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COUNCIL ON REVENUES

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

January 7, 2013

The Honorable Calvin K.Y. Say
Speaker of the House
State Capitol, Room 431
Honolulu, HI 96813

DEPARTMENTAL COMMUNICATION
No. 58

Dear Representative Say:

At its meeting on January 3, 2013, the Council on Revenues increased its forecast for growth in General Fund tax revenues in fiscal year 2013 slightly, from 4.9% to 5.1%. The Council cited a strong visitor industry along with expected expansion in the rest of the economy for the fiscal year 2013 revision. The growth forecast for fiscal year 2014 was increased from 3.9% to 6.8%. The 2014 revision reflected the reduction in the cost of the renewable energy income tax credit that is expected to result from the new Administrative Rules recently issued by the Department of Taxation, and stronger economic growth compared with expectations in the Council's earlier forecast. Revisions for later years also came partly as a result of a reduction in the estimated future revenue costs of the renewable energy credit. The following are important sources of uncertainty over the future growth path of tax collections.

Firstly, the Council is uncertain about the size of future claims for the renewable energy credit. The credit has grown rapidly in recent years. Preliminary data from Department of Taxation indicate that the credit grew from $3.1 million in tax year 2004 to $30.9 million in tax year 2010, and there are indications that the growth in claims for the credit have accelerated in recent years. The Department of Business, Economic Development and Tourism estimated that claims for the credit in tax year 2012 may reach $173.8 million, which would show up mostly in reduced net income tax collections in fiscal year 2013. The Department of Taxation has issued new Administrative Rules that may curb the revenue cost of the credit, but the new rules are not expected to have much influence on tax collections before fiscal year 2014.

Secondly, the Council is also still uncertain about the revenue that will be provided by the tax changes made by the Legislature in 2011, particularly the revenue gains that will come from Act 105, Session Laws of Hawaii 2011. An important question is the extent to which the revenue gains from the Act may be changing over time. The Act eliminated certain exemptions from the General Excise Tax (GET), but allowed the exemptions to continue for some transactions that were "grandfathered." The uncertainty arises partly because data on the GET exemptions are poor, but also because it is hard to know how taxpayers are responding. There are 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 fiscal year 2012 could be as small as $50 million. The Council decided to accept $50 million as the revenue consequences of Act 105 for fiscal year 2012, which was about $120 million lower than the Tax Department's original revenue estimate. The Council also adopted an estimate of $70 million for the expected revenue gain in fiscal year 2013, which is considerably below the Department's original estimate of $216 million.

Among other resources, the Council relies on an econometric model to translate the members' forecasts of economic variables into forecasts of tax collections. The model is a multi-year model for fiscal year 2013 through fiscal year 2019. The model anticipates that in most years, the growth rate for General Fund tax collections is greater than the growth rate for the economy as a whole. However, the relationship between income growth and revenue growth is variable and other factors, such as income tax credits and changes in tax laws, including changes in the allocation of certain taxes among the various funds, also play important roles in determining the General Fund collections.

Finally, I would like to point out that the federal Budget Control Act of 2011 may have important effects on Hawaii's economy. If Congress does not act in time, the so-called "fiscal cliff" may impose $1.2 trillion in cuts, one-half of which will come from defense.

Revised forecasts of State General Fund tax revenues for fiscal year 2013 through fiscal year 2019 are shown in the table below:

Fiscal Year	General Fund Tax Revenues Amount (in Thousands of Dollars)	Growth From Previous Year
2013	5,233,350	5.1%
2014	5,589,486	6.8%
2015	5,937,865	6.2%
2016	6,021,496	1.4%
2017	6,272,062	4.2%
2018	6,585,608	5.0%
2019	6,893,137	4.7%

In producing its forecasts, the Council adopted specific adjustments recommended by the Department of Taxation reflecting impacts on General Fund tax revenues of 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 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.

The Department of Taxation has prepared a report for submission with this transmittal correspondence, 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. These line-item component estimates typically include, for example, General Excise Tax and Income Tax revenues that the Council on Revenues does not forecast individually. Also, the Department of Budget and Finance has prepared the attached report to update its projections for non-tax and special tax revenues Significant Changes from September 2012 Report.

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

Sincerely,

Richard F. Kahle

RICHARD F. KAHLE, JR.
Chair, Council on Revenues

Attachments

c: Representative Marcus Oshiro
Chair, House Committee on Finance