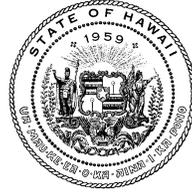


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COUNCIL ON REVENUES

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

September 10, 2019

The Honorable David Y. Ige
Governor, State of Hawaii
Executive Chambers
State Capitol, Fifth Floor
Honolulu, HI 96813

Dear Governor Ige:

At its meeting on August 29, 2019, the Council on Revenues raised its forecast for growth of the State General Fund tax revenue in fiscal year (FY) 2020 from 4.0% to 4.1%. The Council also changed its growth forecast for FY 2021 and FY 2022 to 3.0% and 4.0% for FY 2023 through FY 2026. The change reflects the expectation of economic headwinds in the coming year.

The Council believes that Hawaii's economy continues to be strong but cited uncertainty about the future. The Council discussed the economic and fiscal impact of Honolulu County's Ordinance 19-18, which increases the enforcement capabilities of the county to regulate transient accommodation units. The Department of Taxation briefed the members on the revenue impacts of legislation passed during 2019. In addition, the Director of Taxation discussed additional efforts that the State was taking to expedite deposits and improve tax collections.

Concerns were expressed that the economy may have reached the end of its current expansionary cycle during the seven-year budget window. The Council noted that Hawaii visitor arrivals, job counts, and construction activities are all continuing strong and that current business sentiment in the state remains positive. However, members expressed concern that on the national and global level, future storm clouds and uncertainty remain on the horizon, with the inverted yield curve (where interest rates on long-term debt instruments have a lower yield than short-term debt instruments) appearing, which normally preceded U.S. recessions in the past. In addition, members expressed concern about the impact of the U.S.-China trade war and a slowing global

economy. Finally, the Council also discussed the negative economic impact of Hawaii's population decline in recent years.

The new forecasts for the State General Fund tax revenues FY 2020 through FY 2026 are shown in the table below.

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2020	7,434,603	4.1%
2021	7,657,641	3.0%
2022	7,887,370	3.0%
2023	8,202,865	4.0%
2024	8,530,980	4.0%
2025	8,872,219	4.0%
2026	9,227,108	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 2019 Legislature, including the following:

- Act 2, SLH 2019 deems marketplace facilitators the sellers of tangible personal property, intangible personal property, and services sold through the marketplace. The Act also deems sales of tangible personal property and services by sellers to the marketplace facilitator to be sales at wholesale. The Act is effective January 1, 2020. The estimated gain to the General Fund is \$4.0 million in FY2020, \$9.8 million in FY 2021, \$10.1 million in FY 2022, \$10.4 million in FY 2023, \$10.7 million in FY 2024, \$11.0 million in FY 2025, and \$11.3 million in FY 2026.
- Act 3, SLH 2019 establishes a new estate tax rate bracket for taxable estates exceeding \$10 million. The new bracket is 20%. The Act is effective April 4, 2019, and applies to decedents dying after December 31, 2019. The estimated gain to the General Fund is \$1.9 million in FY 2021, \$2.0 million in FY 2022, \$2.1 million in FY 2023, \$2.2 million in FY 2024, \$2.3 million in FY 2025, and \$2.4 million in FY 2026.
- Act 20, SLH 2019 imposes the transient accommodations tax on resort fees and defines resort fees as "any mandatory charge or surcharge imposed by an

- operator, owner, or representative thereof to a transient for the use of the transient accommodation's property, services, or amenities." The Act is effective July 1, 2019. The estimated revenue gain to the General Fund is \$9.1 million in FY 2020, \$10.3 million in FY 2021, \$10.7 million in FY 2022, \$11.1 million in FY 2023, \$11.6 million in FY 2024, \$12 million in FY 2025, and \$12.4 million in FY 2026.
- Act 260, SLH 2019 establishes a new ship repair industry tax credit which is intended to offset costs incurred in constructing and placing into service a purpose-built floating drydock at Pearl Harbor for use by the United States Navy. The tax credit expires December 31, 2026. The Act also repeals the capital infrastructure tax credit. The Act is effective January 1, 2020, and applies to taxable years beginning after December 31, 2021. The expected net loss to the General Fund is \$6.0 million per year in FY 2023 to FY 2026.
 - Act 261, SLH 2019 amends the tax credit for research activities such that 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 previous years. The Act establishes an annual aggregate cap of \$5 million. The Act extends the tax credit from tax year 2020 through tax year 2024. The expected loss to the General Fund is \$5.0 million per year for FY 2021 to FY 2025.
 - 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. The Act is effective July 10, 2019, and applies to taxable years beginning after December 31, 2018. The tax credit expires December 31, 2025. The expected loss to the General fund is \$15.0 million per year for FY 2020 to FY2026.

The Council also took into account provisions from earlier legislation, 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 per year 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 per year 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.
 - Act 107, SLH 2017 reinstates three tax rates and brackets (9.0%, 10.0%, and 11.0%) for the highest-income taxpayers imposed by Act 60, SLH 2009, for taxable years beginning after December 31, 2017. The estimated gain to the General Fund is estimated to be \$50.7 million in FY 2019, \$53.3 million in FY

2020, \$55.9 million in FY 2021, \$58.7 million in FY 2022, \$61.6 million in FY 2023, and \$64.7 million in FY 2024.

- Act 107, SLH 2017 establishes a nonrefundable earned income tax credit (EITC) equal to 20 percent of the federal EITC. The tax credit applies to tax years 2018 through 2022. The estimated loss to the General Fund is estimated to be \$16.7 million in FY 2019, \$20.4 million in FY 2020, \$23.8 million in FY 2021, \$27.1 million in FY 2022, \$30.1 million in FY 2023, and \$0.0 in FY 2024.
- Act 107, SLH 2017 repeals the sunset date (December 31, 2017) for the amendments to the refundable food/excise tax credit by Act 223, SLH 2015. The estimated loss to the General Fund is estimated to be \$6.5 million per year from FY 2019 to FY 2024.
- Act 143, SLH 2017 amends the motion picture, digital media, and film production tax credit by limiting total amount of credit to \$35 million/year and extending the credit to January 1, 2026. Total tax credits claimed per qualified production shall not exceed \$15 million. The estimated revenue loss to the General Fund is \$35 million per year from FY 2020 to FY 2024.
- Act 54, SLH 2017 exempts certain affordable rental housing projects from the general excise and use tax. The legislation limits total amount of exemptions to \$7 million/ year starting July 1, 2018 through June 30, 2022. The expected revenue loss is \$7 million per year from FY 2019-2022.
- Act 1, SSLH 2017 increases the TAT rate from 9.25% to 10.25%, effective January 1, 2018 through December 31, 2030, and allocates the tax revenue generated from the increase to the Mass Transit Special Fund. The Act also increases the annual allocation to the counties from \$93 million to \$103 million, beginning in FY 2018. The expected revenue loss to the General Fund is \$10 million per year from FY 2018 to FY 2024.

The Department of Taxation has prepared a report (attached) detailing line-item forecasts for various components of the General Fund, reconciled to the Council's forecast growth rate for total General Fund tax revenues. The line-item forecasts include components, such as revenues from the General Excise Tax and from the Individual Income Tax that the Council does not forecast separately. Also, the Department of Budget and Finance has prepared the attached report to update its projections for change in non-tax and special tax revenues from its report on May 29, 2019.

Please advise us if we can be of further assistance or if we can answer any questions.

The Honorable David Y. Ige
September 10, 2019
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Very truly yours,

A handwritten signature in black ink, appearing to read "Kurt Kawafuchi". The signature is fluid and cursive, with a distinct loop at the end.

KURT KAWAFUCHI
Chair, Council on Revenues

Attachments