COUNCIL ON REVENUES

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

May 29, 2020

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

Dear Governor Ige:

The Council on Revenues held a virtual meeting to forecast revenue growth for State General Fund revenues on May 28th, 2020. The Council lowered its forecast to -7.0% for fiscal year (FY) 2020 and -12.0% in FY 2021 in light of the economic downturn prompted by the COVID-19 virus. The Council expects a rebound in revenues of 12.0% in FY 2022 and a growth rate of 3.0% for FYs 2023-2026.

The Council based its FY 2020 forecast on the sharp decline in revenues in the April General Fund statement and the May daily cash report as of May 25, 2020 that resulted from the sudden stop in tourism arrivals and the Governor's Stay-At-Home order. The Council also considered the impacts of the delay in the filing deadline for 2019 income taxes from April 20th, 2020 to July 20th, 2020, which will shift some revenue collections from FY 2020 to FY 2021. The estimated revenue to be shifted for the balance of taxes due in April 20, 2020 is expected to be less than amounts paid with the April 20, 2019 returns since taxes paid then incorporated the 2018 tax rate increases from 8.25% to 11.0% for the highest individual income tax rate bracket. For 2019 tax returns, taxpayers would have increased their 2019 quarterly estimated taxes to take into account the increased tax rates in order to avoid underpayment tax penalties

The Council acknowledged the great amount of uncertainty surrounding the forecast figures for FY 2021 and FY 2022 due to questions surrounding the nature of the disease and the government's response to stop the virus in Hawaii. For the FY 2021 estimate, the Council made the assumption that the 14-day self-quarantine period imposed on transpacific passengers (with exceptions for persons traveling to perform certain critical infrastructure functions) would be lifted by late July 2020 and substituted with other mechanisms to screen for disease, such as pre-flight testing of passengers and/or allowing easier access to passengers flying to Hawaii in "travel bubbles". The Council also considered the possibility of a second wave of infections because of the experiences of Hong Kong and Singapore.

The Council also discussed the infectiousness, modes of transmission, and possible vaccines and treatments for the COVID-19 virus, and assumed in its analysis that a vaccine or effective treatment against the disease would be made available during the FY 2022 period, which would encourage more tourists to fly to Hawaii since they would feel more comfortable flying with less exposure to disease when making long airplane trips to Hawaii.

The Council discussed the significant role that tourism plays in Hawaii's economy and why other industries could not replace tourism in generating significant business revenue and Hawaii General Fund tax revenues in the next two years. For example, although agriculture development is significant in making Hawaii more self-reliant, sales of agricultural products, manufacturers, and wholesalers are often only subject to a 0.5% tax rate, as opposed to the 4.0% tax rate imposed on other types of income such as rental income, retail income, service income, contracting income, and other types of income. In addition, the transient accommodations rental rate of 10.25% is primarily paid by hotels and other transient accommodations connected to tourism such as vacation rentals. Given the prominent role of tourism in Hawaii's economy, extended delays in the return of visitors will have major impacts on the economy and tax collections. The Council noted that the State government's role in facilitating visitor arrivals in a safe and orderly manner is vital for the return of economic growth.

The Council discussed the implications of the Federal fiscal stimulus known as the CARES Act and the importance of the Federal Reserve's actions to supply liquidity to the financial system. The Federal fiscal stimulus directed approximately $7.5 billion to Hawaii's economy. An additional source of uncertainty is what will happen when certain stimulus programs like the $600 per person increase to unemployment insurance and the Payroll Protection Program (PPP) run out in July.

The Council will have a better understanding of these risks when they meet for the next General Fund meeting in early September 2020.

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

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2020	6,641,865	-7.0%
2021	5,844,841	-12.0%
2022	6,546,222	12.0%
2023	6,742,609	3.0%
2024	6,944,887	3.0%
2025	7,153,234	3.0%
2026	7,367,831	3.0%

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 purposebuilt 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 FY 2026.

The Council also considered the 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 FYs 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 March 2020 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