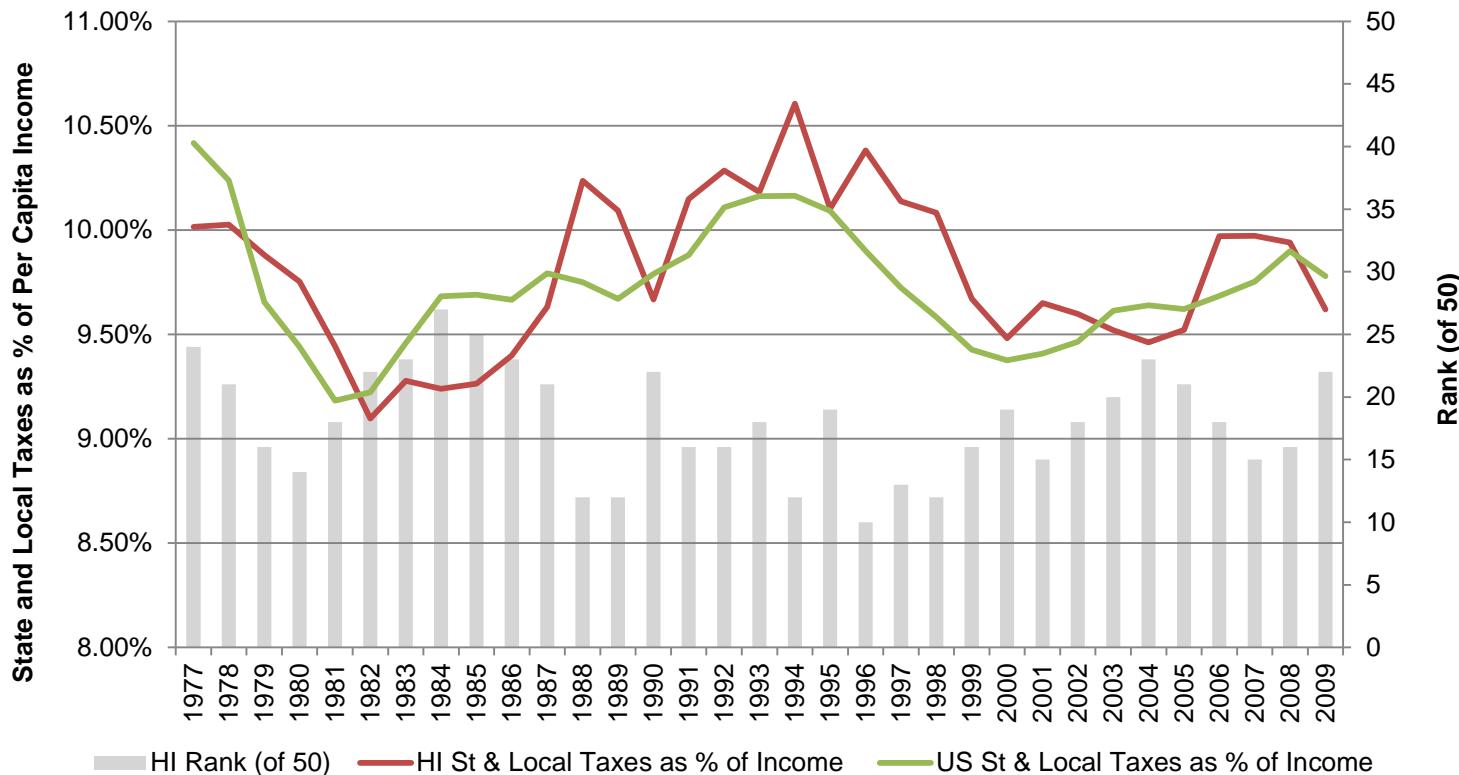


Source: Federation of Tax Administrators (FTA) – 2012 Data; US Census Bureau 2011 State Government Tax Collections Data; Tax Foundation 2011 Data



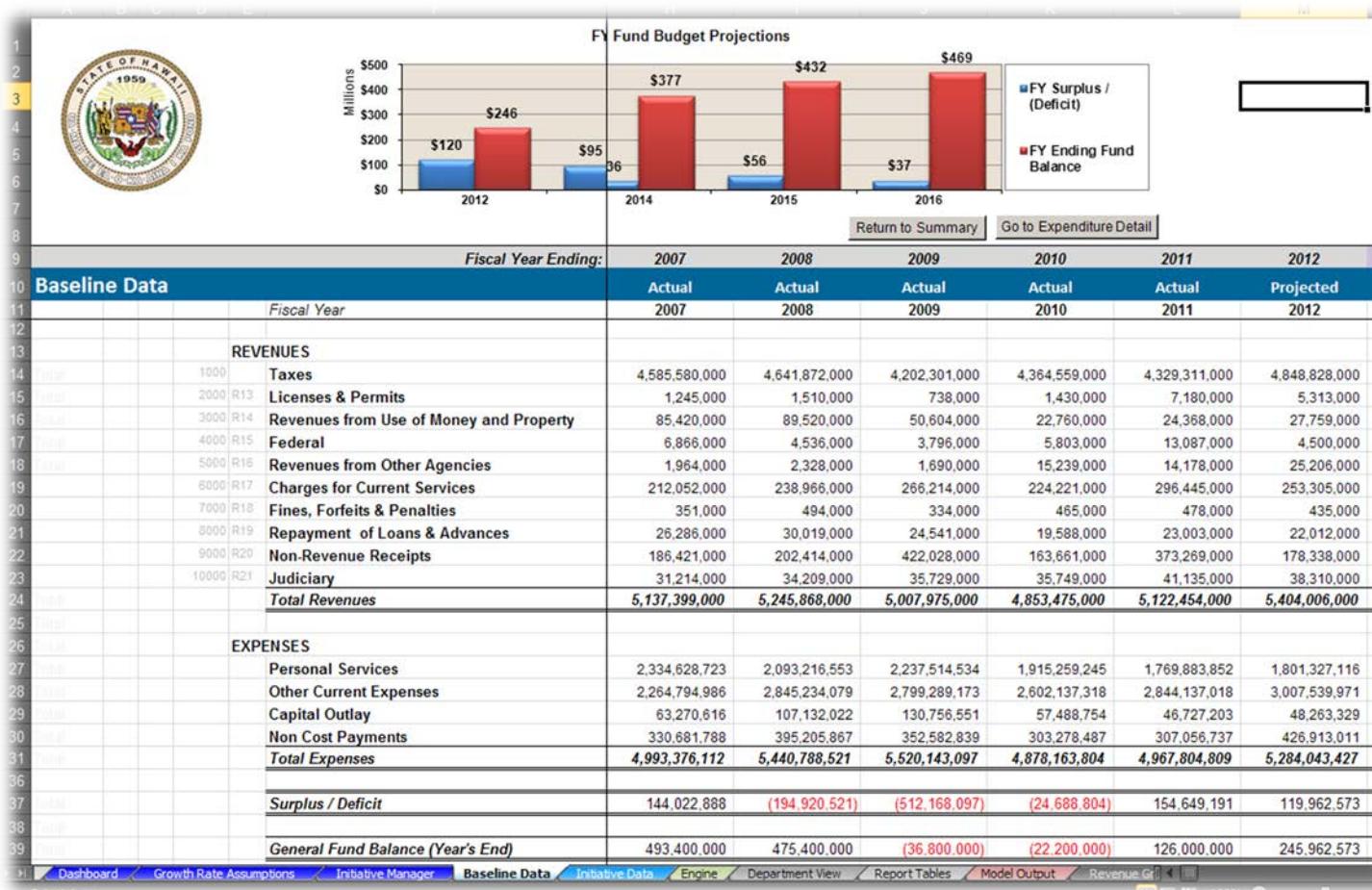
Benchmarking: Tax Burden

- In 2011, Hawai'i ranked 6th on state taxes as a percent of per capita income
- For state and local taxes Hawai'i generally ranks in the top half of states



Source: Tax Foundation Tax Burden Analysis Data – 1997-2009

Financial Projection Model





Financial Model: Overview and Update

- Data provided for FY 2006-2011 by the State has been uploaded into the model; further vetting and quality checking is required
- The recent economic downturn, combined with reductions in State spending has resulted in erratic changes in expenditures since 2009
- In order to mitigate these swings going forward, the Project Team used a preliminary methodology to populate the Financial Projection Model for Hawai‘i
- This methodology will be adjusted based on feedback and additional data analysis



Financial Model: Input Methodology

- The preliminary methodology includes the following:
 - **Flat Growth (0%)** = areas of significant decline in spending or incomplete historical data
 - **State CPI Forecast*** = areas of significant growth in spending or incomplete historical data (3% in 2012, 2.8% in 2013, 2.5% in 2014 and beyond)
 - **Other State Provided Forecasts** = areas where growth / decline is currently known or forecasted with reasonable confidence (i.e. health benefits, pension contributions, current debt service)
 - **Blended AAG / CAGR** = expense areas with similar Average Annual Growth Rate and Compounded Annual Growth Rate were determined using a blended average
 - Council on Revenues projections for 2013-2018 on revenues

*Based on 2nd Quarter Forecast published by Hawaii's Department of Business, Economic Development, and Tourism

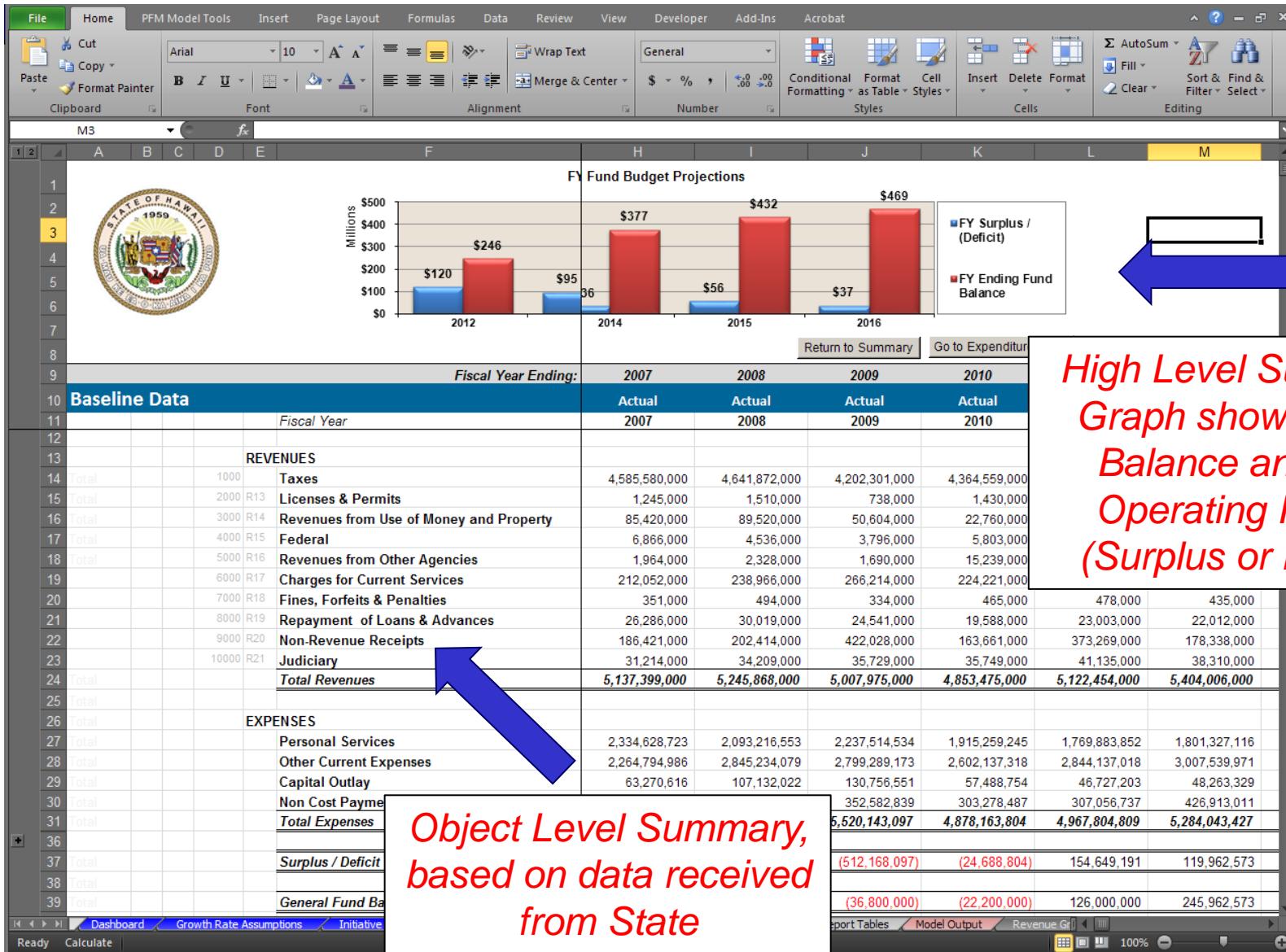


Financial Model: Key Action Items

- Key areas within the model require additional information and quality assurance by State officials and staff:
 - **Personal Services** – Detailed historical collective bargaining agreements and employee data, such as average Salary by Bargaining Unit
 - **Debt Service** – Current breakdown of principal and interest on debt outstanding and future bond issuances
 - **Approval of Expenditure Growth Rates** – Erratic historical data should be vetted with key staff; the quality and approval of growth rates will have direct impact on accuracy of forward projections



Financial Model: Baseline Data





Financial Model: Growth Rate Assumptions

File Home PFM Model Tools Insert Page Layout Formulas Data Review View Developer Add-Ins Acrobat

Cut Copy Format Painter Paste Clipboard Arial 14 A A Wrap Text General \$ % , .00 .00 Merge & Center Alignment Conditional Formatting as Table Styles Cell Styles Insert Delete Format Cells AutoSum Fill Clear Sort & Filter Select Editing

GRAlFunds_GoTo Revenues

FY12 - FY16 General Fund Budget Projections

Revenue Growth Scenario

Multi-Year Budget Projection Model

Growth Rate Assumptions

Revenues

Fund Name	Growth Rate Name	2011	2012	2013	2014	2015	2016
		General Fund	General Excise and Use Tax	0.00%	5.31%	8.45%	3.08%
General Fund	Individual Income Tax	0.00%	16.29%	5.45%	4.84%	8.50%	10.00%
General Fund	Corporate Income Tax	0.00%	126.39%	-24.69%	65.70%	-28.20%	10.00%
General Fund	Public Service Company Tax	0.00%	3.90%	3.19%	3.37%	3.37%	4.08%
General Fund	Tax on Insurance Premiums	0.00%	1.37%	7.15%	2.37%	5.99%	5.89%
General Fund	Cigarette and Tobacco Tax	0.00%	12.52%	4.94%	-14.11%	5.02%	4.89%
General Fund	Liquor Tax	0.00%	2.36%	1.63%	1.37%	1.29%	1.85%
General Fund	Tax on Banks and Other Financial Corps.	0.00%	-11.75%	6.75%	1.24%	4.84%	3.29%
General Fund	Inheritance and Estate Tax	0.00%	184.10%	0.00%	0.00%	0.00%	0.00%
General Fund	Conveyance Tax	0.00%	-13.69%	-13.13%	-25.03%	9.37%	9.01%
General Fund	Miscellaneous Taxes	-1.00%	302.43%	-75.87%	0.09%	-25.97%	-92.82%
General Fund	Transient Accommodations Tax	1.00%	89.06%	13.80%	12.74%	11.87%	-78.09%
General Fund	Licenses & Permits	3.00%	-26.00%	9.41%	0.00%	-82.57%	0.00%
General Fund	Revenues from Use of Money and Property	0.00%	13.92%	-2.74%	-3.21%	-3.69%	-3.74%
General Fund	Federal	0.00%	-65.61%	0.00%	0.00%	0.00%	0.00%
General Fund	Revenues from Other Agencies	0.00%	77.78%	9.78%	-41.56%	-0.01%	-84.37%
General Fund	Charges for Current Services	0.00%	-14.55%	4.10%	1.35%	1.18%	1.09%
General Fund	Fines, Forfeits & Penalties	0.00%	-9.00%	6.90%	-6.45%	6.90%	-6.45%
General Fund	Repayment of Loans & Advances	0.00%	1.24%	10.70%	0.12%	2.24%	2.86%

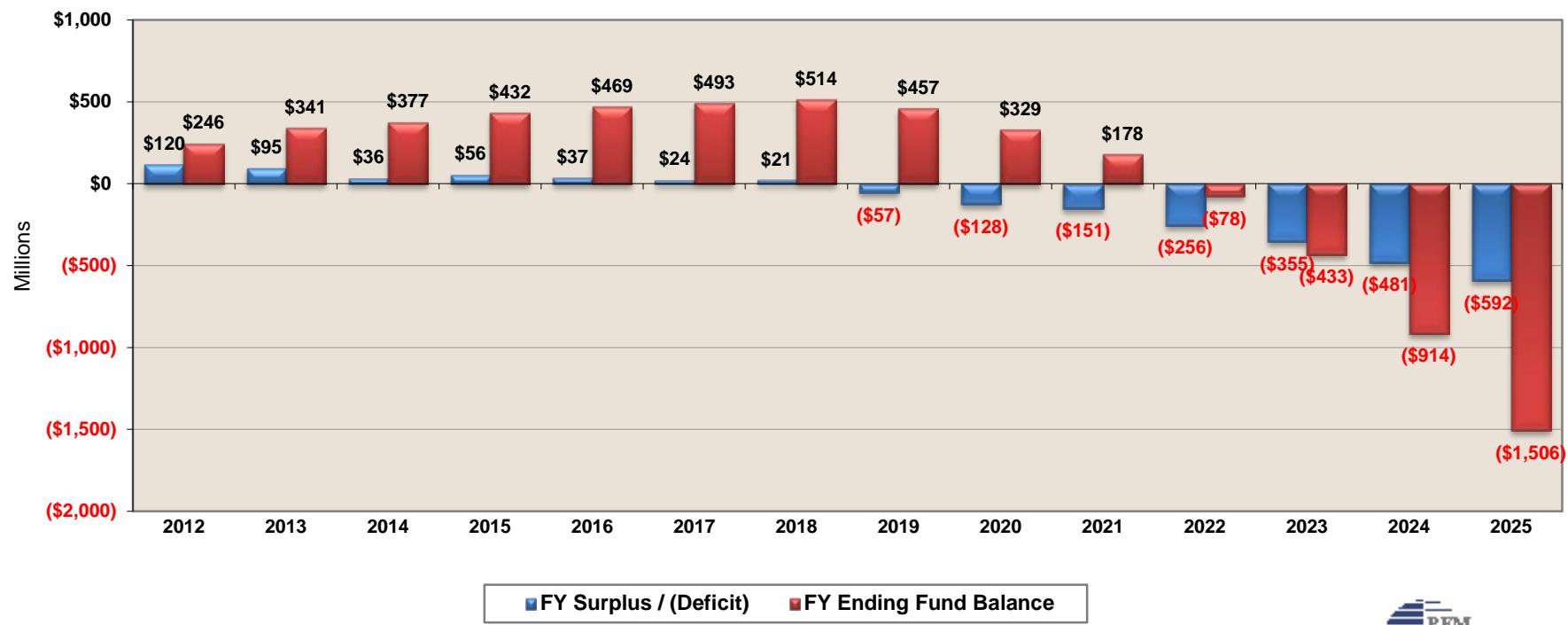
Dashboard Growth Rate Assumptions Initiative Manager Baseline Data Initiative Data Engine Department View Report Tables Model Output Revenue Grid

Flexible Model allows for customizable scenarios and outputs for both Revenues and Expenditures



Financial Model: Current Baseline Forecast

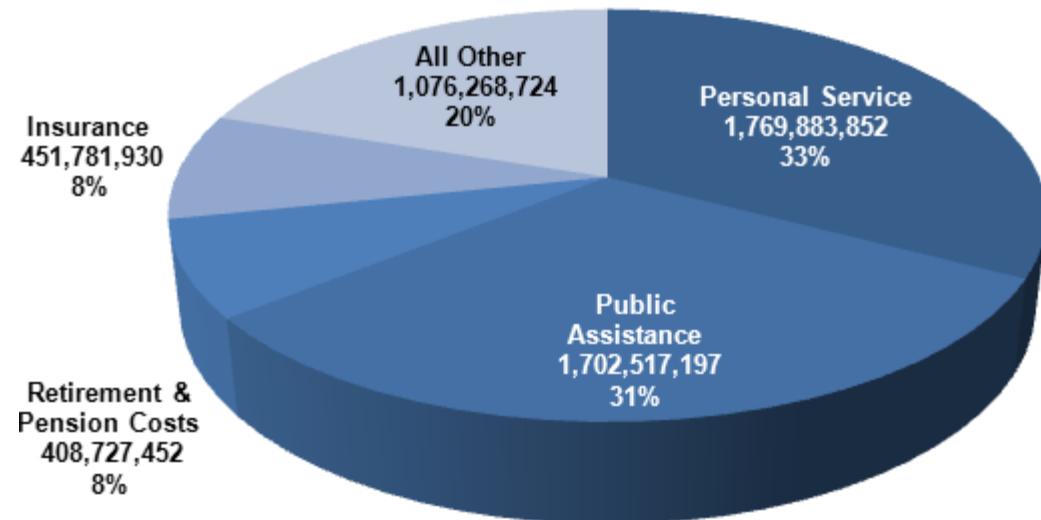
- Using Council on Revenue's current forecast and PFM's current assumptions on expenditure growth, Hawai'i General Fund will begin to experience deficits in FY 2019; these deficits will grow to \$600 million by FY 2025
 - This data is subject to change based on input and additional information from the State***





Key Drivers of Expenses: The “Big 4”

- In FY 2011, four areas accounted for 80 percent of General Fund expenditures, with employee personal services (payroll and contracted services) and public assistance (Medicaid, TANF and Child Care Payments) accounting for over 60 percent

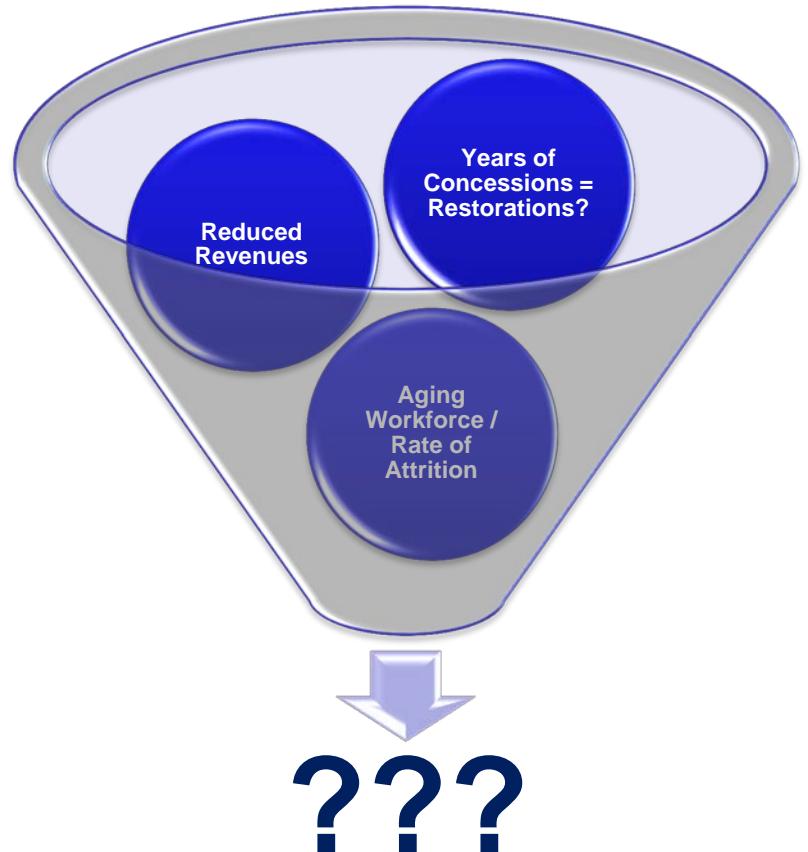


Source: PFM Budget Model; based on data provided by Departments of Revenue and Budget & Finance



Personal Service Costs: Unknown Variables

- Key variable - outcome of labor negotiations post 6/30/13
- Based on historical analysis of salary adjustments for bargaining units, weighted average increase is **3.05%***
- **However...** recent furloughs and reductions in salary could make it likely to assume that unions may call for restorations of past concessions **plus** increases (i.e. COLAs, lump sum payments)

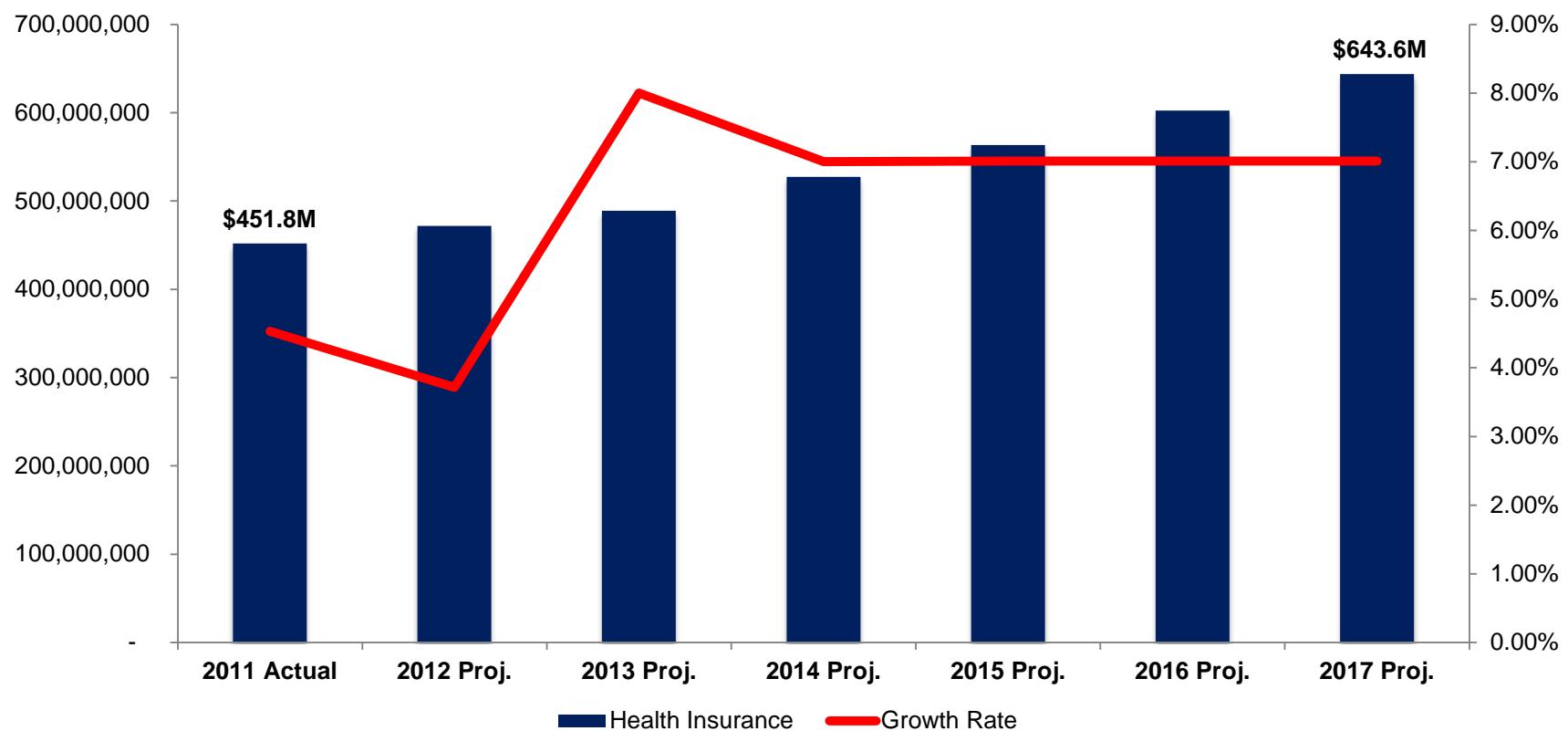


*Subject to revision based on follow up with State officials and staff



Health Benefits

- State currently covers 50 percent of health care premiums
- Current growth rates, as forecasted by EUTF, will result in total health benefit costs of \$644 million by FY 2017, an overall increase of \$192 million, or 43 percent

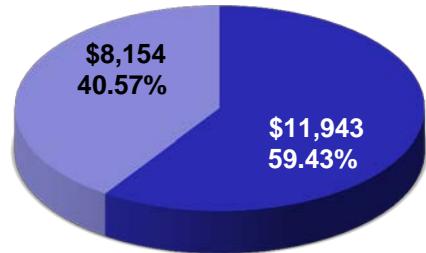




Pension Contributions

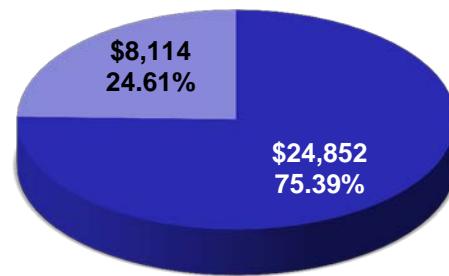
- Significant Unfunded Accrued Actuarial Liability (UAAL) of \$8.154 billion – ERS is currently **60 percent** funded (including county contributions)
- Accrued Actuarial Liability (AAL) of ERS will increase by **64 percent** between 2011 and 2025

2011 Total AAL = \$20.097B



- Actuarial Value of Assets (AVA, in Millions)
- Unfunded Actuarial Accrued Liability (UAAL, in Millions)

2025 Total AAL = \$32.966B

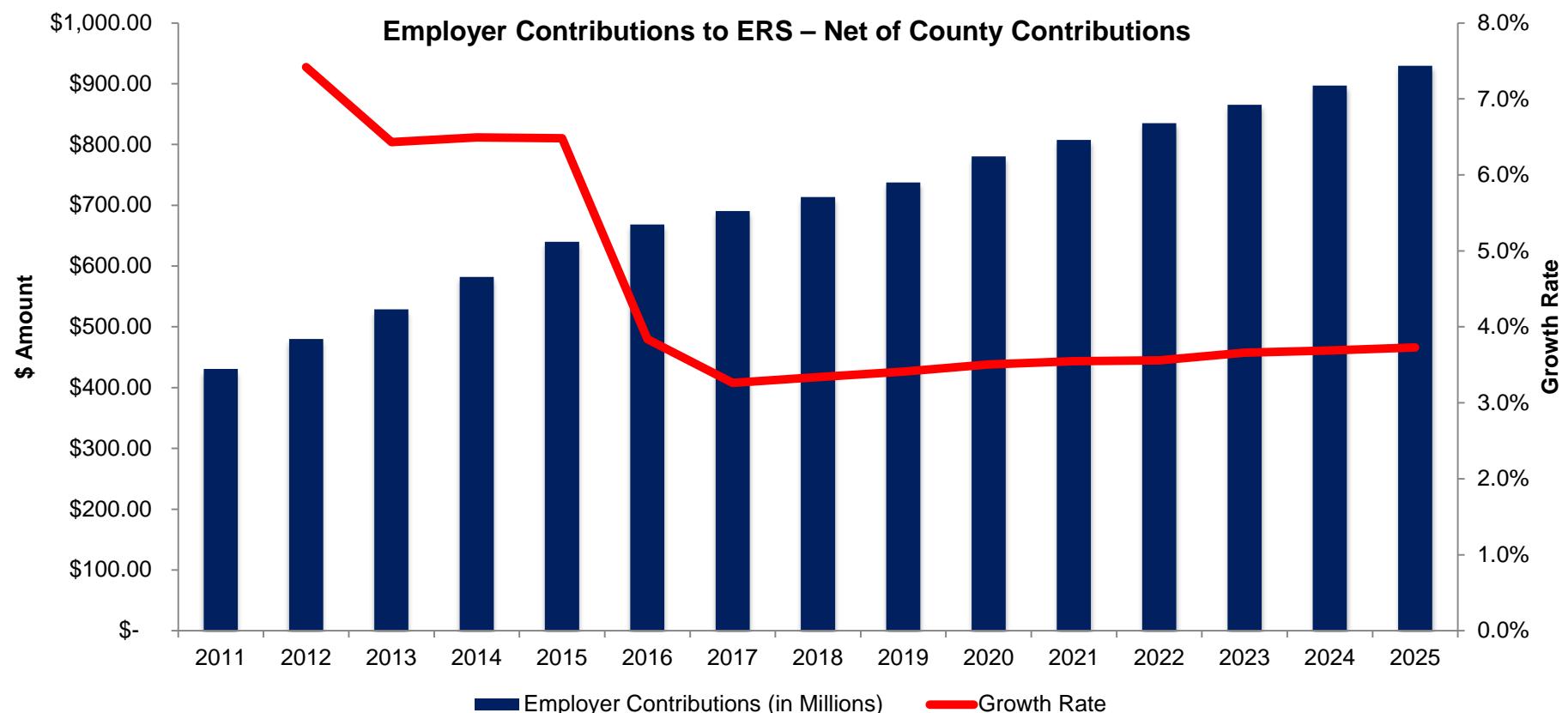


- Actuarial Value of Assets (AVA, in Millions)
- Unfunded Actuarial Accrued Liability (UAAL, in Millions)



Pension Contributions (Con't)

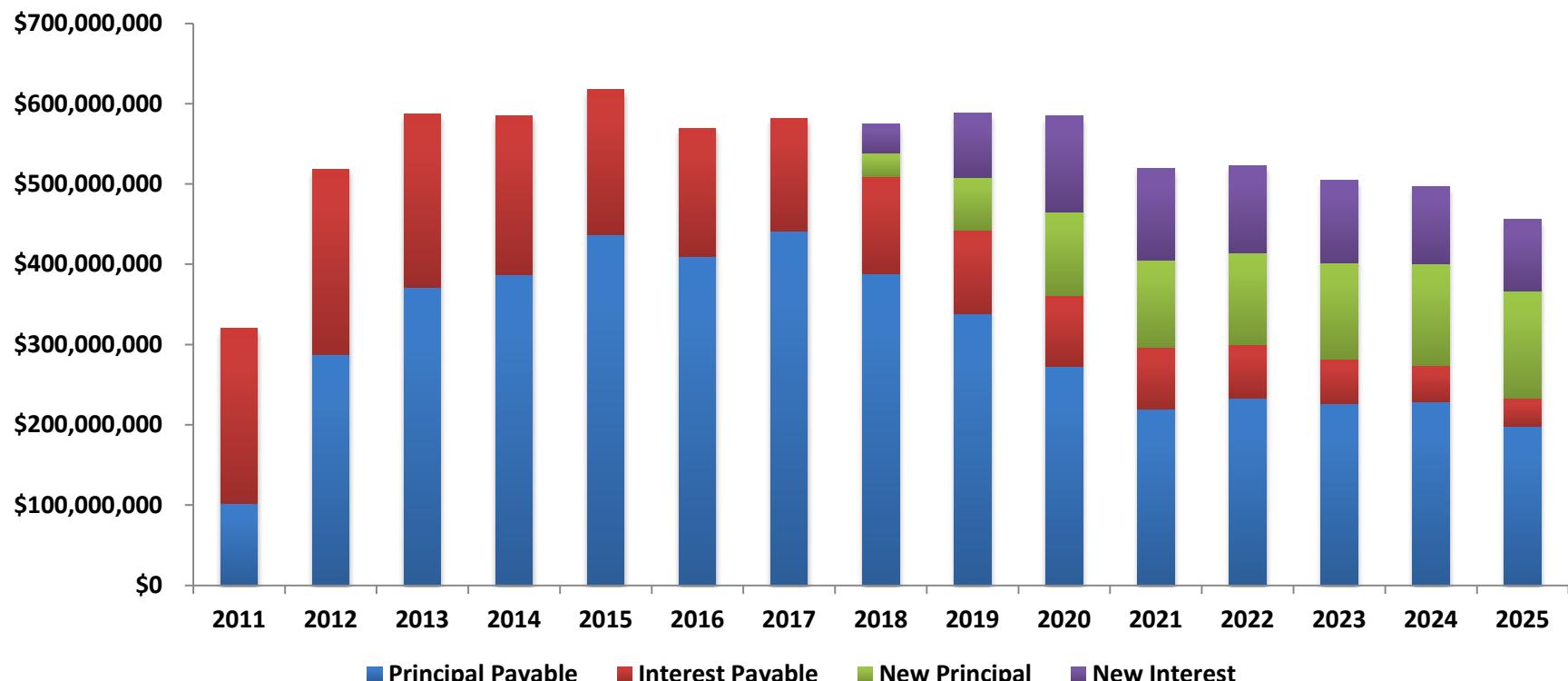
- Based on projected employer contributions to ERS
- Growth rate stabilizes at approximately 3.5 percent post-2016





Debt Service

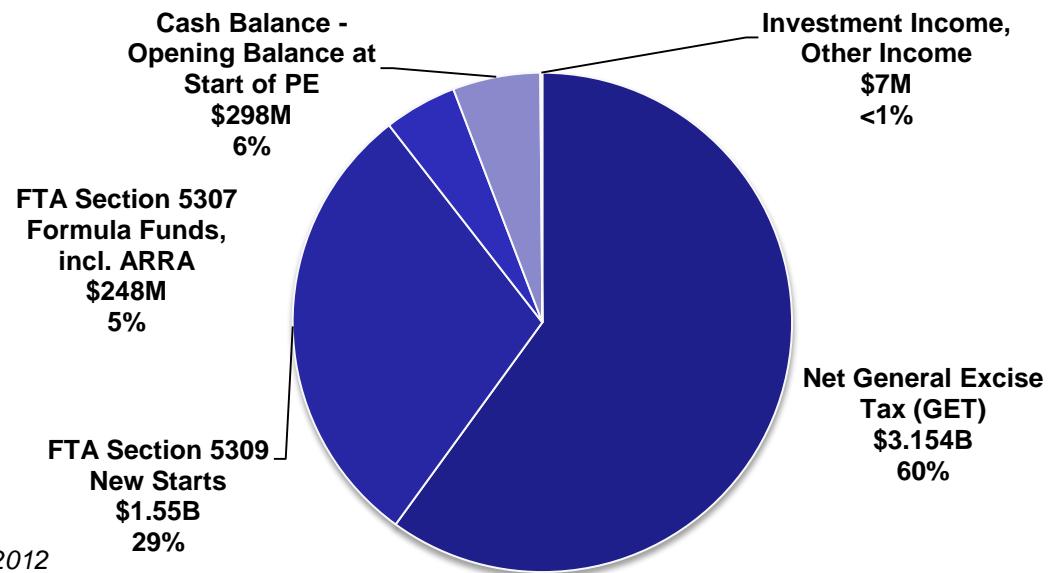
- Current debt service will peak in 2015 and steadily decrease to under FY 2011 level of \$319 million by FY 2021
- **However** – planned future issuances will push total debt service above \$500 million through FY 2023





Future Expenses: Strategic Investments?

- Going Forward, the State will need to adjust for future expenses and strategic investments
 - Rebuild Crumbling Schools
 - Bonded Projects = increased Debt Service, reduce space under Debt Limit
 - Honolulu Rail Project
 - Planned \$3.154 billion investment from GET (60 percent of total revenue), of which \$432 million has been received by HART*



*Source: HART Monthly Report, March 2012

Key Revenue Issues

Jean Baptiste Colbert



“The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing.”



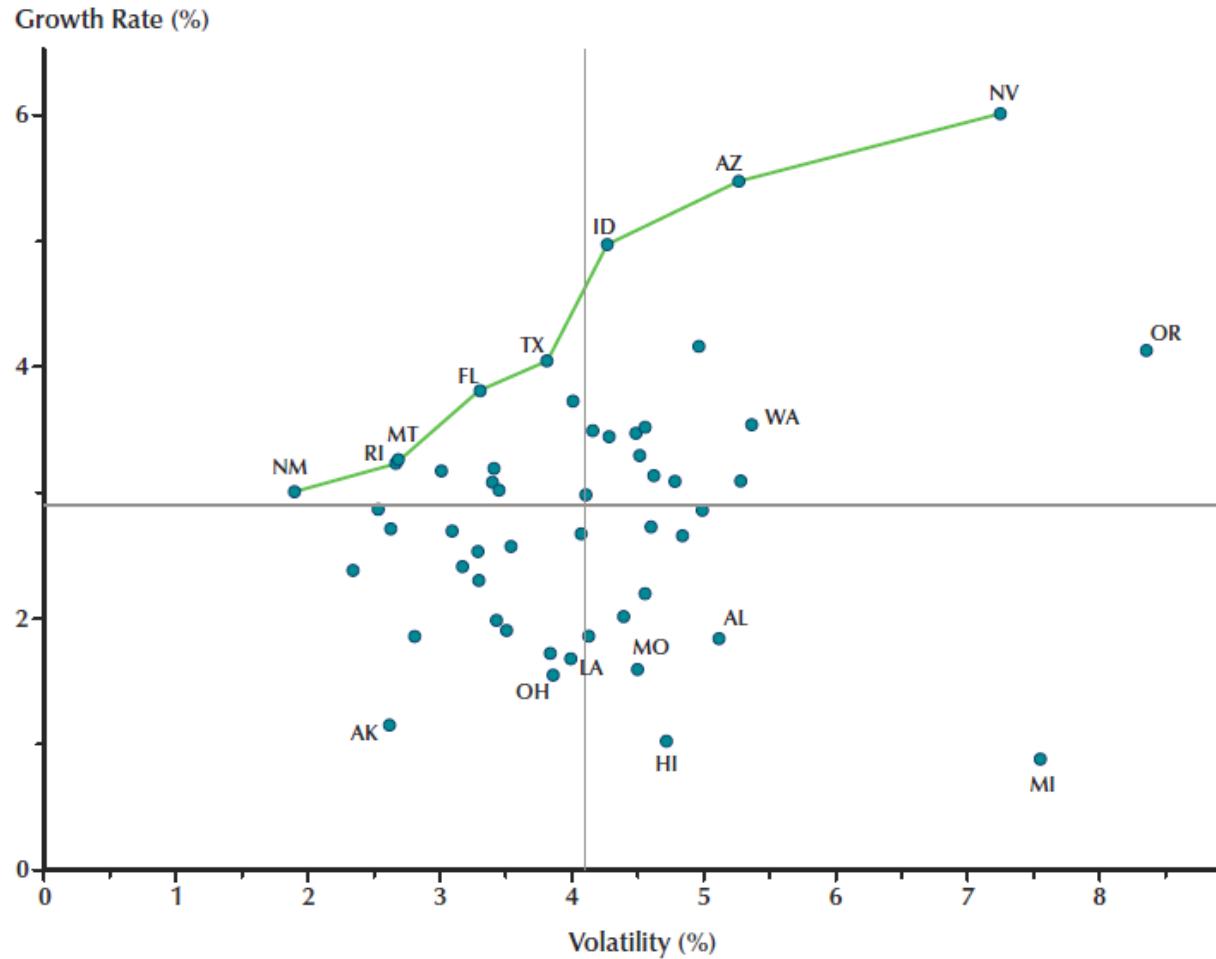
System Volatility

- Recent analysis suggests that state tax structures are becoming more volatile and more susceptible to business cycle swings
- “State tax revenues have become far more sensitive to changing economic conditions since the turn of the century”
Chicago Fed Letter, June 2012
- In the long run, seek to change composition of tax portfolio to minimize the effects of the business cycle on revenue
- Consider the natural tendencies of the economy when formulating tax policy
- States with volatile economies should minimize the impact of national macroeconomic trends



Hawai‘i Growth/Volatility Curve

Year-Over-Year Percentage Change, Monthly Coincident Index, 1995-2009



Source: Gary Cornia and Ray Nelson, "State Tax Revenue and Volatility, Federal Reserve Bank of St. Louis Regional Economic Development, June 2010



Issue: Reduce Volatility

- Research has found the following characteristics impact sales tax revenue system volatility:
 - Full exemption for food (increase)
 - Full exemption for producer goods (decrease)
 - Population (decrease)
 - Working age population (decrease)
 - Wealthy population (increase)
- Characteristics that impact income tax system volatility:
 - Pension and social security exemptions (increase)
 - Exemption for long-term capital gains (decrease)
 - Deductions for property tax paid (increase)
 - Elderly population (decrease)



Issue: Increase Revenue Growth

- While some revenue growth/volatility trade-off is generally acknowledged, higher revenue growth potential is generally associated with taxes with greater income elasticities
- Long-run and short-run elasticities can vary by tax
 - Corporate income tax has similar long-run elasticity as retail sales tax but three times the short-run elasticity
 - Alcohol taxes demonstrate little long run elasticity but are negative in the short-run – suggesting that liquor purchases rise during recessions and fall during booms
- Gaming revenues nationally had demonstrated strong long-run elasticity but the last recession provided the first indication of short-run variation from the trend – which may also be an indication of market saturation in many areas



Key Revenue Issue: Equity

- Generally characterized by vertical (different incomes should pay different amounts of tax) and horizontal (equal treatment of equals) equity
- Application can vary based on use of the benefits or the ability to pay principle
- Under benefits principle, a case can be made for regressive taxes as well as progressive taxes
- Even in an ability to pay model, the nature of progressivity and/or regressivity of specific taxes is generally not a simple answer
- It's possible to ameliorate regressive effects of one tax with credits, exemptions, etc. in another tax



Key Revenue Issue: Tax Exportability

- 1989 study suggests Hawai‘i exports about one-third of its tax burden to non-residents
- An earlier national study estimated the average state exported 23 percent of taxes in 1962
- Tourism-related excise taxes are the most common examples of tax exporting
- Some taxes are exported more broadly – such as corporations deducting state and local taxes from their taxable income for federal corporate income tax purposes

“Tax Pyramiding and Tax Exporting in Hawaii: An Input-Output Analysis” Richard L. Brown and PingSun Leung, University of Hawaii Research Extension Series 102, January 1989

“The Interstate Exporting of State and Local Taxes: Estimates for 1962” Charles E. McLure, Jr., National Tax Journal 20, 1967





Key Revenue Issue: Demographics

- As the population ages, personal income tax exemptions for pension and social security income will depress revenue growth
- While many states exempt sales tax on medical services, Hawai‘i is less likely to see revenue loss in this area
- Hawai‘i does exempt prescription drugs and may see some pressure in this area
- More broadly, consumption (and thus GET collection) likely mirrors that of sale tax, where nationally collections begin to decline in older population cohorts

High Level Findings





High Level Finding: Baseline Budget

- The financial model's baseline budget suggests that short-run budgets can remain balanced but longer-term is more questionable
- This is based on current levels of service – new investments or initiatives absent other spending reductions or revenue increases would accelerate and/or exacerbate budget problems
- This is also based on long-term assumptions that do not factor in budget shocks (on either the expenditure or revenue side) related to economic downturns – or stronger growth associated with more robust expansion
- Long term deficits are also over-stated, as balanced budget requirements would force the State to ameliorate them



High Level Finding: Spending Pressures

- Four key budget areas are associated with over 80 percent of General Fund spending
- These areas are also ones that have generally grown faster than spending as a whole – which puts pressure on other programs or the revenue structure
- In particular, long term cost pressures associated with pension contributions and health benefits will be difficult to manage



High Level Findings: Revenue Structure

- While Hawai‘i’s top two revenue sources are typical for the majority of states, the percentage contributed by the top source (GET) is higher than in most other states
- GET’s broad base and low rate align with taxation best practices, and demographic and economic challenges may balance themselves out more than in other states
- E-commerce issues are still a factor to consider going forward
- Expiring temporary tax increases are one logical answer for preventing erosion of current revenue growth
- The State’s corporate income tax accounts for very little revenue and is viewed as extremely complex for both the State and corporate taxpayers

Revenue Approaches/Opportunities





Exportable Taxes

- Given the State's predominant tourism industry, this is a logical point for analysis – but also a sticking point with a prominent industry
 - Transient Accommodations Tax is below average of comparable tourism destinations
 - Higher tax rate on prepared food is used in a number of states and large cities
 - Rental car taxes already appear to be within the range of comparable tourism destinations, but cross border competition isn't an issue (although substitution may be)
 - Amusement and recreation services taxes
- Maximizing federal income tax deductibility exports tax burden to all US taxpayers



Age-based Taxes

- Given demographic changes, personal income tax exemptions for pension/retirement and social security income should be explored
 - Can be coupled with additional credits/income exclusions to minimize impact on low income Hawaiians
 - Can also apply a sliding scale or percentage of retirement income subject to tax
- Age dependent taxes (with lower overall personal income tax effort for younger workers) may have an overall economic stimulus effect



Base-broadening

- The GET is already the most broad-based of similar states' taxes, but some strategies may provide additional revenue:
 - Internet sales tax loss estimated at \$235 million in FY 2012
 - Primary GET exemption is for non-profits
- Besides removing/reducing the exemption on pension/retirement income, other options include:
 - Reducing/eliminating the deduction for real estate taxes
 - Reducing/eliminating the deduction for state income and sales taxes
 - Reducing/eliminating other federal deductions

"State and Local Government Sales Tax Revenue Losses from Electronic Commerce" Donald Bruce, William F. Fox, LeAnna Luna, The University of Tennessee, April 13, 2009





Rate-raising

- GET low rate is a plus, but an increase would still be competitive with other state rates
 - Can be combined with personal income tax credits/refundable credits to reduce impact on lower income residents
 - Also possible to set variable rates
- Excise taxes
 - Cigarette tax rate is among the nation's highest – but still lower than New York, Connecticut and Rhode Island
 - Motor fuel tax rate is among the lowest in the nation (even with GET applied)
 - Several states have higher rates on distilled spirits and wine (but beer is highest in the country)



Tax Incentives (*rising tide lifts all ships*)

- Can be broad-based or targeted, although states are moving more toward the ‘rifle shot’ approach
 - Specific industries within a state’s economic development plan
 - Often tied to levels of job creation or types of jobs to be created
- Examples:
 - Research and Development and Business Investment tax credits
 - Job creation (sometimes tied to wages or industries) refundable tax credits
 - Worker training tax credits – focus on growing skilled workforce
 - Sales tax exemptions for business investment, such as machinery and equipment in manufacturing processes or computers/technology in high tech/knowledge-based businesses



Others

- Hawai‘i is one of only seven states without a lottery
- Other forms of gambling
 - Slots (allowed in 39 states)
 - Parimutuel (allowed in 35 states)
 - Charitable Games/Bingo (allowed in 47 states)
 - Online Sports Betting (allowed in 4 states, pending in several others)
- Tax/fee status for non-profit organizations – many states reducing or eliminating their exemptions
- License tax collections as a percent of state tax collections is fifth lowest
- Tax gap programs have raised significant revenue in many states



Next Steps

- The Project Team will finalize the model baseline for revenues and expenditures and work to finalize all models and outputs in the following weeks
- We will refine the high level findings that were shared in today's slides and provide a draft report to the TRC the week of August 20th
- Based on feedback, a final report detailing project findings will be delivered the week of September 24th
- We will work with you and key stakeholders to communicate project findings as appropriate



Questions and Discussion

