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COUNCIL ON REVENUES

STATE OF HAWAII
P.O. BOX 259
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March 15, 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 March 12, 2019, the Council on Revenues lowered its forecast for growth of the State General Fund tax revenue in fiscal year (FY) 2019 from 4.2% to 3.0%. The Council's decision to lower the estimate was based on the expectation of lower economic growth and lower than expected tax revenue growth. The cumulative State General Fund growth rate for the first eight months of the current fiscal year ending June 30, 2019 was 2.1% compared to the eight-month growth rate of 6.9% for the same period in the last fiscal year. The Council maintained its annual growth forecast for FY 2020 to FY 2025 at 4.0%.

The Council believes that the growth of Hawaii's economy has declined from the previous year. After the previous period of record growth, the Council expressed additional uncertainty about the future. The Council discussed global and national signs of a slowdown in the economy and their impact on Hawaii’s economy. In addition, the Council considered factors affecting Hawaii’s economy such as a population decline in two previous years, and lower growth in visitor arrivals and expenditures, job creation, and construction activity. The Council also discussed the impact of Southwest Airlines entering the Hawaii market offering lower-cost airline tickets to the islands. Furthermore, the Council expressed concerns that the economy may reach the end of its current expansionary cycle during the seven-year budget window.

The Council also discussed the permanent and temporary effects of the tax law changes of the Tax Cuts and Jobs Act of 2017, such as how temporary tax planning actions taken by Hawaii taxpayers in late 2017 may have caused a one-time increase in state tax payments in the prior fiscal year. Moreover, the Council also discussed whether any new tax collection initiatives had been undertaken for on-line sellers in light of the Wayfair online sales tax case as well as whether there had been any administrative changes impacting the timing of tax collections.

The new forecasts for the State General Fund tax revenues FY 2019 through FY 2025 are shown in the table below.

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2019	6,999,917	3.0%
2020	7,279,914	4.0%
2021	7,571,111	4.0%
2022	7,873,955	4.0%
2023	8,188,913	4.0%
2024	8,516,470	4.0%
2025	8,857,129	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 2018 Legislature, 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 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 from FY 2020 to FY 2025.

- Act 211, SLH 2018 imposes the TAT on transient accommodations brokers, travel agencies, and tour packagers 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.

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

- 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 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, 2017 through June 20, 2022. The expected revenue loss is $7 million in 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 from FY 2018 to FY 2024.

- 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 and FY 2017); 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. Note that Act 107, SLH 2017 directs $103 million from FY 2018 and beyond.

- 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 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.

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 January 2019 report.

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