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TAX FOUNDATION OF HAWAII

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SUBJECT: MISCELLANEOUS, Interdepartmental research task force

BILL NUMBER: SB 2284; HB 1924 (Identical)

INTRODUCED BY: SB by Kim; HB by Luke

BRIEF SUMMARY: Adds a new section to HRS chapter 37 to provide for the establishment of an interdepartmental research task force to: (1) review the economic models used by the council on revenues to prepare economic and tax revenue forecasts; (2) review economic data needed for the economic models; (3) review the data source, data collection, and the reporting schedule and procedures used for the economic models; (4) provide recommendations on the data source, data collection, and reporting schedules and procedures used for the economic models; and (5) develop, modify, or update economic models.

The director of taxation and the director of business, economic development, and tourism, or their designees, shall serve as co-chairs of the task force. Members of the task force shall include the: (1) director of finance; (2) director of labor and industrial relations; (3) executive director of the Hawaii tourism authority; (3) chair of the council on revenues; and (5) chief information officer of the office of information management and technology, or their respective designees.

Appropriates \$125,000 in general funds to the department of taxation for fiscal 2015 to assist the department of taxation with the preparation of tax data, including Hawaii income patterns, tax credit filings, general excise and use tax collections by industry, general excise tax by place of business, withholding tax on wages by industry, and transient accommodations tax on timeshares, for use by the interdepartmental task force.

Appropriates \$150,000 to the department of business, economic development, and tourism for fiscal year 2015 to assist the interdepartmental research task force in developing economic models, including models relating to tourism, construction, real estate, income, employment, consumer price index, and tax revenues, to assist the council on revenues with the preparation of state economic and tax forecasts.

EFFECTIVE DATE: Upon approval; provides that the appropriations shall take effect on July 1, 2014

STAFF COMMENTS: While this measure would establish an interdepartmental research task force to assist the council on revenue in preparing their revenue forecasts, it should be remembered that currently, the departments of budget and finance and taxation provide the council with such staff assistance and technical support and all departments and agencies of the executive branch furnish the council with the necessary information to prepare revenue estimates.

The 1978 Constitutional Convention provided for the establishment of the council on revenues. The council on revenues has provided revenue estimates since the enabling legislation of Act 278, SLH 1980. After nearly 35 years and with no obvious shortcomings with the system now in place, it is questionable whether any need has been shown for the adoption of this measure.

Digested 1/27/14

NEIL ABERCROMBIE
GOVERNOR



DWIGHT Y. TAKAMINE
DIRECTOR

JADE T. BUTAY
DEPUTY DIRECTOR

**STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS**

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HONOLULU, HAWAII 96813

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February 4, 2014

To: The Honorable Clift Tsuji, Chair,
The Honorable Gene Ward, Vice Chair, and
Members of the House Committee on Economic Development & Business

Date: Tuesday, February 4, 2014
Time: 8:30 a.m.
Place: Conference Room 312, State Capitol

From: Dwight Y. Takamine, Director
Department of Labor and Industrial Relations (DLIR)

Re: H.B. No. 1924 Relating to the Council on Revenues

I. OVERVIEW OF PROPOSED LEGISLATION

HB 2284 proposes to amend Chapter 37-111, Hawaii Revised Statutes (HRS) to establish an interdepartmental task force to review the economic models used by the Council on Revenues (COR) to prepare economic and tax revenue forecasts, review economic data needed for the models, provide recommendations on data sources and data collection for the economic models, and develop or update economic models. The measure also proposes that the task force include the Director of the Department of Labor and Industrial Relations on this task force along with the Directors of Finance, Hawaii Tourism Authority, and the State's Chief Information Officer.

The DLIR notes that it does not currently have economists on staff that can prepare or review economic models and that can advise the Director and the COR on economic models.

II. CURRENT LAW

Currently the Council on Revenues prepares revenue estimates of the state government for each fiscal year of the six-year state program and financial plan. Estimates prepared by the Council are considered by the Governor in preparing the state budget, recommending appropriations, and controlling expenditures. The

estimates are considered by the legislature in appropriating funds and enacting revenue measures.

III. COMMENTS ON THE HOUSE BILL

The DLIR's Research & Statistics Office (R&S) has a Cooperative Agreement with the Bureau of Labor Statistics (BLS) to conduct the Quarterly Census on Employment and Wages (QCEW), the Current Employment Statistics (CES) program, the Local Area Unemployment Statistics (LAUS) program, the Occupational and Employment Statistical Survey (OES); federal grants to maintain statistics for OSHA/HIOSH; a Workforce Data Quality Initiative Grant to develop a workforce longitudinal data system; and funds from the Unemployment Insurance Division for UI federal reports and analyses and projections for the Unemployment Insurance Trust Fund. In addition, R&S performs numerous functions for the DLIR's general funded programs.

DLIR importantly also has a Workforce Information Grant (WIG), funded by the U.S. Department of Labor Employment and Training Administration (ETA). The WIG is a requirement of the Workforce Investment Act (WIA) and one of the prescriptive deliverables under this grant is the development of State and local industry and occupational employment projections.

The projections are to be utilized by the Workforce Development Council (WDC), the Workforce Development Division, and the Counties' Local Workforce Information Boards (LWIBs) to plan employment and educational and training programs for job seekers and unemployment claimants. Other entities in the State, such as the COR, UHERO (the University of Hawaii Economic Research Organization), the Department of Business Economic Development & Tourism (DBEDT), the counties' economic development offices, and educational, career development, and workforce development organizations utilize these projections for their purposes.

A second deliverable of the WIG is to populate and maintain a Workforce Information Database (WIDb) with important workforce-related data elements including the employment projections. These are made available on our website located at www.hiwi.org.

In conclusion, R&S has research statisticians on staff and no economists. While the research statisticians are trained and knowledgeable about the industry, occupational, employment, and related data they collect and analyze on a daily basis, they do not have the expertise or qualifications to develop or review economic models or advise the Director in such matters.

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
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DEPARTMENT OF TAXATION

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To: The Honorable Cliff Tsuji, Chair
and Members of the House Committee on Economic Development & Business

Date: Tuesday, February 4, 2014

Time: 8:30 a.m.

Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 1924 Relating to the Council on Revenues

The Department of Taxation (Department) offers the following comments on H.B. 1924 for the committee's consideration.

H.B. 1924 establishes an interdepartmental research task force to: (1) review the economic models used by the Council on Revenues (COR) to prepare economic and tax revenue forecasts; (2) review appropriate and relevant economic data needed for the economic models; (3) review the data source, data collection, and the reporting schedule and procedures used for the economic models; (4) provide recommendations on the data source, data collection, and reporting schedules and procedures used for the economic models; and (5) develop, modify, or update economic models for the Council on Revenues. H.B. 1924 would take effect July 1, 2014.

H.B. 1924 designates the Director of Taxation and the Director of Business, Economic Development and Tourism to serve as co-chairs of the task force. The members of the task force include the: (1) Director of Finance; (2) Director of Labor and Industrial Relations; (3) Executive Director of the Hawaii Tourism Authority; (4) Chair of the Council on Revenues; and (5) Chief Information Officer of the Office of Information Management and Technology. H.B. 1924 also appropriates \$125,000 to the Department and \$150,000 to the Department of Business, Economic Development and Tourism to assist the task force.

Pursuant to section 37-111 and 37-112, Hawaii Revised Statutes (HRS), the Department and the Department of Budget and Finance (B&F) currently provide administrative support to the COR to assist with the performance of their duties. This administrative support includes gathering data from other governmental agencies and preparing revenue estimates and economic models for the COR. The two economic models administered by the Department help to translate the COR's forecasts of economic changes into forecasts of general fund tax collections, which the COR uses as starting points for their discussions.

The Department notes that the proposed research task force would be duplicating much of the work currently performed by the Department, pursuant to sections 37-111 and 37-112, HRS. At this time, it is unclear that establishing a separate research task force could generate better economic models for the COR, given that most of the data necessary for inclusion in the economic models are already gathered from the appropriate government agencies.

In 2009, the Department awarded a contract to UCLA Anderson Forecast to improve the economic model it had been using to translate the economic forecasts of the Council members into forecasts of changes in the general fund tax revenues. The contractors provided equations for predicting changes in collections of the general excise tax, individual income tax and corporate income tax. The equations are a useful "second opinion," but do not necessarily provide more accurate results than the Department's existing economic model. At this time, the Department uses both models to provide forecasts for the COR members' review.

The Department has serious concerns about the provisions which would have the research task force members "review the data source," which could mean review of individual tax returns. If that is not the intent, clarification would be necessary to avoid violating current taxpayer confidentiality provisions.

The Department is aware that there is certain information, such as updated tax credit reports, that would be helpful for the COR's forecasting. However, the Department's ability to issue these reports in prior years has been hampered by a lack of research statisticians within the Tax Research and Planning Office (TRP) of the Department of Taxation. Due to the limitations of the current computer system's reporting capabilities, production of the tax credit report requires a substantial amount of work by research statistician staff to format the raw tax data properly for statistical reporting. It can take an experienced research statistician staff, working full-time, a minimum of six months to produce the tax credit report.

The last research statistician left the Department in March 2009, and during the 2009 legislative session, all the research statistician positions in TRP were abolished. In 2012, the Department was given a research statistician position via Act 189, SLH 2012; starting in early 2013, the Department initiated the recruitment process and currently has one research statistician on staff. Recently, the Department has been able to produce the Tax Credits Claimed by Hawaii Taxpayers for Tax Year 2011.

At this time, the Department has difficulty in finding qualified applicants for the research statistician positions. The Department is hoping to address some of the staffing difficulties by seeking better and more efficient data reporting from our next computer system.

Finally, this bill provides an appropriation for use by the research task force to "assist the department of taxation with the preparation of tax data, including Hawaii income patterns, tax credit filings, general excise and use tax collection by industry, general excise tax by place of business, withholding tax on wages by industry, and transient accommodations tax on timeshares..." Much of the required information is not currently available due to the tax form format and data reporting limitations of our current computer system. The Department lacks the

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resources to make all the modifications to the tax forms and the computer system to capture and report the desired information; the proposed appropriation would need to be substantially increased.

Thank you for the opportunity to provide comments.

NEIL ABERCROMBIE
GOVERNOR



SANJEEV "SONNY"
BHAGOWALIA
CHIEF INFORMATION
OFFICER

RANDY BALDEMOR
DEPUTY CHIEF INFORMATION
OFFICER – BUSINESS
TRANSFORMATION

KEONE KALI
DEPUTY CHIEF INFORMATION
OFFICER -- OPERATIONS

STATE OF HAWAII
OFFICE OF INFORMATION MANAGEMENT AND TECHNOLOGY

P.O. BOX 119, HONOLULU, HAWAII 96810-0119
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TESTIMONY OF
KEONE KALI, DEPUTY CHIEF INFORMATION OFFICER
TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT AND BUSINESS

Tuesday, February 4, 2014
8:30 a.m.
Conference Room 312
State Capitol

H.B. 1924
RELATING TO THE COUNCIL ON REVENUES

Chair Tsuji, Vice Chair Ward, and Members of the Committee:

I am Keone Kali, Deputy Chief Information Officer (Operations), in the State Office of Information Management and Technology (OIMT), speaking in support of the intent of H.B. No. 1924 to improve economic modeling and tax collection forecasting.

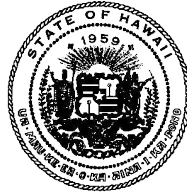
The OIMT encourages discussions and initiatives that will improve government data analysis and decision-making. OIMT is now engaged in a multi-year program to transform how State government does business by building Enterprise Resource Planning (ERP) systems that integrate the processing and sharing of key information across many departments and agencies. That ERP development process will provide opportunities for departments to review and coordinate use of business intelligence systems that transform raw data into meaningful and useful information.

Since OIMT presently supports data systems for the Department of Taxation and the Department of Business, Economic Development, and Tourism, OIMT is prepared to work with those departments to review existing processes and identify new requirements that will assist the State Council of Revenues to carry out its mission.

We thank the Committee for this opportunity to testify in support of this bill's intent to improve how government uses data.

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



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Jack P. Suyderhoud
Kristi L. Maynard

COUNCIL ON REVENUES

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

Statement of
Marilyn M. Niwao, Vice Chair
Council on Revenues
Before the

House Committee on Economic Development & Business

February 4, 2014 at 8:30 a.m.
State Capitol, Conference Room 312

In consideration of

H.B. 1924

RELATING TO THE COUNCIL ON REVENUES

Chair Tsuji, Vice Chair Ward, and Members of the Committee:

I am the Vice Chair and tasked to be acting Chair of the Council on Revenues (COR) with respect to testimony on this bill by COR Chair Kurt Kawafuchi. Since the COR's next scheduled meeting is on March 11, 2014, the COR has not deliberated and voted on this bill. Accordingly, the COR is unable to support or oppose this bill, but does offer the following information and comments for your consideration:

Overview

The COR is tasked with the responsibility of forecasting General Fund Tax Revenue Growth and Total Personal Income Growth. In forecasting General Fund Tax Revenue growth rates, the COR considers:

1. Various economic variables as part of two economic models (discussed in attached Exhibit A as the "Regular Model" and the "UCLA Model");
2. Tax laws and tax law changes affecting tax collections; and

3. DOTAX administrative effects, such as the timing of the collection of taxes and payment of tax refunds to taxpayers and allocations to the City and County of Honolulu.

Since the State of Hawaii recognizes General Fund Tax Revenue on the cash basis of accounting, any errors in forecasting General Fund growth rates can be the result of:

- 1) errors in estimating the underlying economic growth rates;
- 2) timing differences (i.e., where there was a delay in collection of taxes or payment of refunds);
- 3) errors in estimating the effect of new tax laws (such as Act 105 having to do with the subcontractor exemption) and tax credits; or
- 4) any combination of the above.

The COR makes its own forecasts with input from its members. As a starting point for discussion, it uses two economic models administered by the Tax Research and Planning Office (TRP) under the Department of Taxation (DOTAX) that help translate forecasts for Hawaii economic growth into changes in General Fund tax collections.

Comments From Individual COR Members Are As Follows:

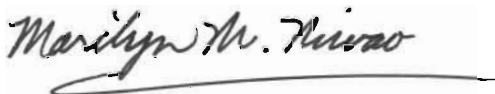
1. COR forecasts are published widely and relied upon not only by the Governor and the Legislature, but also by many Hawaii businesses in their business plans. Accordingly, if more timely statistical information and studies are available to the COR, it would be helpful in the COR forecasts and to businesses.
2. Currently, the bill includes only the Chair of the COR as a member of the interdepartmental research Task Force. As this Task Force is designed to give administrative and technical support to the COR, more members of the COR should be part of the Task Force to assist the other Task Force members in gathering statistics and studies that would be helpful to the COR in forecasting. As such, the Task Force should possibly include not only the Chair, but the Vice Chair and one other COR member designated by the Chair since COR members are consumers of the statistics to be gathered and studies to be performed.
3. More timely data from DOTAX and other departments would be useful in generating more accurate forecasts. For example, one of the challenging topics is trying to determine the effect of tax credits when data the COR

receives is several years old. This bill could assist in making more timely data available to the COR.

4. It may be helpful to analyze statistics and data to determine if the COR's forecasts are affected by inaccurate estimates of the impact of new tax laws (including new tax credits) and administrative matters in the timing of tax collections and paying of refunds as opposed to underlying economic forecasts. Unfortunately, although tax data is collected from taxpayers, some of it cannot be easily retrieved and studied, such as exemption information collected on the Hawaii General Excise tax returns. Software programming changes are needed to capture this data.
5. Forecast models need constant feeding and care. There should be a monthly evaluation of the model and its parameters in an effort to identify when equilibrium mean shifts may have occurred and to correct for them. By making corrections quickly or robustifying the models to shocks and structural shifts, current literature demonstrates that forecasts can be put back on track quickly after events such as the '08 recession.
6. Historically, when the economy is improving, the COR underestimates the growth of tax collections. When the economy is getting worse, the COR overestimates the tax revenue collections. Part of the reason could be that capital gains income and business income fluctuates greatly with changes in the economy, and future tracking of these types of income separately may result in better forecasts when the economy shifts.
7. Statistical reports that were available in the past, such as the "Hawaii Income Patterns – Individuals" and "Tax Credits Claimed by Hawaii Residents," were last available for tax year 2005. The report "Hawaii Income Patterns – Corporations, Proprietorships and Partnerships" was last available for tax year 2002. These reports should be updated to provide current useful information to COR members.

Thank you for this opportunity to testify. I will be available to answer any questions you may have.

Respectfully submitted,



Marilyn M. Niwao, M.S.P.H., J.D., CPA
Vice Chair, Council on Revenues

Exhibit A

BACKGROUND - TRP'S ECONOMIC MODELS AND THE GENERAL FUND FORECASTS

The COR produces forecasts of General Fund tax revenues four times each year. The forecasts are transmitted to the Governor and to the Legislature in reports that are due by January 10, March 15, June 1, and September 10. Before each meeting, the Tax Research and Planning Office (TRP) under the Department of Taxation (DOTAX) sends the COR members a survey to complete. The survey asks for members' individual forecasts for economic variables ("indicators") that predict what will happen to Hawaii's economy over the next seven years. The survey is accompanied by the results from the previous survey and tables showing historical values of the economic indicators, which are listed below:

- 1) Real growth of Hawaii total personal income
- 2) Nominal growth of construction completed in Hawaii
- 3) Honolulu consumer price index
- 4) Growth in the number of total State visitor arrivals by air
- 5) Nominal growth of U.S. GDP
- 6) U.S. GDP deflator
- 7) Nominal growth of total wages in Hawaii
- 8) Nominal growth in visitor expenditures in Hawaii
- 9) Real growth of Hawaii GDP

After the members return their surveys, TRP provides them with a workbook for the meeting. The workbook contains a table with the average of the members' forecasts for each economic indicator, a table with historical data on the economic indicators, and tables with predictions of General Fund tax revenues based on the members' economic forecasts.

TRP uses the COR's forecasts for economic indicators to predict General Fund collections from the following taxes:

- 1) General excise and use taxes
- 2) Individual income tax
- 3) Corporate income tax
- 4) Public service company tax
- 5) Tax on insurance premiums
- 6) Cigarette and tobacco tax
- 7) Liquor tax
- 8) Tax on banks and other financial corporations
- 9) Inheritance and estate tax
- 10) Conveyance tax

- 11) Miscellaneous taxes
- 12) Transient accommodations tax

TRP uses two models to make its predictions. The first model, which is referred to as the “Regular Model”, has a separate regression equation for each of the above-listed taxes, except for the Transient Accommodations Tax (TAT) and the inheritance and estate tax. The TAT is simply predicted to grow by the rate of growth of visitor arrivals plus the rate of inflation in Honolulu. Collections from the estate tax are assumed to grow at the rate of inflation, because we have not had enough experience with the new tax to develop a regression equation. The results for each equation are summed to get the forecast for total General Fund tax collections.

The second model, which is referred to as the UCLA Model, contains only three regression equations and predicts collections for the general excise tax, the individual income tax, and the corporate income tax. These three taxes accounted for 87% of total General Fund tax revenues in fiscal year ended June 30, 2012. The collections for the remaining taxes are predicted using the same equations as in the first model. The UCLA model was developed by Anderson Forecasting under a contract with the Department of Taxation in 2009.

At the request of Council members, TRP added a third model in 2012 that uses a single regression equation to forecast total General Fund collections based on the economic variables.

The regression equations from all of the models predict future tax collections based on the COR's forecasts for what will happen to Hawaii's economy. However, the amount of taxes paid into the General Fund also depends on new legislation, such as changes in tax rates, in tax credits, or in the portion of a tax that is dedicated to the General Fund. To take account of the effects of such changes, TRP uses revenue estimates that were prepared for the Legislature. These adjustments are combined with the regression results to predict the actual General Fund tax collections.

To clarify the nature of the Department's contribution to the work of the Council, the Department does not engage in forecasting. Instead, the Department provides a conditional prediction of General Fund tax revenues, based on the Council's economic forecasts. That is, the Department provides regressions that predict what the tax collections will be if the economy behaves as forecast by the Council. Essentially, the regressions tell us what to expect if tax collections react to economic changes the way they have reacted to similar economic changes in the past. Then, special adjustments are added to account for changes in tax laws and for other things that might cause the reaction to be different in the future than it was in the past.

TRP regularly updates the regression equations (at least once each year), trying new variables and different equations to improve its predictions. In addition, TRP informs the Council of any changes that it believes might materially affect the General Fund tax revenue forecast, such as unusual receipts from court settlements, or changes in processing times of refunds.

How have the model performed? The question cannot be answered without looking at how accurate the Council forecasts of economic variables have been. If the Council's forecasts were completely accurate, so that any prediction error was the fault of the models, here is what the results would look like from the May meeting in each year:

FY2011

Actual GF growth: -0.8%

Model I: +0.8%

UCLA Model: +0.9%

COR's Forecast: -1.6%

FY2012

Actual GF growth: 15.0%

Model I (Adjusted): 14.9%

UCLA Model (adjusted): 14.5%

COR's Forecast: 12.0%

FY2013

Actual GF growth: 9.9%

Model I: 5.4%

UCLA Model: 4.4%

Single Equation model: 5.7%

COR's Forecast: 6.7%

Virtually the entire model error in Model I in FY2013 came from the regressions for the individual and corporate income taxes, as both of these taxes provided much higher revenues than expected based on their responses to growth in prior years. Part of the effect might have come from proposed changes in the federal tax law, which caused wealthy taxpayers to recognize capital gain income in 2012 to avoid the federal capital gains tax increase from 15% in 2012 to 20% in 2013, and the 3.8% tax on net investment income that was to take effect in 2013.