COUNCIL ON REVENUES

STATE OF HAWAII
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January 9, 2012

Senator David Ige
Chair, Senate Committee on Ways and Means
State Capitol, Room 210
Honolulu, HI 96813

Representative Marcus Oshiro
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 Richard F. Kahle, Jr. and I am the Chair of the Council on Revenues. Today, I would like to give you a review of recent trends as well as the Council's latest forecast.

Current Revenue Trends

Of the total $5.3 billion in tax revenues collected in FY 2011, $4.3 billion or 81.7% was deposited into the State's General Fund. This was a decline of 0.8% compared with FY 2010, mainly due to the delay in individual income tax refunds that were held up in the latter part of fiscal year 2010 and paid out in the first month of FY 2011. Without the refund delay, the General Fund tax revenues would have grown by 8.1% in FY 2011.

General Excise and Use Tax collections, which typically make up about half of the total General Fund tax revenues and is a good indicator of economic activities, increased by 7.7% from the previous fiscal year to $2.5 billion in FY 2011.

Construction spending, which is measured using data on the General Excise Tax resulting from contracting, declined by only 1.0% in FY 2011. In FY 2010, construction spending fell by 23.1%.

Improved economic conditions caused total personal income (as reported by the Bureau of Economic Analysis) to grow by 4.7% in FY 2011. At the same time, the State

Department of Taxation reported that income tax withheld from wages increased by 4.7%. Recorded net individual income tax collections fell by 18.4% in FY 2011, but that was due to the delay in refunds in FY 2010. Without the refund delay, individual income tax collections would have grown by 6.9% in FY 2011.

In the current FY 2012, the number of visitors arriving during the first quarter has fallen slightly compared with the same period last year, despite the economic recovery. However, the General Excise and Use Tax collections grew by 7.1%.

State General Fund tax collections for the first 4 months of fiscal year 2012 are up 21.7% compared to the same period last year, but this is due mainly to the refund delays. If the refunds are factored out, General Fund collections would have increased by only 6.4%. Here is what happened in the biggest categories of the State's taxes that are dedicated to the General Fund in the first 4 months of the fiscal year:

- The cumulative total for the General Excise and Use Taxes, the largest single tax category, grew by 8.2% from the same period last year, from $805.3 million to $871.2 million.

- The cumulative total for the Individual Income Tax, the second largest tax category, grew by 72.8%, from $294.3 million to $508.7 million, but this was due mainly to the delayed refunds I mentioned earlier. Without the refund delay, these collections would have grown by only 5.8%.

- The cumulative total for the Insurance Premiums Tax fell by 42.1%, from $55.8 million to $32.3 million.

- The cumulative total for the Public Service Company Tax grew by 41.1%, from $35.3 million to $49.8 million.

Forecasts of General Fund Tax Revenues

At its meeting on January 5, 2012, the Council on Revenues lowered its forecast for State General Fund tax revenue growth in FY 2012 from 14.5% to 11.5%. The Council kept its growth forecast for FY 2013 at 6.5%. It lowered the growth rate for FY 2016 from 5% to 3%, but the growth rates for the other fiscal years were unchanged.

The FY 2012 forecast revision reflected mainly the failure of tax collections in the first part of the fiscal year to meet expectations based on the original forecast. Based on preliminary data, the Department of Taxation has estimated that cumulative General Fund collections for the first five months of FY 2012 (July through November) were $1,930.5 million. The Department also provided a very preliminary estimate of $399 million for General Fund collections in December. Also, new procedures at the Department of Taxation that accelerated the processing of collections may have increased the base for FY 2011, against which growth for FY 2012 is measured.

The Council is still uncertain about the revenue that will be provided by the tax changes made by the Legislature in 2011. The biggest part of the uncertainty is over the revenue consequences of Act 105, Session Laws of Hawaii 2011. In deliberations during its meeting on September 6, 2011, the Council members discussed the various revenue raisers enacted by the 2011 Legislature. The Tax Department stated that they were reasonably comfortable with the revenue estimates for most of the provisions, but that there was considerable uncertainty over the revenue consequences of Act 105, which eliminated a number of exemptions in the General Excise Tax (GET). The uncertainty arises partly because data on the GET exemptions are poor, but also because it is hard to know how taxpayers will respond.

The Council members questioned whether the revenue estimates adequately accounted for the responses of taxpayers to the legislation and pointed out that tax avoidance behavior might reduce the expected revenues substantially. For example, the grandfathering clause might allow a substantial number of taxpayers to escape the immediate effects from eliminating the exemption for the subcontractor's deduction. There are also ways taxpayers can work around some of the lost GET exemptions to avoid the additional tax. The Tax Department agreed that the revenue gain from the Act in FY 2012 could be as small as $50 million. Consequently, the Council decided to accept $50 million as the revenue consequences of Act 105 for FY 2012, which was about $120 million lower than the Tax Department's original revenue estimate. The Council also adopted a more conservative estimate for the expected revenue gain in FY 2013.

It should be noted that the model is a multi-year forecasting model from FY 2012 through FY 2018. As in all multi-year forecasts some years are over-estimated and other years are under-estimated. In most years, the growth in General Fund tax collections is greater than the growth in personal income. However, the relationship between income growth and revenue growth is variable and other factors, such as income tax credits, also affect the net collections.

Finally, I would like to point out that the federal Budget Control Act of 2011 will affect Hawaii. It may impose $1.2 trillion in cuts, one-half of which will come from defense.

Revised forecasts of State General Fund tax revenues for FY 2012 through FY 2018 are shown in the table below:

Fiscal Year	General Fund Tax Revenues Amount (in Thousands of Dollars)	Growth From Previous Year
2012	4,827,182	11.5%
2013	5,140,949	6.5%
2014	5,295,177	3.0%
2015	5,559,936	5.0%

2016	5,726,734	3.0%
2017	6,013,071	5.0%
2018	6,313,724	5.0%

In producing its forecasts, the Council adopted specific adjustments recommended by the Tax Department reflecting impacts on General Fund tax revenues of recent tax law changes enacted by the 2011 Legislature, including the following:

- Act 97 (SB 570 SD2 HD1 CD1). Part II repeals state tax deduction for taxpayers with Federal AGI above $100,000 (for single taxpayers), $200,000 (for joint filers), and $150,000 (for heads of households). Part III caps itemized deductions at $25,000 for a single taxpayer with Federal AGI of $100,000 and above; $50,000 for a joint filer with Federal AGI of $200,000 and above; and $37,500 for a head of household with Federal AGI of $150,000 and above. Parts II and III sunset on January 1, 2016. Part IV delays the 10% increase in the standard deduction and the personal exemption by 2 years and makes them permanent.

- Act 103 (SB 1186 SD2 HD1 CD1) establishes a temporary $10 minimum daily tax on each transient accommodation furnished at no charge. The act also temporarily limits the TAT revenue distribution to the counties to $93 million per year, and limits the distribution to the Tourism Special Fund to $69 million per year.

- Act 104 (HB 1039 HD1 SD2 CD1) changes the Rental Motor Vehicle Surcharge Tax to $7.50 per day from July 1, 2011 to June 30, 2012, then $3.00 per day beginning July 1, 2012. The Act allocates the $4.50 per day increase to the General Fund from July 1, 2011 to June 30, 2012.

- Act 105 (SB 754 SD1 HD1 CD1) suspends certain GET exemptions and imposes tax at 4 percent on the previously exempt amounts for the period from July 1, 2011 to June 30, 2013.

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

Sincerely,

Richard F. Kahle, Jr.

Richard F. Kahle, Jr.
Chair, Council on Revenues