

COUNCIL ON REVENUES

No. 1 Capitol District Building
250 S. Hotel Street, Fourth Floor
DBEDT Diamond Head Conference Room 436
Honolulu, HI 96813

Wednesday, March 7, 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 and, Marilyn M. Niwao

Staff Members:

Department of Taxation: Donald Rousslang, Hamid Jahanmir and
Jacquelyn Guitguiten

Department of Budget and Finance: Terri Ohta, Karen Matsunaga, Keith Shimada
and Gregg Hirohata-Goto

Others:

Titin Sakata, Department of Taxation
Paul Kanohe, House Minority Research Office
Wayne Yoshioka, KHPR
Dennis N., University of Hawaii
Neal Miyahira, Budget and Finance
Sharon Kotaka, Budget and Finance
Susan Hirai, Senate Ways and Means
Anthony Valdez, Senate Ways and Means
Roderick Becker, Senate Ways and Means
Lowell L. Kalapa, Tax Foundation of Hawaii
Paul Young, HAH

ABSENT:

Ronald K. Migita, Council Member

CALL TO ORDER:

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

COMMUNICATIONS TO THE COUNCIL:

Chair Kahle asked if there was any communications to the Council. Dr. Rousslang told the Council that the top line of the Summary Sheet of the Council's individual forecasts was not updated. The updated information can be found in the Tables 6A and 6B of the workbook.

MINUTES OF THE MEETING OF JANUARY 5, 2012:

The Chair asked the members for comments to the minutes of the January 5th meeting. There were no comments. The Chair called for an all in favor of approving the minutes. The vote was unanimous.

The Chair called for the vote, and the motion passed with the following votes:

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

GENERAL FUND REVENUE FORECAST:

The Council discussed the General Fund revenue forecast for FY 2012. Dr. Grandy said he thought the economy was doing better than a couple of months ago. Dr. Suyderhoud noted that the previous meeting was the first time in a while that two members had voted against the consensus forecast. He agreed that the economy was slightly better than when the Council met last (January 5, 2012). He suggested the members look at Table 2B of the workbook provided by Tax Research and Planning. Dr. Rousslang explained that the Table takes the Council's current forecast and compares it with actual collections. The forecast amounts presented for each month are adjusted for tax law changes and seasonal effects. He said that according to his calculations, collections as of the end of January were running almost 1% above the current forecast of 11.5%. Dr. Suyderhoud noted that the Council's forecast is for the entire fiscal year, not just for the first 6 months. He asked what would have to happen in the next 5 months in order for the Council to come in at 11.5%. Dr. Rousslang answered that he thought tax collections would have to slow a little bit from their current pace. Mr. Aoki brought up the point that collections in April of 2011 had exceeded \$490 million, which would be a big hurdle that has to be overcome this year. He thanked Ms. Niwao for making the point at the last meeting.

Ms. Niwao thought there was little improvement for certain businesses and that others were probably in decline. She said surveying tax practitioners provided information on what was going on in the economy. And, she repeated her concerns that high income taxpayers had paid ahead of time (at the end of the calendar year) due to the effects of the tax law changes and that the change in deposit procedures within the Tax Department may have caused the collections in fiscal 2011 to be higher, raising the base against which growth for fiscal year 2012 would be measured.

With respect to the forecast of the revenue collections for the year, she said there were two items that may not have been properly factored into the equation that predicted a 12.4% annual growth rate (Table 2B of the workbook). One was the assumption that the tax law changes would be coming later in the year. She pointed out that we have already seen a blip in personal income tax collections in January 2011 (she made reference to a graph she prepared and distributed), which

may have been caused by an increase in tax payments by many high income individuals. They may have paid early as a result of year-end tax planning. Instead of waiting until April 15th of the following year, many tax practitioners had their clients pay their State taxes prior to the end of the year, which was probably reflected in this year's high January collections. She said that the revenue forecast of 12.4% also did not take into account the large collections in April of 2011.

Dr. Suyderhoud noted that the Council is not forecasting 12.4%.

Mr. Aoki asked Dr. Rousslang if the Department had any figures for February 2012. Dr. Rousslang said that the Department just had preliminary data on total collections for Oahu and that collections for the State's General Fund had not yet been calculated. Ms. Sakata said that collections would definitely be higher than February of last year. The Council further discussed Ms. Niwao's concerns and whether or not they should change the current forecast. Dr. Suyderhoud said the Council was looking at about \$45 million in personal income tax collections that might have been pushed forward owing to tax planning by high income individuals that would otherwise come in later months. Ms. Niwao agreed.

Chair Kahle asked Dr. Rousslang to confirm that the expected extra personal income tax payments from recent legislation, was about \$45 million. Dr. Rousslang said that was the Tax Department's estimate.

The Council further discussed Table 2 of the workbook. Dr. Bonham said the Table did not help him understand what was happening, but that his model also showed that collections were coming in about 1% above the Council's last forecast as of the end of December, which is the same result as that shown in the Table. Ms. Niwao asked if his calculations accounted for the April 2011 blip, which she said represented an extra \$100 million in collections. Dr. Bonham said that it was in the data and so was taken into account.

Dr. Bonham said the question was whether the tax law changes were showing up in collections earlier than had been anticipated in the fiscal year, and how this might affect the forecast. Chair Kahle mentioned that the Council forecast for growth in collections at the last meeting was broken down into components of 4.3% for the effect of the delayed refunds, 5.2% for the economy and 2% for tax law changes. Dr. Bonham suggested that the problem could be reduced by ignoring January collections entirely and focusing on the first six months of the fiscal year and what the members thought would happen to collections in the next 6 months. He said that the economy appeared to be improving but that there were still big risks. Ms. Niwao said she believed that the growth in collections would be somewhat muted, because businesses may not be able to collect money that is due to them. Also, businesses that are doing very badly may not pay their GET in a timely manner. She said accrual basis companies are required to recognize revenue and pay GET as if they had received the money. But if they are doing badly and have built up receivables, they would not have cash to pay the GET in a timely manner. Dr. Suyderhoud said that in spite of stories of this sort, there would still be a strong linkage between the economy and tax collections.

Ms. Niwao repeated her concern that the forecast might be high if it does not account for the move forward in income tax collections caused by the tax law changes and if it does not account for the move forward in collections caused by tax processing changes that the Department of Taxation made in 2011.

Dr. Suyderhoud asked if Ms. Niwao thought that the members were being misled in some way by the data on monthly collections. He said not too many people were looking at the monthly numbers. Dr. Bonham said that his model used quarterly data and that his forecast for the 2nd calendar quarter (which includes April) was for growth in collections compared with the same quarter last year.

Dr. Suyderhoud asked Ms. Niwao what her forecast was. Ms. Niwao responded that she would be happy with 11 or 11.5%. Dr. Suyderhoud said he was also happy with 11.5%. Mr. Aoki thought it should be at least 11.5%. Dr. Grandy suggested a growth forecast of 13%. Dr. Bonham said he thought his forecast would be 15%. Ms. Niwao said she thought that the Council estimates have historically been too high. Dr. Suyderhoud said the estimates were high when things are going bad, but low when things were improving. Dr. Bonham said that before the great recession, forecasts were pretty accurate, but that the Council tended to under-forecast in situations like those we are in right now and that when the economy really starts to expand, the Council may underestimate by as much as 4 or 5 percentage points, just as it did in 2004, 2005 and 2006.

Dr. Bonham and Dr. Grandy questioned the importance of high income taxpayers paying tax early as a result of tax law changes. Dr. Bonham asked Dr. Rousslang for a breakdown of taxes collected by income distribution. Dr. Rousslang said he would supply it.

Dr. Bonham asked about some inconsistencies in Table 3 of the workbook, which showed forecasts of key economic indicators. He pointed out that there was a discrepancy between real growth, nominal growth and inflation. He asked why real growth and inflation did not always sum to nominal growth. Dr. Suyderhoud said he also wondered why the figures did not appear to agree.

Dr. Bonham suggested that the Council's forecast might be too low, because it was the beginning of a new construction cycle. He said he also thought the members' construction forecasts were too low for 2013, 2014, and 2015. He said there might also be an increase in public spending.

Ms. Niwao said that for the out years, she was concerned about the demographic changes, about the aging of the baby boomers and the pension income that will be exempt from tax. She was also concerned about the effects of people who invested in ROTH IRAs, because there would be no tax when they take the money out.

Dr. Bonham noted that the Council currently had forecasts of 5% growth in 2015, 2016, 2017 and 2018. He asked the members for opinions on inflation. Dr. Suyderhoud said he thought inflation would be about 2.5%. Dr. Bonham said that implied a real growth forecast of 2.5%, part of which would be covered by the State's population growth of between 0.5% and 1%. The members discussed risks to the forecast, including events in Europe.

Dr. Grandy suggested entertaining a motion for the growth forecast for 2012.

Dr. Bonham made a motion to forecast the general fund tax revenues growth rate for FY2012 at 12%. Dr. Grandy seconded the motion. The Chair called for the vote, and the motion passed with a 5 to 1 vote:

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

Next, the Council discussed the forecasts for fiscal years 2013 through 2018. Dr. Suyderhoud asked if tax law changes were the reason why the forecast for fiscal year 2014 was so low. Dr. Bonham said he thought the forecasts for the out years might be a little low, especially if the rail project goes forward. The members discussed briefly the cut-backs in federal spending and the effects of higher oil prices. Ms. Niwao said she had asked Senator Inouye's office for information on federal spending for Hawaii and she promised to share the information with the other members when it is received.

It was moved by Dr. Grandy to forecast the growth rate of general fund tax revenues at 7.5% for FY 2013; 4.0% for FY 2014; 6.2% for FY 2015; 4.0% for FY 2016; and 5.0% for FYs 2017 and 2018. The Chair called for the vote, and the motion passed unanimously 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 | Absent |
| 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. Matsunaga reported the changes for the General Fund Non-Tax Revenues and for Special Tax Revenues since the January 2012 meeting.

General Fund Non-Tax Revenues

There are no significant changes to the general fund non-tax revenue estimates.

Special Tax Revenues

Liquid Fuel, Highways – decreases in FYs 12-18 reflect lower liquid fuel tax collection estimates due to lower anticipated growth as well as an increase in the use of more fuel efficient vehicles (Department of Transportation’s (DOT) – Highways Division).

Special Fund Non-Tax Revenues

Federal Grants – the increase in FY 11 reflects an increase in New Starts and Small Starts Program funds for the DOT’s General Administration (pass-through grant for the DLNR). Decreases in FYs 13-18 reflect projected decreases in Medicare payments for the Hawaii Health Systems Corporation (HHSC).

Charges for Current Services, Others – the changes in FYs 11-18 reflect an increase in FY 11 actual revenues and decreased FY 12-18 revenue projections from Hawaii Medical Service Association and Medicaid payments received by the HHSC.

Charges for Current Services, Utilities – the decreases in FYs 13-18 reflect lower terminal rental payments for the DOT’s – Airports Division.

Other than Special Fund Non-Tax Revenues

Federal Grants – the increases in FYs 12-14 reflect increases in federal grants available to fund federally-aided low-income housing projects (Hawaii Housing Authority) and the Hawaii Health Insurance Exchange that was established pursuant to Act 205, SLH 2011 (Department of Commerce and Consumer Affairs).

ARRA Funds – the net decreases in FYs 11-14 reflect federal reimbursements for Race to the Top funds coming in at a slower rate than originally projected (Department of Education).

Non-Revenue Receipts – net increases in FYs 12-14 reflect increased revenues from the sale of real property deposited into the Hawaiian Home Lands Trust Fund (Department of Hawaiian Home Lands) and increased projections in employer and employee contributions by the State, City and County of Honolulu, County of Hawaii, Kauai County, Maui County, and Hawaii Department of Water to the Employees-Union Trust Fund (Department of Budget and Finance) based on actual contributions received through the first seven months of the fiscal year.

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

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|------------------------------|------------|
| Richard F. Kahle, Jr. | Yes |
| Jack P. Suyderhoud | Yes |

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Wednesday, March 7, 2012

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|---------------------------|---------------|
| Avery A. Aoki | Yes |
| Carl S. Bonham | Yes |
| Christopher Grandy | Yes |
| Ronald K. Migita | Absent |
| 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 Tuesday, May 29, 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 11:27 a.m.