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COUNCIL ON REVENUES

STATE OF HAWAII
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January 4, 2013

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

Results for fiscal year 2012

Total tax collections in FY 2012 totaled $6.0 billion, up by 13.4% over the $5.3 billion collected in fiscal year 2011. The growth in total collections is exaggerated, however, because part of the increase reflects the delay in tax refunds made by the previous Administration. Refunds of individual and corporate income taxes totaling $187.4 million were withheld toward the end of fiscal year 2010 and paid out in the first month of fiscal year 2011. If the refunds had been timely released, the total collections in fiscal year 2012 would have increased by only 9.5%.

General Fund tax revenues (which are the part of total tax collections dedicated to the General Fund) grew by 15.0%, from $4.3 billion in fiscal year 2011 to $5.0 billion in fiscal year 2012. This growth rate is also exaggerated by the effect of the refund delay: Without the refund delay, General Fund tax revenues in fiscal year 2011 would have been $4.5 billion and the growth from fiscal year 2011 to fiscal year 2012 would have been only 10.2%.

General Excise and Use Tax collections, which typically make up almost half of the total General Fund tax revenues and which provide a good indicator of economic activity, increased by 8.1%, from $2.5 billion in fiscal year 2011 to $2.7 billion in fiscal year 2012.

Construction spending, which is measured using data on the General Excise Tax on contracting activities, increased by 10.7% in fiscal year 2012. In fiscal year 2011, construction spending fell by 1.0%.

Improved economic conditions caused total personal income (as reported by the Bureau of Economic Analysis) to grow by 4.4% in fiscal year 2012, but the Department of Taxation reported that income tax withheld from wages increased by only 2.9% that year. Recorded total net individual income tax collections rose by 23.6% in fiscal year 2012, but this growth rate is greatly exaggerated by the delay of some $186.1 million in individual income tax refunds made by the previous Administration. Without the refund delay, the growth rate for fiscal year 2012 is only 7.5%.

The number of visitors arriving in fiscal year 2012 grew by 5.8% over fiscal year 2011.

Results since the beginning of fiscal year 2013

Preliminary data for November of 2012 indicate that General Fund tax revenues for the first 5 months of fiscal year 2013 (July through November of 2012) are up by 12.3% compared to the same period in fiscal year 2012. Here is what happened with collections from the General Excise Tax and the Individual Income Tax, the two biggest taxes dedicated to the General Fund, in the first 5 months of fiscal year 2013:

- The cumulative total for the General Excise and Use Taxes, the largest single tax category, grew by 11.8% from the same period last year, from $1,077.7 million to $1,205.1 million.

- The cumulative total for the Individual Income Tax, the second largest tax category, grew by 13.6%, from $620.9 million to $705.2 million.

Together, these two taxes accounted for 87.9% of the estimated total General Fund tax revenues for the first five months of fiscal year 2013.

Forecasts of General Fund Tax Revenues

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 growth forecast for fiscal year 2014 was increased from 3.9% to 6.8%. The fiscal year 2014 forecast 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 from 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. Congress has still not arrived at a permanent solution to prevent us from going over the so-called "fiscal cliff," which 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.

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

Sincerely,

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