DAVID Y. IGE
GOVERNOR

JOSH GREEN MD
LT. GOVERNOR

.

KURT KAWAFUCHI
CHAIR

MARILYN M. NIWAO
VICE-CHAIR

MEMBERS:
Carl S. Bonham
Christopher Grandy
Jack P. Suyderhoud
Kristi L. Maynard
Vacant, Member

COUNCIL ON REVENUES

STATE OF HAWAII
P.O. BOX 259
HONOLULU, HAWAII 96809-0259

January 3, 2019

The Honorable Donovan M. Dela Cruz
Chair, Senate Committee on Ways and Means
Hawaii State Capitol, Room 208
Honolulu, Hawaii 96813

The Honorable Sylvia Luke
Chair, House Committee on Finance
State Capitol, Room 306
Honolulu, Hawaii 96813

Chairpersons and Members of the Committees:

Thank you for inviting the Council on Revenues (Council) to appear before your committees to present the current tax revenue forecasts for the State of Hawaii. My name is Kurt Kawafuchi, and I am the Chair of the Council on Revenues. Today, I would like to present a review of recent revenue trends and of the Council's latest forecasts.[1]

Recent Revenue Trends

Results for fiscal year 2018

In fiscal year (FY) 2018, the state's general fund tax revenue increased by 7.6% over 2017. This was above the Council's March 2017 forecasted rate of 5.3%. This growth rate was also higher than the actual FY2017 rate of 2.0%. In dollar terms, General Fund revenue grew to $6,796 million in FY18 from $6,315 million in FY17, a $481 million increase.

The general excise tax (GET) comprises slightly less than half of total general fund tax revenue. GET revenue grew by 4.8% from FY17 to FY18. Individual income tax revenue, the second largest source of general fund revenue, grew by 13.7%

The acceleration in the revenue of the GET, individual income tax, and the general fund was due to a robust economy and strong growth in the tourism sector. Part of increase in individual income tax revenue may have resulted from the passage of the Tax Cut and Jobs Act that became effective on January 1, 2018.

1 The Council of Revenues will have its next general fund meeting during the afternoon of Wednesday, January 9, 2019.

Results for the first five months of fiscal year 2019

At its meeting on September 6, 2018, the Council maintained its forecast for general fund revenue at 5.0%. At that meeting, the Council noted that Hawaii's economy continued to be strong, but cited uncertainty about the future.

The preliminary collection data through November 30, 2018 shows a general fund growth rate of 4.8% for the first five months of FY19 compared to the same period in FY18, which is quite close to the Council's forecast of 5.0%. Cumulative net collections of GET revenue for FY18 were $1,446M, compared to $1,415M for the same period in FY18, for a year over year growth rate of 2.2%.

Below is the cumulative growth rate in general fund revenues during FY19 over the same period in FY18 for each month.

July 2018	2.6%
August 2018	0.8%
September 2018	0.4%
October 2018	4.1%
November 2018*	4.8%

* Preliminary data

General fund collection figures have been volatile during the first half of the fiscal year in part due to the adoption of the Tax System Modernization (TSM) occurring at the Department of Taxation. The conversion of different tax types from the legacy system to the new system has led to temporal shifts in collection trends, which in turn has made it harder to make year over year comparisons when we only have a few months of data in the fiscal year. It is important to understand that the TSM project has not affected the amount of collections; rather, it has affected the timing of collections which impacts the year over year growth numbers. The volatility in the month to month revenue growth attributed to the TSM project is expected to decline in the second half of the fiscal year since the conversion to the new system has been completed for the major tax types.

Individual income tax revenue for FY19 was $955 million compared to $888 million for the same period in FY18, for a year-over-year growth rate of 7.5%. Cumulative net collections of corporate income tax for FY19 were $42 million compared to $27 million for the same period in FY18, for a year-over-year growth rate of 57.1%.

Below is a breakdown of net individual and corporate income tax revenues through November 2016 compared to the same period of FY16.

Year-on-year net income tax collections FY18 and FY19 *

	FY19	FY18	DIFFERENCE AMOUNT	% CHANGE
Income Tax - Corp.	**42,405**	**26,992**	**15,413**	57.1%
Decl. Est. Taxes	67,665	52,668	**14,997**	28.5%
Payment w/returns*	13,769	5,462	**8,306**	152.1%
Refunds	(39,029)	(31,138)	**(7,891)**	25.3%
Income Tax - Ind.	**955,451**	**888,382**	**67,069**	7.5%
Decl. Est. Taxes	159,416	189,857	**(30,441)**	-16.0%
Payment w/returns	51,453	48,545	**2,908**	6.0%
WH Tax on Wages	855,125	798,505	**56,620**	7.1%
Refunds	(110,542)	(148,525)	**37,983**	-25.6%

* Based on preliminary data for November

While generally comprising less than 1.0% of general fund revenue, the breakdown of net income tax revenues for corporations shows that the largest boost on corporate income tax revenues comes from higher Declared Estimated Taxes and Payment with returns.

Individual income tax revenues comprised approximately 35.0 – 37.0% of general fund revenue during the last two fiscal years. The component with the most significant increase is Withholding Taxes on Wages which is generally consistent with strong employment, e.g., withholding of income taxes from employees. At the same time, there was a decrease in declaration of estimated taxes. Declaration of estimated taxes is comprised of profits from many businesses operated by sole proprietorships and pass through entities such as partnerships, limited liability companies, and Subchapter S corporations, and certain capital gains.

November collection numbers are reasonably good predictors of the year-end general fund growth. Over recent years, the difference in absolute terms between the average growth figure for November collections and fiscal year end collections is 1.8%.

The Council's Forecasts of General Fund Tax Revenues

Before providing the Council's latest forecast, I will explain how the Council produces its forecasts. The Council meets four times per year to forecast general fund tax revenues. The Council's forecasts are due by January 10, March 15, June 1, and September 10 of each year.

Prior to each General Fund meeting, each Council member completes a survey provided by the Office of Tax Research and Planning (TRP) in the Department of Taxation (Department). The survey asks for the member's forecasts for growth in key economic variables, including construction, the Honolulu consumer price index, total visitor arrivals coming to Hawaii by air, U.S. Gross Domestic Product (GDP), the U.S. GDP deflator (a measure of inflation in the national economy), total state wages, visitor expenditures, and Hawaii GDP in real (deflated) terms. After receiving the Council members’ growth for key economic variables, the TRP staff inputs such variables into econometric models to estimate the implied growth in General Fund tax revenue.

The primary model used by TRP staff has a separate econometric equation to predict the growth in revenues from each major tax type (the Individual Income Tax, the Corporate Income Tax, the General Excise Tax, the Public Service Company Tax, and others). All of the models incorporate estimates for the effects of tax law changes that impact the general fund tax revenues. TRP staff provide historic data on the economic variables to be forecast by the Council members, the econometric predictions of general fund revenue growth based on the Council's economic forecasted, and information about matters of tax administration that could affect the general fund tax revenues, such as delays in processing or unusual collections of delinquent taxes.

In their meetings, Council members review the results of the econometric models and consider other factors, such as the current trends in monthly collections and changes in the economy that might change the current revenue trends. Among the factors that the Council considers are tourist arrivals, tourist spending, construction activity and revenue, inflation, interest rates, rents, and energy prices, federal fiscal and monetary policy, major local events, geopolitical events, and other relevant and timely factors. The members then decide on the official forecast for the growth in General Fund tax revenue. The forecast may or may not agree with the results of the econometric models. The Council forecasts only the total general fund tax collections. The TRP staff imputes the implied growth in collections of the individual tax types using the Council's General fund forecast numbers.

Over the last seven years, the Council's forecasts have had an average margin of error of less than 2.0% for the March forecast.[2] During the last five years, the Council's forecasts have had an average margin of error of less than 1.5% for the March forecast. During the last seven years when comparing the Council's March forecasts to actual year end revenue, the Council has underestimated revenue growth five times and overestimated growth two times.

The Council's Current Forecasts

At its latest General Fund meeting on September 6, 2018, the Council maintained its forecast of growth in General Fund revenues for FY19 at 5.0%. The Council also maintained the growth forecast of 4.0% for FY2020 to FY2025.

The Council believes that Hawaii's economy continues to be strong, but cited uncertainty about the future. Concerns were expressed that the economy may have reached the end of its current expansionary cycle during the seven-year budget window. They noted that visitor arrivals and expenditures, job counts, and construction activities, are all continuing strong. Members cited that the construction cycle may have reached a sustained plateau after falling from its peak several years back.

The new forecasts for the State General Fund tax revenues FY 2019 through FY 2025 are shown in the table below.

[2] Because at its September meeting, the Council has historically only had 1-2 months of actual general fund revenue for the current fiscal year, the Council's forecasts a 3.4% margin of error in absolute terms for the September forecast, compared to 1.9% for the March forecasts when it historically has had 7-8 months of actual revenue.

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2019	7,135,838	5.0%
2020	7,421,272	4.0%
2021	7,718,123	4.0%
2022	8,026,848	4.0%
2023	8,347,922	4.0%
2024	8,681,839	4.0%
2025	9,029,113	4.0%

The Council adopted specific adjustments recommended by the Department of Taxation to reflect effects on general fund tax revenues due to tax law changes enacted by the 2018 Legislature, including the following:

- Act 27, SLH 2018 selectively conforms Hawaii income tax laws and estate tax laws to the Internal Revenue Code as of February 9, 2018, and as of December 31, 2017, respectively. The Act is effective June 7, 2018, and applies to taxable years beginning and to decedents dying after December 31, 2017. The estimated gain to the General Fund is estimated to be $9.2 million in FY 2019, $14.2 million in FY 2020, $20.1 million in FY 2021, $26.9 million in FY 2022, $34.9 million in FY 2023, $37.9 million in FY 2024, and $37.1 million in FY 2025.

- Act 39, SLH 2018 increases the aggregate amount of the GET cost exemption for developing affordable rental housing from $7 million to $30 million per year. Extends the exemption from June 30, 2022, to June 30, 2030. The Act is effective July 1, 2018, and applies retroactively to taxable years beginning after December 31, 2017. The estimated loss to the General Fund is estimated to be $23.0 million in FY 2019, $23.0 million in FY 2020, $23.0 million in FY 2021, $23.0 million in FY 2022, $30.0 million in FY 2023, $30.0 million in FY 2024, and $30.0 million in FY 2025.

- Act 41, SLH 2018 provides that a person is engaging in business in the State for the purpose of the general excise tax law if, in the current or immediately preceding calendar year, the person has $100,000 or more in gross income, or two hundred or more separate transactions, from the sale of tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State. The Act is effective July 1, 2018, and applies to taxable years beginning after December 31, 2017. The estimated gain to the General Fund is estimated to be $6.8 million in FY 2019, $7.6 million in FY 2020, $7.9 million in FY 2021, $8.1 million in FY 2022, $8.3 million in FY 2023, $8.6 million in FY 2024, and $8.9 million in FY 2025.

- Act 86, SLH 2018 reduces the allocations of TAT to the Convention Center Special Fund from $26.5 million to $16.5 million and the Tourism Special Fund from $82 million to $79 million. The Act is effective July 1, 2018. The estimated revenue gain to the General Fund is $13 million from FY 2019 to FY 2025.

- Act 122, SLH 2018 increases the withholding on the amount realized from the disposition of Hawaii real property by nonresidents (HARPTA) from 5% to 7.25%. The Act is effective July 5, 2018, and applies to real estate dispositions that occur on or after September 15, 2018. The expected revenue gain is $8.1 million in FY 2019 and $2.6 million from FY 2020 to FY 2025.

- Act 211, SLH 2018 imposes the TAT on transient accommodations brokers, travel agencies, and tour packages that enter into arrangements to furnish transient accommodations at noncommissioned negotiated contract rates on their share of the proceeds. The Act is effective July 1, 2018, and applies to taxable years beginning after December 31, 2018. The expected revenue gain to the General Fund is $14.7 million in FY 2019, $36.6 million in FY 2020, $38.0 million in FY 2021, $39.3 million in FY 2022, $40.6 million in FY 2023, $42 million in FY 2024, and $45.6 million in FY 2025.

That concludes my presentation. I am available to answer any questions you may have.

Very truly yours,

KURT KAWAFUCHI
Chair, Council on Revenues