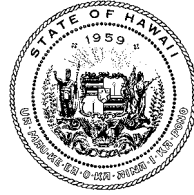


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COUNCIL ON REVENUES

STATE OF HAWAII
P.O. BOX 259
HONOLULU, HAWAII 96809

January 5, 2010

The Honorable Donna Mercado Kim
Chair, Senate Committee on Ways and Means
State Capitol, Room 210
Honolulu, HI 96813

The Honorable Marcus R. Oshiro
Chair, House Committee on Finance
State Capitol, Room 306
Honolulu, HI 96813

Chairpersons and Members of the Committees:

Thank you for inviting the Council on Revenues to appear before your committees to present the current tax revenue forecasts for the State of Hawaii. My name is Paul Brewbaker, and I am the Chair of the Council on Revenues. I would like to present to you a review of recent trends as well as the Council's latest forecast.

Current Revenue Trends

Fiscal year (FY) 2009 had a 9.5% decrease in the State's General Fund tax revenues, which followed a relatively modest 1.2% increase in FY 2008. This decrease was a reflection of the ongoing weak national and local economic conditions that contributed to the decline of both visitor arrivals and visitor expenditures in Hawaii. Despite a 7.4% decrease in hotel room rates, a significant increase in visitor arrivals did not materialize and transient accommodations tax collections disproportionately fell by 8.2% in FY 2009.

General excise and use tax collections, which typically make up about half of the total General Fund tax revenues, totaled \$2.4 billion in FY 2009, a 7.7% decrease from the previous fiscal year. In addition to the decline in visitor arrivals and expenditures, general excise tax collections were also significantly impacted by the decline in construction activity. Following a decrease of 1.9% in FY 2008, construction expenditures, as measured by the general excise tax resulting from contracting, declined by 4.3% in FY 2009.

Total personal income grew by a modest 1.1% in FY 2009. Net individual income tax collections decreased by 13.3% in FY 2009, mainly due to a 39.0% decrease in estimated individual income tax payments. Net corporation income taxes also decreased by 37.1% in FY 2009, primarily due to lower estimated tax payments.

In summary, slower economic growth resulting from declines in the visitor and construction industries was the main reason for the 9.5% decline in FY 2009 General Fund tax revenues.

In the current fiscal year, the nascent recovery of the U.S. economy has resulted in a positive 2.0% growth in number of visitors during the first four months of FY 2010. However, the downward cycle of the construction industry, higher unemployment rate, and lower inflation pressure have negatively impacted tax revenue collections.

The latest published data for FY 2010 indicate that the cumulative revenues, up to the month of November, deposited into the State General Fund totaled \$1,733 million. For this period, General Fund revenue collections decreased by \$121 million or 6.5 % when compared to the same period in the previous year. The growth of key components of the State tax revenue collections are as follows:

Cumulative general excise and use taxes, the largest single category of tax collections, amounted to \$955 million through November. It decreased by 7.3% from the same period last year.

Transient accommodations tax collections were about \$86 million through November or down 5.6% from the same period during the last fiscal year.

Individual income tax collections amounted to \$568.5 million through November or a decrease of 9.1% from the same period last year. Corporate income tax collections for this same period were down by 38.5%.

Forecasts of General Fund Tax Revenues

The Council continuously reduced its FY 2009 forecast in its previous meetings due to a greater-than-expected downturn in economic conditions. While the Council correctly anticipated the slowdown of the economy, the degree of the slowdown was underestimated.

It should be noted that the model is a multi-year forecasting model from FY 2010 through FY 2016. As in all multi-year forecasts some years are over-estimated and other years are under-estimated. In most years, the growth in General Fund tax collections is greater than the growth in personal income. General Fund tax collections are also impacted by tax credits given to individuals and businesses. The 2-year time lag in tax credit data increases the problem of getting accurate forecasts of the General Fund tax collections, which are net of tax credits.

At its meeting on December 17, 2009, the Council on Revenues adjusted the forecasted growth rates of General Fund tax revenues. The forecast was reduced from negative 1.5% to negative

2.5% for FY 2010 and from 6.5% to 7.6% for FY 2011. The Council also updated its forecasts of General Fund tax revenues for FYs 2012 through 2016.

The revised forecasts of State General Fund tax revenues for fiscal years 2010 through 2016 are listed below:

Fiscal Year	Thousands of Dollars	% Growth From Previous Year
2010	\$4,097,243	-2.5%
2011	\$4,408,318	7.6%
2012	\$4,672,817	6.0%
2013	\$4,953,186	6.0%
2014	\$5,250,377	6.0%
2015	\$5,512,896	5.0%
2016	\$5,788,541	5.0%

Details of the Council's forecasts of the State's General Fund tax revenues for FY 2010 through FY 2016 are presented in the attached Table 1. These detailed forecasts are based on the Council's forecasts of total State General Fund tax revenues and the econometric model currently used by the Tax Research and Planning Office. Thus, while the forecast components of General Fund tax revenues are consistent with the overall Council forecasts, these estimates should not be labeled as "Council on Revenues' forecasts."

For FY 2010, the mean Council forecast of key economic indicators (Table 2) is that construction will decline by 15.0%, total personal income will decline by 0.5%, and visitor arrivals will increase slightly by 0.2%. Inflation (as measured by the Honolulu Consumer Price Index) is forecast to be 0.4%. For FY 2011, the mean Council forecast is that construction will decline by 6.0%, total personal income will grow by 2.7%, visitor arrivals will continue its upward trend and grow by 4.2%, and inflation will go up to 1.3%.

In producing its forecasts, the Council has adopted specific adjustments recommended by the Hawaii Department of Taxation to reflect the impacts on General Fund tax revenues of recent tax law changes, including:

- Act 209, Session Laws of Hawaii (SLH) 2007—exempts from the general excise tax sales of alcohol fuel.
- Act 211, SLH 2007—provides a refundable food/excise tax credit.
- Act 143, SLH 2008—amends provisions relating to agricultural businesses qualifying for enterprise zone benefits.

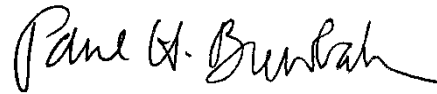
- Act 156, SLH 2008—allows state and county governments to hire retired state or county government employees.
- Act 233, SLH 2008—provides an important agricultural land qualified agricultural cost income tax credit.
- Act 14 SS, SLH 2009—phaseout of personal exemption.
- Act 40, SLH 2009—reduces the interest rate applied to overpayments of tax.
- Act 56, SLH 2009—increases the cigarette tax by one cent on July 1, 2009, July 1, 2010, and July 1, 2011.
- Act 58, SLH 2009—increases the tobacco tax on tobacco products other than cigarettes and taxes "little cigars" as cigarettes.
- Act 59, SLH 2009—increases the conveyance tax and reduces the conveyance tax allocations to the Rental Housing Trust Fund and the Natural Area Reserve Fund.
- Act 60, SLH 2009—temporarily increases the income tax rate on high income individuals and increases the standard deduction and personal exemption amounts.
- Act 61, SLH 2009—provides an additional 1% transient accommodations tax from July 1, 2009 through June 30, 2010, and an additional 2% transient accommodations tax from July 1, 2010 through June 30, 2015.
- Act 134, SLH 2009—Tax Administration; Cash Economy Enforcement Act.
- Act 166, SLH 2009—conforms to certain Federal penalties; promotes expedited tax appeals; creates 15 year collection statute.
- Act 178, SLH 2009—establishes a temporary 80% tax credit cap (80% of tax liability) and restricts carryover credits for the high technology business investment tax credit and the technology infrastructure renovation tax credit for investments made on or after May 1, 2009. Limits investment credit allocation ratio to 1 to 1. Temporarily suspends the capital goods excise tax credit (May 1, 2009 – December 31, 2009).
- Act 196, SLH 2009—Electronic filing and payment of taxes; accelerates tax payments.

The Council emphasizes the challenge it faces in forecasting tax revenues due to the interactions of significant tax law changes with unpredictable external factors. In arriving at the most recent forecast, Council members' implied revenue forecasts were based on their own individual economic assumptions.

The Honorable Donna Mercado Kim
The Honorable Marcus R. Oshiro
January 5, 2010
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This concludes my presentation. Again, thank you for this opportunity to appear before these Committees.

Respectfully submitted,

A handwritten signature in black ink that reads "Paul H. Brewbaker". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Paul Brewbaker, Ph.D.
Chair, Council on Revenues

Attachments

Table 1. ESTIMATES OF GENERAL FUND TAX REVENUE: FY 2010 to FY 2016

(in thousands of dollars)

TYPE OF TAX	ACTUAL		ESTIMATED						
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
General Excise & Use 2/	\$2,618,787	\$2,417,580	\$2,350,845	\$2,535,286	\$2,681,932	\$2,846,825	\$3,016,732	\$3,171,122	\$3,374,995
Income - Individual 4/	1,544,307	1,338,451	1,264,796	1,374,051	1,461,627	1,560,849	1,663,470	1,749,315	1,867,815
Income - Corporation	85,081	53,522	50,103	36,724	39,290	47,964	59,525	71,776	84,610
Public Service Company	127,481	126,069	124,519	124,868	126,161	128,348	131,259	134,607	138,823
Insurance Premiums	95,742	93,720	90,703	90,880	96,324	97,425	98,651	97,810	97,382
Tobacco & Licenses 5/	83,443	76,955	94,253	93,736	90,045	84,032	80,845	77,911	75,175
Liquor & Permits	45,620	47,242	49,446	51,953	54,454	56,891	59,247	61,483	63,628
Banks & Other Fin Corps	18,212	26,075	24,318	26,734	33,357	37,580	41,241	43,332	46,725
Conveyance 3/	6,513	8,311	9,551	8,866	8,632	6,280	6,224	6,188	6,162
Miscellaneous *	751	810	535	537	540	542	544	545	547
Transient Accommodation Tax 1/	15,935	13,566	38,174	64,683	80,455	86,450	92,639	98,807	32,679
NET TOTAL	\$4,641,872	\$4,202,301	\$4,097,243	\$4,408,318	\$4,672,817	\$4,953,186	\$5,250,377	\$5,512,896	\$5,788,541
GROWTH RATE	1.2%	-9.5%	-2.5%	7.6%	6.0%	6.0%	6.0%	5.0%	5.0%

Notes:

1/ Deposits of 44.8% of TAT revenues to counties (Act 156, SLH 1998); 32.6% to the tourism special fund and 5.3% to the TAT trust fund (Act 250, SLH 2002); 17.3% to the convention center enterprise fund (Act 253, SLH 2002); all net of general fund deposits of excess of fund ceilings. Act 235, SLH 2005, increases allocation to the tourism special fund to 34.2% and repeals the TAT trust fund. Effective on July 1, 2007. Act 209, SLH 2006, increases ceiling on allocation to the convention center enterprise fund to \$33 million. Effective on July 1, 2006. Act 61, SLH 2009, temporarily imposes an additional 1.0% TAT for the period 7/1/2009 through 6/30/2010, and an additional 2.0% TAT for the period 7/1/2010 through 6/30/15. These additional amounts will be deposited into the general fund. Act 5, Special Session Laws of Hawaii 2009, allocates 12.5% of the revenues derived from Act 61 to the tourism special fund for one fiscal year (FY 2011).

2/ Act 209, SLH 2007, exempts gross income received from the sale of alcohol fuel from the general excise tax. Effective on July 1, 2007, provided that the exemption repeals on June 30, 2009. Act 40, SLH 2009, reduces the interest rate on overpayments due to taxpayers from 2/3 of 1% to 1/3 of 1% per month or fraction thereof.

3/ Due to the expiration of Act 222, SLH 2007, on June 30, 2008, the amount of conveyance tax deposited into the General Fund increased from 15% to 35%. Act 59, SLH 2009, increased the conveyance tax rates for properties valued \$1 million or more.

4/ Act 60, SLH 2009, temporarily increases the standard deduction and personal exemption amounts for taxable years beginning after 12/31/10, and also temporarily creates new 9%, 10%, and 11% tax brackets for certain individuals with high taxable income beginning with taxable years beginning after 12/31/08. Act 60, SLH 2009, will be automatically repealed on December 31, 2015.

5/ Act 58, SLH 2009, taxes "little cigars" in the same manner as cigarettes beginning 9/30/09; increases the tax on tobacco products other than cigarettes, little cigars, and cigars from 40% to 70% beginning 9/30/09; imposes a 50% tax on cigars. Act 56, SLH 2009, increases the cigarette tax from 11¢ to 13¢ on 7/1/09, from 12¢ to 14¢ on 7/1/10, and from 13¢ to 15¢ on 7/1/11; and also amends the dates on which changes in the allocation of cigarette tax revenues changes.

* Includes inheritance and estate tax.

Table 2
FORECASTS OF KEY ECONOMIC INDICATORS: FY 2010 TO FY 2016

A. VALUE

Council MEAN Forecasts

Fiscal Year	2010	2011	2012	2013	2014	2015	2016
Total Personal Income (\$1982-1984 mil.)	23,414	23,742	24,217	24,750	25,294	25,927	26,575
Total Personal Income (\$ mil.)	53,882	55,337	57,551	60,083	62,786	65,863	69,090
Construction Completed (\$ mil.)	6,372	5,990	6,097	6,384	6,837	7,384	7,968
Honolulu CPIU (1982-1984=100)	230	233	238	243	249	254	260
Visitor Arrivals (1,000)	6,378	6,646	6,865	7,071	7,269	7,451	7,630
U.S. GDP in Current Dollars (\$ bil.)	14,463	15,027	15,703	16,441	17,214	18,023	18,852
U.S. GDP Deflator (2000=100)	110	112	114	116	119	121	124
Calendar Year Wages (\$ mil.)	25,146	25,574	26,418	27,369	28,436	29,716	31,083
Visitor Expenditures (\$ mil.)	10,001	10,511	11,163	11,810	12,401	12,971	13,555
Hawaii Real GDP (\$2000 mil.)	49,470	49,965	50,915	51,984	53,127	54,296	55,491

B. ANNUAL PERCENTAGE GROWTH RATE

Total Personal Income (\$1982-1984 mil.)	-0.9	1.4	2.0	2.2	2.2	2.5	2.5
Total Personal Income (\$ mil.)	-0.5	2.7	4.0	4.4	4.5	4.9	4.9
Construction Completed (\$ mil.)	-15.0	-6.0	1.8	4.7	7.1	8.0	7.9
Honolulu CPIU (1982-1984=100)	0.4	1.3	2.0	2.2	2.3	2.3	2.4
Visitor Arrivals (1,000)	0.2	4.2	3.3	3.0	2.8	2.5	2.4
U.S. GDP in Current Dollars (\$ bil.)	1.1	3.9	4.5	4.7	4.7	4.7	4.6
U.S. GDP Deflator (2000=100)	0.9	1.3	1.8	2.0	2.1	2.1	2.1
Calendar Year Wages (\$ mil.)	-0.1	1.7	3.3	3.6	3.9	4.5	4.6
Visitor Expenditures (\$ mil.)	-2.9	5.1	6.2	5.8	5.0	4.6	4.5
Hawaii Real GDP (\$2000 mil.)	-0.1	1.0	1.9	2.1	2.2	2.2	2.2