COUNCIL ON REVENUES

Meeting Minutes, Thursday, August 29, 2019 (2pm)

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

PRESENT:

Council Members:

Kurt Kawafuchi, (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham, Jack P. Suyderhoud, Jessica E. Gluck, Kristi Maynard and Scott W. Hayashi

Staff Members:

Department of Taxation (the Department): Seth Colby and Baybars Karacaovali

Department of Budget and Finance (B&F): Terri Ohta, Ken Shirokane and Gregg Hirohata-Goto

Others:
Sharon Kotaka, Budget & Finance
Roth Puahala, State Senate
Cibtoria Maioa, HART
Rona Suzuki, Director of Taxation
Damien Elefante, Deputy Director of Taxation

CALL TO ORDER:

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

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

Chair Kawafuchi asked if there was any communication to the Council on Revenues (the Council). There was none.

APPROVED MINUTES OF THE MEETING OF August 1, 2019:

Chair Kawafuchi called for a motion to approve the minutes. Ms. Maynard moved to approve the minutes. Dr. Suyderhoud seconded.

It was moved by Ms. Maynard and seconded by Dr. Suyderhoud that the minutes of the August 1st meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**Yes**

Carl S. Bonham	**Yes**
Jack P. Suyderhoud	**Yes**
Jessica E. Gluck	**Yes**
Kristi L. Maynard	**Yes**
Scott W. Hayashi	**Yes**

REVENUE IMPACTS OF 2019 HAWAII TAX LEGISLATION

Seth Colby presented the General Fund revenue impacts of 2019 Hawaii tax legislation with revenue impacts greater than $5 million.

Act 2, SLH 2019 deems marketplace facilitators the sellers of tangible, personal property, and services sold through the marketplace. This bill affects GET collections at the retail rate and wholesale rate.

Act 3, SLH 2019 establishes a new estate tax rate bracket for taxable estates exceeding $10 million. The bill affects estate tax collections.

Act 20, SLH 2019 imposes the TAT tax on resort fees and defines resort fees as "any mandatory change or surcharge imposed by the operator, owner or representative thereof to a transient for the use of the transient accommodation's property, services, or amenities." This act affects TAT collections.

Act 260, SLH 2019 establishes a new ship repair industry tax credit which is intended to offset costs incurred in construction and placing into service a purpose-built floating dry dock at Pearl Harbor for use by the US Navy. This affects corporate income tax revenues.

Act 261, SLH 2019 amends the tax credit for research activities such that the references to the base amount contained in section 41 of the IRC do not apply, and credit may be taken based upon all qualified research expenses incurred in Hawaii without regard to the amount of expenses for the previous year. This effects corporate and individual income tax revenues.

Act 275, SLH 2019 amends the motion picture, digital media, and film production income tax credit by increasing the credit annual aggregate cap from $35 million to $50 million. This effects corporate income tax collections.

Dr. Suyderhoud noted that the aggregate impact of all tax legislation in 2019 was minimal.

DISCUSSION OF LEGISLATION PERTAINING TO TEMPORARY VACATION UNITS

Dr. Colby presented potential impacts of the City and County Honolulu County Ordinance Bill 89 which increases the enforcement capacity for short term rentals. The impacts varied by the severity of enforcement and the reaction of visitors to the decrease in stock of short term accommodations. The economic impacts included the direct loss of revenue from the transient accommodations and the secondary economic impacts. The model that was presented showed the economic impact and the impact on tax revenues. Dr. Colby noted that the model assumed that only 10% of the existing transient accommodation listings are legal under the new law. Dr. Bonham noted that UHERO researched this issue, and 35% of existing listings are in fact legal. These listings are primarily based in Waikiki. Dr. Bonham noted that approximately 17% of listings have been taken down since Bill 89 passed on August 1, 2019. The problem with any of these calculations is there are so many unknowns and assumptions. Dr. Colby noted the range of potential impacts is large and a lot depends on your assumptions. Dr. Suyderhoud noted that all of these impacts represent a one-time shift. After which, the economic trends continue as they had before, and the economy grows from a lower base. Dr. Bonham noted there are effects that are not captured in the model. There could be a reduction in rents and housing costs.

Ms. Niwao asked about the current compliance rate of paying tax. Dr. Colby said that the assumption of compliance in the model is 66% for general excise tax and transient accommodations tax. That is based on overall tax liability and not on the percentage of total rentals.

Dr. Bonham said the incentive is for owners to shift to advertising for a 30 day minimum as this would be compliant with Bill 89. He believed that these type of shifts are likely to happen. As a result, he feels comfortable with a decrease in listings of 50% or less.

Ms. Niwao noted that bookings occur several months in advance, so the impact of this ordinance would not occur for several months out. Dr. Bonham agreed with the analysis. Dr. Colby noted that the model is based on calendar year 2020. Dr. Bonham noted that even a large decrease in listings would take tourist arrivals back to early 2019 levels. Additionally, lower home prices could limit demand for new home construction and renovation.

Ms. Niwao noted that the impacts of the trade war with China could have effects. Also the tariffs are likely to increase the cost of raw materials for construction.

Ms. Maynard cited the recent DBEDT June report reflecting a decrease in employment and population decline in 2017 and 2018. Given the fragility of the current economy, any shock to the system is worrisome. The GDP forecast is already low, even without any shocks.

Dr. Bonham noted that many of these factors have existed for the last thirty years. There seems to be a disconnect between the tax revenue and the underlying performance of the economy. Dr. Bonham says he has spoken with contractors, and they are all bullish.

DISCUSSION AND VOTE ON THE GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2020

Chairman Kawafuchi asked Director Suzuki to comment on the strong tax collection revenues in recent months. Director Suzuki noted that the Department is in the final stages of the Tax System Modernization program. As a result, the Department is processing payments a lot faster than it was doing last year. Due to the differences in processing payments, the year on year numbers may not be entirely comparable. However, these figures should be more comparable going forward. Both the processing of payments and processing of refunds were accelerated, which moderates the net revenue impact. This acceleration in processing affect all tax types, not just individual income.

Dr. Suyderhoud asked if GET revenues is a result of processing versus the impact of the underlying economy. Director Suzuki says there is a lot going on, and she could not offer a definitive process. Dr. Colby also noted that an increase in revenues could be due to lagged collections from the increase in tax rates for the highest income brackets. It was not until May 2019 that high income taxpayers realized the full impact of the higher rates on their liabilities. Taxpayers may be adjusting their estimated payments to reflect their higher liabilities.

Dr. Suyderhoud noted that Table 6A is the average of all three models produced by the Department. Dr. Bonham moved to have the growth rates be the average of all three models. The Council is on record for 4.0% across the board. Chairman Kawafuchi asked Dr. Bonham if he sees a recession in FY 2021. Dr. Bonham says he sees a slow down but not a recession. Ms. Niwao says that many economists are expecting a recession in the next 12 to 24 months. The trade war and the interest rates are also negative indicators. This could affect people thinking of visiting Hawaii.

Mr. Hayashi asked about tourist spending. Dr. Bonham said that the reduction in tourist spending is coming from international tourists.

Dr. Bonham said that tax revenue usually lags recessions quite considerably. Most of the models predicting recessions are doing so because of the behavior of the bond market. There is no sign of recession in the labor market. And there is reason to believe that for the yield curve (i.e bond market) this time is, in fact, different.

Dr. Bonham noted that tourist arrivals for the third quarter is up by about 9%. He expects tourist spending to be up 1% to 2% in the calendar year. He thinks the negative impacts will show up in later years.

Ms. Maynard says she is ok with Dr. Bonham's suggestion that they follow the models. Dr. Bonham noted that he had the lowest forecast, which included the fallout from the new vacation rental in Oahu.

Dr. Bonham noted that he talked to 8 or 9 contractors. Not one said that business was dropping off. There biggest worry was finding labor for their projects. The construction seems like a strong spot in the economy. However, the upside is not captured in the data.

It was moved by Dr. Bonham that the General Fund tax revenues growth rate be 4.1% for FY 2020 (below-the-line). Ms. Maynard seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**No**
Carl S. Bonham	**Yes**
Jack P. Suyderhoud	**Yes**
Jessica E. Gluck	**Yes**
Kristi L. Maynard	**Yes**
Scott W. Hayashi	**Yes**

DISCUSSION AND VOTE ON THE GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2021 THROUGH 2026

Ms. Maynard said that the model for the out year may be too optimistic. Dr. Bonham said that the averages of the forecasting models usually produce the best result.

Dr. Suyderhoud suggested 3.0% for FY 2021 and then the model figures for the out years. Dr. Bonham said that if you fall below expectations, they will usually rebound after that.

Ms. Niwao motioned for 3.0% for all of the out years. Ms. Maynard seconded the motion. Dr. Suyderhoud said that Council was on the record for 4.0%. He wanted to know why they wanted to lower the forecast. Ms. Niwao says she thinks that there will be a recession. Ms. Maynard asked if there is a declining population, should they expect a growing economy? Ms. Niwao said they should not expect growth if population declines. Dr. Bonham agreed, but said that he does not see a reason why the population decline should continue in out years. He also said that even if population decreases, this usually results in lower home prices and rents, which makes the state more affordable relative to other US cities, making Hawaii more attractive and encouraging immigration to the state. There are counter-balancing forces at work. Hawaii is already cheap compared to San Francisco and Seattle. UHERO is expecting flat population, which still affects economic growth.

Dr. Colby mentioned that the long term growth rate is around 5.0%. Dr. Bonham said that the average growth rate for the past ten years was 4.2%. Ms. Niwao said that much of the revenue growth probably came from increases in tax rates. Ms. Maynard said she was concerned about the prospects for economic growth. She sees very few bright spots on the horizon and big limits on productivity growth. Dr Suyderhoud said that they have been sharing those concerns for the last 30 years, yet the economy and tax revenues continue to increase. Dr. Suyderhoud said he was uncomfortable with 3% for all out years. Dr. Bonham says that if you take a historical average over multiple years, you usually get higher levels of growth.

Dr. Bonham suggested two year at 3.0% and then 4.0% for the rest of years. Dr. Suyderhoud seconded that. Chairman Kawafuchi and Ms. Niwao thought the out years were 3.7% instead of 4.0% but were corrected.

A motion was made by Dr. Bonham that the General Fund revenue growth of 3.0% for FY 2021 and FY 2022 and 4.0% for FY 2023, FY 2024, FY 2025, and FY 2026 . Dr. Suyderhoud seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	**Yes**
Marilyn Niwao	**Yes**
Carl S. Bonham	**Yes**
Jack P. Suyderhoud	**Yes**
Jessica E. Gluck	**Yes**
Kristi L. Maynard	**Yes**
Scott W. Hayashi	**Yes**

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REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES
Significant Changes from the May 2019 Report

Mr. Gregg Hirohata-Goto said he provided the B&F report of revised projections of General Fund non-tax revenues, non-General Fund tax, and non-tax revenues since the May 29 meeting. He said although the report includes a summary of significant changes. There are several significant changes highlighted:

Special Fund Non-Tax Revenues

Federal Grants - the net increases in FY s 19-26 primarily reflect a change in tax revenue projections versus previously used estimated entitlement (Department of Transportation (DOT) - Airports) for (-$15 million) and increases in emergency expenditures to address natural disaster damage (+$37 million) and efforts to address a backlog of federal highway construction grand awards (DOT - Highways) (+$43 million).

Other Than Special Fund Non-Tax Revenues

Use of Money and Property - the net decrease in FY 19 reflects lower than anticipated returns on Other Post-Employment Benefits funds not held in the State Treasury at the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), B&F (-$72 million). This decline resulted from a lower rate of return on investments than expected.

Non-Revenue Receipts - the net increase in FY 19 reflects the actual employer contributions into the employees' medical health premiums for active employees at EUTF, B&F (+$41 million). The net decrease in FY 20 reflects the change of projected bond issuances for affordable rental housing projects in FY 21 (-$9 million). The net increases in FYs 22-26 reflect expected increases in employees' premiums and employers' contributions into the EUTF (+$38 million).

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	**No**
Carl S. Bonham	**Yes**
Jack P. Suyderhoud	**Yes**
Jessica E. Gluck	**Yes**
Kristi L. Maynard	**Yes**
Scott W. Hayashi	**Yes**

SCHEDULE THE NEXT MEETING FOR THE TOTAL PERSONAL INCOME FORECAST

The Council tentatively agreed to meet on Thursday, October 31, 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 3:41 PM.