COUNCIL ON REVENUES

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

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Senator David Y. Ige
Chair, Senate Committee on Ways and Means
State Capitol, Room 208
Honolulu, HI 96813

Representative Sylvia Luke
Chair, House Committee on Finance
State Capitol, Room 306
Honolulu, HI 96813

Chairpersons and Members of the Committees:

Thank you for inviting the Council on Revenues 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 trends and the Council's latest forecast.

Recent Revenue Trends

Results for fiscal year 2013

In fiscal year (FY) 2013, the State's General Fund tax revenues grew by 9.9%, to $5.47 billion from $4.97 billion in FY 2012.

The General Excise Tax makes up almost half of the State’s total General Fund tax revenues and usually is a good indicator of economic activity in Hawaii. Revenue from the tax increased by 9.1% in FY 2013, to $2.94 billion from $2.70 billion in FY 2012.

Construction spending, as measured using data from the General Excise Tax on contracting activities, increased by 20.7% in FY 2013.

Improved economic conditions caused total personal income (as reported by the Bureau of Economic Analysis) to grow by 3.2% in FY 2013, but the Department of Taxation reported that income tax withheld from wages increased by 7.0% that year. Total net individual income tax collections rose by 12.7% in FY 2013.

Results since the beginning of fiscal year 2014

Preliminary data for November of 2013 indicate that General Fund tax revenues for the first five months of FY 2014 (July through November of 2013) are down slightly (0.6%) compared to the same period in FY 2013, but this year's growth has been affected by two unusual events. The first unusual event is the once-per-year allocation of $55.5 million from the General Excise Tax directly to the Hawaii Hurricane Relief Fund that was mandated by Act 62, Session Laws of Hawaii 2011. The first allocation was made in August of 2013 and the final allocation is scheduled for August of 2014. The second unusual event is the unusually high allocation to the county surcharge in the first month of FY 2014 which, when coupled with the unusually low allocation to the county surcharge in the first month of FY 2013 depressed the growth rate of General Fund collections for FY 2014. According to the Department of Taxation, the unusually low allocation in the first month of FY 2013 was due mostly to the correction of a prior posting error; the higher allocation in the first month of FY 2014 was due mostly to having additional staff available, resulting in higher numbers of tax returns processed. The effect of the change in timing of allocations on the growth rate of General Fund tax collections should diminish over time, although it looms large in the growth rate comparisons in the first months of the fiscal year.

If we are to meet the Council's current forecast for FY 2014, General Fund tax revenues for December through June will have to surpass those of FY 2013 by 7.2%. The Council's next General Fund forecast will be made on January 7, 2014.

Here is what happened with cumulative collections from the General Excise Tax (the biggest tax) and the Individual Income Tax (the second biggest tax) in the first five months of fiscal year 2014:

- Cumulative net collections of the General Excise Tax (before allocations to the Hawaii Hurricane Relief Fund) were $1,165 million from July through November of FY 2014, compared to $1,205 million for the same period last year. The year-over-year growth rate for the tax is -3.4%, but it was adversely affected by the allocations of the County Surcharge collections, as I mentioned earlier.

- Cumulative net collections for the Individual Income Tax were $719.4 million from July through November of FY 2014, compared to $705.2 million for the same period last year, a growth rate of 2.0%.

Forecasts of General Fund Tax Revenues

At its meeting on September 5, 2013 the Council on Revenues lowered its forecast for State General Fund tax revenues in FY 2014 from $5.74 billion to $5.69 billion. The Council's previous forecast, made at its meeting on May 28, 2013, did not take into account the automatic transfers from the General Excise Tax to the Hawaii Hurricane Relief Fund in each of FY 2014 and FY 2015. Without these transfers, the Council's current forecasts would show higher General Fund tax revenues in both FY 2014 and FY 2015 than the May forecasts. Therefore, the drop in the forecasts does not reflect a more pessimistic view of the economy on the part of the Council since its meeting in May.

The Council discussed the visitor and construction sectors of Hawaii's economy and expressed concerns about the slowdown in the growth of visitor expenditures, the effects of higher hotel room rates and higher airfares, and the potential effects of future unfavorable exchange rates changes. However, members also noted that positive effects may come from growth in new construction.

The tabulation below shows the Council's latest forecast for the next seven years (FY 2014 through 2020). Of course, the forecasts for the later years are subject to greater uncertainty.

Fiscal Year	General Fund Tax Revenues Amount (in Thousands of Dollars)	Growth From Previous Year
2014	5,690,941	4.1%
2015	6,114,867	7.4%
2016	6,587,722	7.7%
2017	6,962,696	5.7%
2018	7,388,572	6.1%
2019	7,792,538	5.5%
2020	8,205,620	5.3%

The Council is scheduled to meet on January 7, 2014 to review and possibly revise these forecasts.

In producing its forecasts, the Council adopted specific adjustments recommended by the Department of Taxation to reflect effects on General Fund tax revenues of tax law changes enacted by the 2013 Legislature, including the following:

- Act 89 amends the motion picture digital media and film production tax credit. The Act increases the credit rate from 15% to 20% for productions on Oahu and from 20% to 25% for productions on the neighbor islands. The Act also increases the cap on the amount of the credit per production from $8 million to $15 million and moves the expiration date for the credit from January 1, 2016 to January 1, 2019. The Act is estimated to raise the annual cost of the tax credit by about $21 million over the level in FY 2013.

- Act 160 eliminates the General Excise Tax (GET) exemption for liquor, tobacco and food sold to common carriers. The Act is estimated to raise GET collections by about $6 million per year.

- Act 161 makes permanent the Transient Accommodations Tax (TAT) rate of 9.25% and the caps on TAT allocations to the special funds. The Act raises the cap on the allocation to the Tourism Special Fund by $11 million. Act 161 is estimated to reduce General Fund revenues by $11 million in FY 2014 and in FY 2015, but is expected to increase General Fund revenues by amounts ranging from $177 million in FY 2016 to $246 million in FY 2020.

- Act 163 makes permanent the GET exemption for certain expenses paid by hotel operators and timeshare projects and removes the cap on the aggregate amount of the exemptions that can be claimed. The Act is estimated to reduce GET collections by about $20 million in FY 2014 and by about $13 million annually thereafter.

The Council also took into account provisions from earlier legislation, including the following:

- Act 105, SLH 2011, eliminated certain GET exemptions. The Act expired June 30, 2013. Its expiration is estimated to reduce GET collections by about $70 million annually relative to the level in FY 2013.

- Act 62, SLH 2011, allocates GET revenues directly to the Hurricane Relief Fund to replace amounts that were taken from the Fund in prior years. The Act will reduce GET allocations to the General Fund by $55.5 million in FY 2014 and in FY 2015.

I am available to answer any questions you may have.

Sincerely,

Kurt Kawafuchi
Chair, Council on Revenues