COUNCIL ON REVENUES

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

June 1, 2015

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 May 21, 2015, the Council on Revenues raised its forecast for growth in the State's General Fund tax revenues in fiscal year (FY) 2015 from 5.5% to 7.5%. The Council lowered its forecast for growth in FY 2016 from 5.5% to 2.7% and raised the forecast for growth in FY 2017 from 5.5% to 6.4%. The Council kept its forecast for growth in FY 2018 at 5.5% and also kept its forecast for growth in FY's 2019 through 2021 at 5.0% for each year.

The forecast changes were made, based on information provided by the Department of Taxation on the status of refunds of the individual income tax (IIT). The Department predicted that delays in IIT refunds caused by new processing procedures put in place to prevent paying fraudulent refund claims would cause about $104 million of refunds that would ordinarily have been paid out in FY 2015 to be paid out instead in FY 2016. The Department also predicted that refund delays would occur in future years, but that the amount of the delayed refunds would be only about half as great as in FY 2015. The changes in the forecast growth rates reflect the Department's assessment of the effect of changes in processing of refund claims on the timing of future refund payments.

In reaching the new forecast, the Council noted that General Fund tax revenues grew much faster so far in FY 2015 than their earlier forecast, but noted also that the higher growth was due mainly to the fact that the Tax Department has slowed processing of individual income tax refunds to prevent paying fraudulent refund claims. The members discussed the refund delays at length before adopting the Tax Department's predictions of how they would affect the timing of General Fund tax collections.

Council members discussed the effect of the significant drop in oil prices, of the continued strength of the dollar in foreign exchange markets, and of the recent slowdown in U.S. economic growth. The members noted that the drop in oil prices has not yet translated into an increase in consumer spending on other things and that the exchange rate changes do not yet appear to have had a substantial adverse effect on tourism. They also noted that the recently reported slowdown in the US economy in the first quarter of

2015 may be due to one-off events, such as the bad weather and to other seasonal factors not accounted for by seasonal adjustments. (Growth in GDP has been consistently low in the first quarter in recent years.) Overall, the members found no reason to change their assessment of economic growth for Hawaii.

Revised forecasts of State General Fund tax revenues for FY 2015 through FY 2021 are shown in the table below. As in all multi-year forecasts, the estimates for the later years are subject to greater uncertainty.

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2015	5,773,038	7.50%
2016	5,928,910	2.70%
2017	6,308,360	6.40%
2018	6,655,320	5.50%
2019	6,988,086	5.00%
2020	7,337,490	5.00%
2021	7,704,365	5.00%

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 2014 Legislature, including the following:

- Act 107, SLH 2014 reestablishes the energy systems development special fund. It also extends the $1.05 per barrel rate for the environmental response tax, which was set to expire at the end of fiscal year 2015, through fiscal year 2030, as well as the allocations of the tax to the general fund. The annual general fund revenue gain is estimated to be a loss of $2.6 million for fiscal year 2015 and annual revenue gains of $15.5 million for fiscal years 2016 through 2030.

- Act 163, SLH 2014 increases allocations of the conveyance tax to the rental housing trust fund from 30% to 50% beginning July 1, 2014. The annual general fund revenue loss is estimated to be $11.5 million per year in fiscal year 2015 and later.

- Act 174, SLH 2014 increases allocations of the TAT to the counties from $93 million to $103 million for fiscal years 2015 and 2016. The general fund revenue loss is $10 million in fiscal years 2015 and 2016.

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

- Act 89, SLH 2013 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 161, SLH 2013 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 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, SLH 2013 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.

- 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 each of FY 2014 and FY 2015.

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 March 12, 2015.

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

Very truly yours,

KURT KAWAFUCHI
Chair, Council on Revenues

Attachments