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COUNCIL ON REVENUES

STATE OF HAWAII
P.O. BOX 259
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March 15, 2017

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 March 13, 2017, the Council on Revenues (the "Council") lowered its fiscal year (FY) 2017 revenue forecast for the General Fund from 3.0% to 2.5%. This was in part due to the fact that General Fund revenues in the first eight months of FY 2017 came in lower than forecast at 1.8% v. 3.0%. Lower General Fund revenue resulted from lower than expected collection from the General Excise (GET) and Use Tax (0.1%) and the Individual Income Tax (IIT) (3.3%), the two largest sources of tax revenue for the State. The Council expects revenue growth to rebound slightly in the last four months of FY 2017, resulting in an estimated year-on-year growth rate of 2.5%. The Council also lowered its growth forecasts from 5.0% to 4.0% in FY 2018 and from 4.4% to 4.0% in FY 2019. The Council expects revenue growth to be 4.5% from FY 2020 to FY 2023 which was slightly higher than the previous forecasted growth rate of 4.4%.

The Council discussed the possible causes of lower tax revenue collections for the first eight months of FY 2017. At the outset of its deliberations, the Council noted the higher than expected growth rate in FY 2016 at 8.0%. The Council also recognized that one off adjustments related to litigation resulted in higher collections in the prior FY 2016, in other words, a higher prior base period. Further, the Council was informed of an accounting adjustment to the current general fund tax revenue in FY 2017 that stems from a reclassification of general excise tax revenue to transient accommodations tax revenue, which had no impact on the overall general fund tax revenue but impacted the general excise tax revenue growth rate.

The Council noted and considered the expiration of higher income tax rates on the top income brackets for individual taxpayers after 2015, i.e., decreasing from 11% to 8.25%. The Council also discussed the potential impact of the reduced higher income tax rates on declared estimated taxes for certain individual taxpayers during the current FY 2017, which may adversely affect income tax revenue due to higher refunds associated with the lowering of the rates.

The lower multi-year forecasts beginning in FY 2018 reflect the Council's belief that the State of Hawaii had experienced higher than normal levels of economic growth over the last five years and that forecasted growth rate of Hawaii's economy may be lower in the current and succeeding two years than in the prior five years.

The new forecasts of State General Fund tax revenues for FY 2017 through FY 2023 are shown in the table below.

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2017	6,349,215	2.5%
2018	6,603,184	4.0%
2019	6,867,311	4.0%
2020	7,176,340	4.5%
2021	7,499,275	4.5%
2022	7,836,742	4.5%
2023	8,189,395	4.5%

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 2016 Legislature, including the following:

- Act 129, SLH 2016 amends the low-income housing tax credit for buildings that became eligible for the tax credit after December 31, 2016 and before December 31, 2021. The amendment allows investors to take the tax credit over a period of only five years, instead of ten years under prior law. The amendment is estimated to reduce General Fund revenues by $4 million in FY 2019, by $8 million in FY 2020, by $12 million in FY 2021, by $16 million in FY 2022 and by $20 million in FY 2023.

- Act 202, SLH 2016 creates a nonrefundable tax credit for production of renewable fuels and eliminates the ethanol facilities tax credit. The change is repealed December 31, 2021. The annual General Fund revenue loss is estimated to be $3 million from FY 2018 to FY 2022.

- Act 223, SLH 2016 extends the Transient Accommodations Tax (TAT) allocation of $103 million to the counties to FY 2017. The allocation will reduce General Fund revenues by $10 million in FY 2017. (The Act amends the county allocations made in Act 121, SLH 2015, described below.)

- Act 258, SLH 2016 provides a new tax credit for organic food production. The tax credit applies to taxable years beginning after December 31, 2016 and is repealed December 31, 2021. The tax credit will reduce General Fund revenues by $2 million annually in FY 2018 through FY 2022.

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

- Act 84, SLH 2015 establishes maximum dollar amounts for the allocations of the Conveyance Tax to the Land Conservation fund and the Rental Housing trust fund, and eliminates allocations to the Natural Area Reserve fund starting in FY 2016. The annual General Fund revenue gain is estimated to be $19.7 million for FY 2016 and later.

- Acts 117 and 121, SLH 2015 changed allocations of the TAT. According to Act 121, TAT allocations for FY 2016 and later are as follows: Tourism special fund $82 million; Counties $93 million (except $103 million in FY 2016); Convention Center special fund $26.5 million; and Turtle Bay conservation easement $1.5 million. Act 117 allocated $3 million annually to the Special Land Development fund starting in FY 2017. The changes in allocations are expected to yield $2 million in additional General Fund tax revenues in FY 2017 and thereafter.

- Act 120, SLH 2015 provides a tax credit for converting cesspools to a septic system or connecting to a wastewater system. The tax credit expires December 31, 2020 and is estimated to reduce General Fund tax revenues by $5 million annually from FY 2017 through FY 2021.

- Act 223, SLH 2015 modifies the food/excise tax credit (an increase for certain taxpayers) for tax years 2016 and 2017. The Act is estimated to reduce General Fund tax revenues by $6.5 million in FY 2017 and in FY 2018.

- Act 238, SLH 2015 reduces the allocation of tobacco taxes to the Trauma special fund, caps the amount allocated to the fund, and also caps the allocations to the Emergency Medical Services and Community Health Centers special funds, effective July 1, 2015. The Act is estimated to increase General Fund tax revenues by $4 million in FY 2016 and later.

- Act 107, SLH 2014 reestablished 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 FY 2015, through FY 2030, as well as the allocations of the tax to the General Fund. The annual general fund revenue gain is estimated to be $15.5 million for FYs 2016 through 2030.

- 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.

- 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 $13 million annually.

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 January 4, 2017.

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