

COUNCIL ON REVENUES

Meeting Minutes, Thursday, May 23, 2019 (2pm)

No. 1 Capitol District Building
250 S. Hotel Street
Office on Aging Conference Room
Fourth Floor, Room 410
Honolulu, HI 96813

PRESENT:

Council Members:

Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham, Christopher Grandy, Jack Suyderhoud, Jessica E. Gluck and Kristi L. Maynard

Staff Members:

Department of Taxation (DOTax): Seth Colby, Baybars Karacaovali, and Jacquelyn Guitguiten

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

Others:

Sharon Kotaka, Budget & Finance
Linda Chu Takayama, Director of Taxation
Damien Elefante, Deputy Director of Taxation

CALL TO ORDER:

Chair Kawafuchi called the meeting to order at 2:00 p.m. A quorum was present.

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

There was no communication to the Council and there was no public comment. Chair Kawafuchi welcomed the Council's newest Member, Jessica E. Gluck. Ms. Gluck told the Council that she has worked for Alexander & Baldwin for a year and a half. Prior to that, she was employed at Outrigger Hotels for 7 years and was with KPMG before that. She said she's always been on the tax side—corporate tax, banking, hospitality and real estate. Chair Kawafuchi said thank you, and asked the rest of the COR Members to introduce themselves.

APPROVED MINUTES OF THE MEETING OF MARCH 12, 2019:

Chair Kawafuchi asked if there was any discussion on any item in the minutes. There were none mentioned. Chair Kawafuchi called for a motion to approve the minutes for the meeting of March 12, 2019.

It was moved by Dr. Suyderhoud and seconded by Ms. Maynard that the minutes of the March 12, 2019 meeting be approved. 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	Yes
Kristi L. Maynard	Yes
Jessica E. Gluck	Abstain

GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2019:

Next, the Council discussed the general fund revenue forecast for FY 2019. Chair Kawafuchi asked Dr. Colby to explain what happened in April with the increase in the general fund growth rate at 5.7% year-to-date (March was at 2.6%). Dr. Colby said there was a transfer of \$140 million out of the GET into the individual withholding, corporate declared estimated taxes, and other tax types in April 2018. This affected the recorded growth rates of the different tax types, but it did not affect the general fund growth.

He said that the declared estimated taxes for March was down 22.8% and in April it was up at 2.8% with more people paying their declared estimated taxes, and with a large increase in payments with returns at 37.8%. Dr. Colby referred to Table A & B: 'Required Growth in GF Tax Revenues' and the 'Growth Rate of FY 2019 GF Tax Revenues' and Charts: 'Monthly Declared Estimated Taxes (Indv) & GF Collections' and the 'Declared Estimated Taxes YTD'.

He said this is a national phenomenon, which all states saw a huge decrease in declared estimated taxes. There was also an increase in the individual income tax rate on high earners in 2018 in the State of Hawaii.

The Tax department believes taxpayers didn't pay full tax liability the first year with their declared estimated taxes. The data suggests that affected taxpayers did their taxes and realized they were short so they started paying.

Ms. Niwao said practitioners have made a lot of estimated tax payments by early 2017. And, in 2018, there were no pre-payments because the State taxes would not be deductible for federal purposes. Instead they waited until the last minute to pay their State and federal taxes.

Dr. Bonham asked if a taxpayer filed on the deadline and paid it with a return and filed on the deadline is it in the April data. He said he didn't think it would be. Dr. Colby said the Tax department believes it is. Dr. Colby said one of his concerns is maybe everything is just being accelerated because this is the first year that individual income taxes is part of the TSM (computer system). Chair Kawafuchi said he assumes that also means the returns are being processed faster. Dr. Colby said yes, and last year in May the declared estimated taxes were \$110 million and up until May 20th with a total of \$87 million declared estimated taxes.

The Council discussed estimated tax payments of \$87 million in May exceeding last year May (2018), filing of tax returns and payments with refunds. Chair Kawafuchi said we've got 10 more days and that he expected it to be up because the rates went up from 8.25% to 11%. Dr. Colby presented a graph of the 12-month moving average, requested by Dr. Grandy.

Ms. Niwao was concerned and referred to the chart in the below-the-line deductions that combined the tax effect, tax rates with earned income credit, etc. She said there was a netting of all the adjustments. She said it should've been more than \$53 million although it's difficult because there were a lot of things relied upon with the federal tax laws that applied to the State. Ms. Maynard said we were up month-over-month at \$199 million, which is a large number.

Dr. Colby said the individual income tax was now being processed under the new TSM system, as were the withholding. Ms. Maynard said there's some indication that things were accelerating just because of that. Dr. Colby said he doesn't have the answer as to what percentage of individual income filers filing electronically versus paper.

Dr. Colby said there's a credible story of why payments with returns are higher. Just about every other State in the country had a massive drop-off in declared estimated taxes around December/January and they've gone up to 100% of where they were before. So this is where we're conforming to national terms as well.

Chair Kawafuchi asked if the Tax department had a 20-day snapshot of the estimated tax payments. Dr. Colby said we don't have the comparison from the first 20 days of last year due to it not being in the same tax system—we have this year only. Chair Kawafuchi said he would've expected the estimated tax payments would go up with the higher tax rates.

Dr. Bonham suggested the Council focus on this year's growth rate and whether the growth rate needs to be lowered. Dr. Bonham moved 5% for this fiscal year 2019--a 2% increase for the next two months. Dr. Grandy seconded the motion. He said that in discussion, his number is 5.4% (with the tax rates factored in) which is actually higher. Dr. Bonham said he thought his is too high. He said he's just being realistic. Dr. Grandy said he's not explicitly adjusting the forecast from the economic forecast. He said those below-the-line adjustments get folded into the actual receipts--adjusting the forecast as we're getting new data, effectively it's built in.

Ms. Niwao said the below-the-line is the tax adjustments for change of tax laws. Dr. Bonham said it's the way they're running the model--the data you're using in your models has been adjusted for some of the tax law changes and putting them back in after the model adjusts the forecast. Dr. Grandy said he thinks of it as forecasting below-the-line. Dr. Bonham said his forecast from his model is 4.7%.

Chair Kawafuchi asked how the underlying economy is doing in Hawaii with tourism and construction. Dr. Bonham said very mediocre. He said to remember that we're forecasting tax revenue not the economy. Chair Kawafuchi agreed and said we do take into account the economic conditions. Dr. Bonham said yes and that he's not optimistic for the next fiscal year. He said he thought they're getting some boost out of the tax rule changes; job growth is really stagnated—almost near no job growth statewide. He said last year we saw enormous downward revision in the jobs data—a full one percentage point. He said he thought we ended the year a .4

or .5% growth. So far it's been weaker than that. He said arrivals are recovering largely due to the Southwest effect, and Maui is doing by far the best of any of the counties right now. Dr. Suyderhoud asked about wages in the labor market. Dr. Bonham said the income data has been very, very weak—real income growth close to 1%. It hasn't done better than that in the last couple of years. He said just sort of barely moving along .50% to 1% growth.

Chair Kawafuchi asked about construction. Dr. Bonham said it's all over the map. Dr. Bonham said he agreed that we could actually see increases in the excise tax revenue collected because of the tariffs. He said he was thinking more about the effect on the rest of world. Ms. Niwao said people don't have an unlimited amount of funds to spend. She said she sees problems with the fact that home equity loans are no longer tax deductible.

Dr. Bonham said we're being affected by all the tax law changes (lack of deductibility over three-quarters of a million dollars on a mortgage; the lack of deductibility over \$10,000 for your state & local property taxes). So the tax benefits of buying housing has diminished significantly particularly in the very high-end. And, that's how they're going to affect nationwide he thought. He said we're seeing significant slowdown in home sales down 9% for the US. Interest rates have come back down but they were up with the inflation scare that immediately went away.

Dr. Grandy said the US real GDP (Gross Domestic Products) trend has been rising – we're now above 3% year-over-year for the 12-month moving average. He said we haven't been at that level for years. He said he thought there may be some push back. And, if that turns out to be less of a problem than it was then there's some underlying US economy strength that would probably filter into putting a floor under the lower growth rates than we're seeing in Hawaii and actually reverse that in the next couple of quarters.

Dr. Bonham said he thinks Dr. Grandy is right. He said it is the US economy that is creating that floor and, now Southwest Airlines is helping with that floor.

Ms. Maynard said she thought that's helpful but the State GDP forecast is still pretty dismal. Dr. Bonham said but we're not forecasting to make it lower. Our forecast for the calendar year is actually up slightly from what we saw for 2018 at 1% to 1.1%. It's weak growth, but it is growth.

Dr. Suyderhoud said he's sharing Dr. Grandy's outlook on the US economy that he thought has a base that the labor market is relatively strong, taken into consideration also the population growth slowing down.

Dr. Bonham said if this were a UHERO forecast that we were doing this for release to the public, we wouldn't swing from 3 to 5% and that they would ease it up. He thought they would probably be too low. Dr. Suyderhoud said there's a motion on the floor for 5% and that for multiple reasons he's not comfortable with 5%. He said he's certainly comfortable with anything 4% to 4.5% range. Dr. Grandy said that argument would have a fair amount of weight with him if not for the April data. Dr. Bonham said we're basically forecasting two months and May was a big month last year and June wasn't. Ms. Maynard said that's the hard part, because monthly data as we've just seen goes all over the place suggest to forecasting what those two months are going to be.

Ms. Niwao said she would be more comfortable with 4%, 4.5% or 4.3%. She said she thought last year May was quite high. Dr. Bonham said he's perfectly fine with 4.7% and that's what his forecast is. Dr. Bonham said he will withdraw his 5% motion and make the 4.7% motion. Dr. Suyderhoud seconded. Chair Kawafuchi asked if there was any further discussion. There was no further discussion. The vote was unanimous.

Dr. Bonham made a motion that the general fund tax revenues growth rate be 4.7% for FY 2019 (below-the-line). 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	Yes
Kristi L. Maynard	Yes
Jessica E. Gluck	Yes

GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2020 THROUGH 2025:

Next, the Council discussed the general fund revenue forecast for fiscal years 2020 through 2025. Dr. Bonham said his forecast for the next year is higher, and he wasn't sure why. Dr. Suyderhoud said if you're assuming zero rates and another structural change in the taxes, the revenues would all be a function of economic growth more or less. Ms. Niwao said there may be some timing differences by withholding taxes being withheld as it would be more economic growth. Dr. Bonham said UHERO's model of tax revenue growth takes off because we have some recovery of visitor spending, partly because we were expecting some bounce back after a really weak 2nd half last year. He said the year-over-year growth rates get a lot easier, the comparison gets a lot easier for visitor space because of the 2nd half of last year was so weak. Ms. Maynard said DBEDT's forecast for FY 2020 is 1.5% and 2021 is 2%. Dr. Colby said the long run growth rate for the general fund over the last 10 years is 5%.

Ms. Maynard said she thought 4% is a good number. Dr. Bonham said to remember their forecast at the beginning of this year at 4.2% so they've only raised the growth forecast by half a percentage point so there's no reason to be changing the long range forecast. Ms. Niwao said we have a higher base that we're comparing. Dr. Bonham said the 4.2% forecast that we should've left alone.

Dr. Suyderhoud moved to retain the current forecast in the out years. Chair Kawafuchi asked if there were any developments at the Tax department in terms of accelerating or enhancing revenue besides the new computer system.

Dr. Colby referred the question to Director Takayama. Director Takayama said we are looking at a number of things: 1) increasing use of outside collection agencies for the existing AR and using other kinds of aggressive tactics. Last year the legislators gave the Tax department additional investigators to go after non-filers in particular but also those in the cash economy. She said there're other kinds of tactics the department is looking to increasing the fraud

capabilities. The TSM program itself has a whole program of filters for fraud detection. And, we're making aggressive use of those as well. She said as to how or whether that pays off, we're not quite sure yet, it's too early to tell.

Dr. Suyderhoud asked Director Takayama what is the expected success for these kinds of programs in terms of magnitude of an annual amount. He asked if it would be in tens of millions or hundreds of millions. Director Takayama said she has no idea. She said we're doing everything we can to increase the revenue sources and doing things like what you were talking earlier about the timing in terms of deposits and those kinds of things. One of the things that we've done is that we told our processing units that they are to process first, all of the returns that come in with checks. On the electronic side, we are encouraging more electronic filing now. And, of the filings that are made to the Tax department, more than 50% are now done electronically.

Director Takayama said in addition to this last TSM roll-out, which is roll-out 5 that completed in early September applies to tobacco, fuel and liquor. Those tax categories are being told that when we push the button on that cut-over, they will be required to file electronically or face a 2% penalty. Director Takayama said we're more diligent in sending out notices—billing notices to taxpayers who owe us money and so we've been sending out notices more or less every other month called soft notices. In addition the Tax department started up a new program called TOP which is the Treasury Off-set Program in which we partner with the federal government and we share information for those taxpayers who owe us money but are expecting a refund from the feds, it will be taken off of the top from the refund.

Dr. Suyderhoud said we got a motion on the floor. Dr. Bonham asked if anyone seconded it. Ms. Niwao said no. Dr. Bonham seconded the motion. Dr. Grandy said the motion is to maintain the same forecast. He said he would note before they vote on this that the maintained forecast is below what the historical average is. Dr. Suyderhoud said he understood that. And, there are reasons for it including the fact that we have a slowing economy, a slowing underlying growth rate and, maybe we're at maximum capacity in terms of what our economy can do to begin with. Ms. Niwao said and we have a declining population. Dr. Suyderhoud said that's part of the story. Ms. Maynard agreed.

Ms. Gluck said 4% sounds reasonable. Chair Kawafuchi said all in favor to keep the remaining out years the same at 4%. The vote was unanimous.

Dr. Suyderhoud moved that the General Fund revenue for the remaining out years remain the same: 4.0% (2020); 4.0% (2021); 4.0% (2022); 4.0% (2023); and 4.0% (2024) and, FY 2025 at 4.0%. Dr. Bonham 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	Yes
Kristi L. Maynard	Yes

Jessica E. Gluck **Yes**

**REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:
Significant Changes from March 2019 Report**

Mr. Donovan Chun said we have provided you with our report of revised projections of general fund non-tax revenues, non-general fund tax and non-tax revenues since the March 12 meeting. He said although our report includes a summary of significant changes, there are several significant changes highlighted:

General Fund Non-Tax Revenues

Non-Revenue Receipts – the net increases in FY 19 – 25 is attributed to increases in transfers of unencumbered cash balances to the general fund from the: 1) Natural Area Reserve Fund as required by Act 12, SLH 2018 (Department of Land and Natural Resources (DLNR)) +\$15,307,518; 2) Tax Administration Special Fund as required by Act 164, SLH 2018 (Department of Taxation (DOTAX)) +\$5,255,847 ; and 3) Ceded Land Trust Funds (DLNR) +\$6,738,286. Total is \$27,301,651

Other Than Special Fund Non-Tax Revenues

Charges for Current Services – the net increase in FY 19 reflects rebates on prescription drug plans and rate credits or experience gains from insurance carriers to the Hawai‘i Employer-Union Health Benefits Trust Fund (EUTF), Department of Budget and Finance (B&F). +\$42,831,391 (\$118M refund on \$904M.)

**Dr. Suyderhoud moved to accept the B&F report as submitted. 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	Yes
Kristi L. Maynard	Yes
Jessica E. Gluck	Yes

Chair Kawafuchi said there was one last item that Dr. Colby wanted to bring up to the Council. Dr. Colby said the department has a verbal proposal for the Council. If they are interested, he would submit something more formal in the next meeting. He said the proposal is to compliment the COR forecast with stress test scenarios. The idea behind all of this is that a lot of other States after the last recession were beginning to think about the estimated revenue short falls in case of a mild recession or severe recession. And, so by giving those kinds of estimates--ranges that add to the COR estimate, it would allow B&F and others to plan better going forward. He said he discussed the matter with B&F, and they thought this would be a useful exercise for them. He said the department would use similar models to what we do to create the forecast however we would purchase additional information about macro-economic scenarios in the case of a mild

recession and a severe recession. And, we would use our models to compliment the COR numbers. The different scenarios are fanned-out across different areas. So one of the things we're trying to do with this is, see what would happen in lower-bound scenarios in the case of an unexpected economic downturn.

Dr. Grandy said initially this would be for the working purposes of the Council--it wouldn't necessarily be included in the transmittal letter to the Governor.

Dr. Colby said this information is for the Legislature and not for the Department of Taxation. He said whether we include it in the transmittal letter or some other mechanism that's what we would be doing. If there's interest from the Council, the department would draw up a proposal and submit it to the Council.

NEXT MEETING:

The Council tentatively agreed to meet on Thursday, August 1, 2019 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 310-314.

ADJOURNMENT:

The meeting adjourned at 3:31 p.m.