NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

KURT KAWAFUCHI
CHAIR

MARILYN M. NIWAO
VICE-CHAIR

MEMBERS:
Carl S. Bonham
Christopher Grandy
Elizabeth P. Cambra
Jack P. Suyderhoud
Kristi L. Maynard

COUNCIL ON REVENUES

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

December 18, 2013

Senator David Y. Ige
Chair, Senate Committee on Ways and Means
State Capitol, Room 208
Honolulu, HI 96813

Representative Sylvia Luke
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 Kurt Kawafuchi and I am the Chair of the Council on Revenues. Today, I would like to present a review of recent trends and the Council's latest forecast.

Recent Revenue Trends

Results for fiscal year 2013

In fiscal year (FY) 2013, the State's General Fund tax revenues grew by 9.9%, to $5.47 billion from $4.97 billion in FY 2012.

The General Excise Tax makes up almost half of the State’s total General Fund tax revenues and usually is a good indicator of economic activity in Hawaii. Revenue from the tax increased by 9.1% in FY 2013, to $2.94 billion from $2.70 billion in FY 2012.

Construction spending, as measured using data from the General Excise Tax on contracting activities, increased by 20.7% in FY 2013.

Improved economic conditions caused total personal income (as reported by the Bureau of Economic Analysis) to grow by 3.2% in FY 2013, but the Department of Taxation reported that income tax withheld from wages increased by 7.0% that year. Total net individual income tax collections rose by 12.7% in FY 2013.

Results since the beginning of fiscal year 2014

Preliminary data for November of 2013 indicate that General Fund tax revenues for the first five months of FY 2014 (July through November of 2013) are down slightly (0.6%) compared to the same period in FY 2013, but this year's growth has been affected by two unusual events. The first unusual event is the once-per-year allocation of $55.5 million from the General Excise Tax directly to the Hawaii Hurricane Relief Fund that was mandated by Act 62, Session Laws of Hawaii 2011. The first allocation was made in August of 2013 and the final allocation is scheduled for August of 2014. The second unusual event is the unusually high allocation to the county surcharge in the first month of FY 2014 which, when coupled with the unusually low allocation to the county surcharge in the first month of FY 2013 depressed the growth rate of General Fund collections for FY 2014. According to the Department of Taxation, the unusually low allocation in the first month of FY 2013 was due mostly to the correction of a prior posting error; the higher allocation in the first month of FY 2014 was due mostly to having additional staff available, resulting in higher numbers of tax returns processed. The effect of the change in timing of allocations on the growth rate of General Fund tax collections should diminish over time, although it looms large in the growth rate comparisons in the first months of the fiscal year.

If we are to meet the Council's current forecast for FY 2014, General Fund tax revenues for December through June will have to surpass those of FY 2013 by 7.2%. The Council's next General Fund forecast will be made on January 7, 2014.

Here is what happened with cumulative collections from the General Excise Tax (the biggest tax) and the Individual Income Tax (the second biggest tax) in the first five months of fiscal year 2014:

- Cumulative net collections of the General Excise Tax (before allocations to the Hawaii Hurricane Relief Fund) were $1,165 million from July through November of FY 2014, compared to $1,205 million for the same period last year. The year-over-year growth rate for the tax is -3.4%, but it was adversely affected by the allocations of the County Surcharge collections, as I mentioned earlier.

- Cumulative net collections for the Individual Income Tax were $719.4 million from July through November of FY 2014, compared to $705.2 million for the same period last year, a growth rate of 2.0%.

Forecasts of General Fund Tax Revenues

At its meeting on September 5, 2013 the Council on Revenues lowered its forecast for State General Fund tax revenues in FY 2014 from $5.74 billion to $5.69 billion. The Council's previous forecast, made at its meeting on May 28, 2013, did not take into account the automatic transfers from the General Excise Tax to the Hawaii Hurricane Relief Fund in each of FY 2014 and FY 2015. Without these transfers, the Council's current forecasts would show higher General Fund tax revenues in both FY 2014 and FY 2015 than the May forecasts. Therefore, the drop in the forecasts does not reflect a more pessimistic view of the economy on the part of the Council since its meeting in May.

The Council discussed the visitor and construction sectors of Hawaii's economy and expressed concerns about the slowdown in the growth of visitor expenditures, the effects of higher hotel room rates and higher airfares, and the potential effects of future unfavorable exchange rates changes. However, members also noted that positive effects may come from growth in new construction.

The tabulation below shows the Council's latest forecast for the next seven years (FY 2014 through 2020). Of course, the forecasts for the later years are subject to greater uncertainty.

Fiscal Year	General Fund Tax Revenues Amount (in Thousands of Dollars)	Growth From Previous Year
2014	5,690,941	4.1%
2015	6,114,867	7.4%
2016	6,587,722	7.7%
2017	6,962,696	5.7%
2018	7,388,572	6.1%
2019	7,792,538	5.5%
2020	8,205,620	5.3%

The Council is scheduled to meet on January 7, 2014 to review and possibly revise these forecasts.

In producing its forecasts, the Council adopted specific adjustments recommended by the Department of Taxation to reflect effects on General Fund tax revenues of tax law changes enacted by the 2013 Legislature, including the following:

- Act 89 amends the motion picture digital media and film production tax credit. The Act increases the credit rate from 15% to 20% for productions on Oahu and from 20% to 25% for productions on the neighbor islands. The Act also increases the cap on the amount of the credit per production from $8 million to $15 million and moves the expiration date for the credit from January 1, 2016 to January 1, 2019. The Act is estimated to raise the annual cost of the tax credit by about $21 million over the level in FY 2013.

- Act 160 eliminates the General Excise Tax (GET) exemption for liquor, tobacco and food sold to common carriers. The Act is estimated to raise GET collections by about $6 million per year.

- Act 161 makes permanent the Transient Accommodations Tax (TAT) rate of 9.25% and the caps on TAT allocations to the special funds. The Act raises the cap on the allocation to the Tourism Special Fund by $11 million. Act 161 is estimated to reduce General Fund revenues by $11 million in FY 2014 and in FY 2015, but is expected to increase General Fund revenues by amounts ranging from $177 million in FY 2016 to $246 million in FY 2020.

- Act 163 makes permanent the GET exemption for certain expenses paid by hotel operators and timeshare projects and removes the cap on the aggregate amount of the exemptions that can be claimed. The Act is estimated to reduce GET collections by about $20 million in FY 2014 and by about $13 million annually thereafter.

The Council also took into account provisions from earlier legislation, including the following:

- Act 105, SLH 2011, eliminated certain GET exemptions. The Act expired June 30, 2013. Its expiration is estimated to reduce GET collections by about $70 million annually relative to the level in FY 2013.

- Act 62, SLH 2011, allocates GET revenues directly to the Hurricane Relief Fund to replace amounts that were taken from the Fund in prior years. The Act will reduce GET allocations to the General Fund by $55.5 million in FY 2014 and in FY 2015.

I am available to answer any questions you may have.

Sincerely,

Kurt Kawafuchi
Chair, Council on Revenues

General Fund Tax Revenue Forecasts of the Council on Revenues

Presentation before the

Senate Committee on Ways and Means

and the House Committee on Finance

December 18, 2013

by Kurt Kawafuchi,

Chair, Council on Revenues

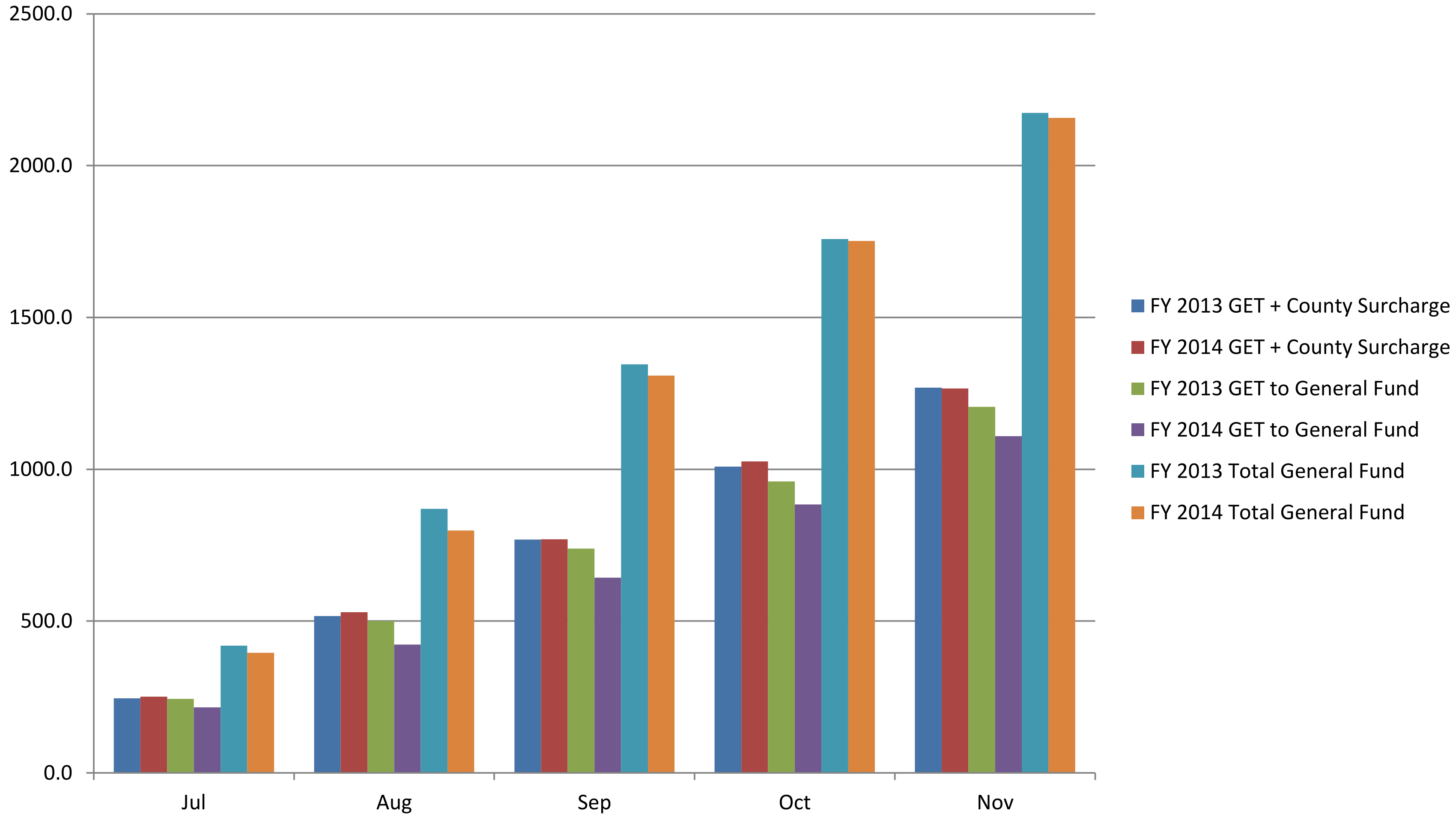
Hawaii’s economy and the State’s General Fund tax revenues showed robust growth in FY 2013

- In FY 2013, the State’s General Fund tax revenues were $5.47 billion, up by 9.9% from the previous year.
- General Excise Tax (GET) collections rose by 9.1%, to $2.94 billion.
- Taxes withheld from wages grew by 7.0%.
- Total net individual income tax collections rose by 12.7%, to $1.73 billion.
- Construction spending, as measured using data on GET collections, increased by 20.7%.

Growth in General Fund tax revenue has been less robust in FY 2014

- In the first five months of FY 2014 General Fund tax revenues are down by 0.6% from FY 2013 and GET tax revenues are down by 3.4%.
- The decline in GET tax revenues is partly due to unusual allocations of the County Surcharge (CS) in the first month of FY 2013 and of FY 2014.
  - The CS was allocated $34.8 million of the total GET plus County Surcharge collections in July of FY 2014, but was allocated only $1.7 million of the total in July of FY 2013.
  - The CS averaged about $16 million a month in FY 2013.
- The contribution of the GET to the General Fund was also reduced in FY 2014 by an allocation of $55.5 million to the Hawaii Hurricane Relief Fund in August.
- Total net collections of the Individual Income Tax have grown by 2.0% in the first five months of FY 2014.
- Collections of GET + CS (a good indicator of economic activity) have largely kept pace with last year (they are down by only 0.2%), but GET allocations to the General Fund are down.

Cumulative collections of the GET and CS combined, allocations of the GET to the General Fund, and total General Fund tax revenues in the first five months of FY 2014 and FY 2013



The Council's Forecast for FY 2014 and FY 2015

- The Council's current forecast is that General Fund tax revenues will grow by 4.1% in FY 2014, to $5.69 billion.
- The revenues for the remainder of the fiscal year (December through June) will have to surpass those for the same period last year by 7.2% if we are to meet this forecast.
- The revenue growth for the first five months of the fiscal year has been considerably below this rate, but the growth has been slowed by the unusual GET allocations in the first two months of the fiscal year.
- The growth forecast for FY 2015 is 7.4%.

What to expect, based on Collections so far this Fiscal Year

- Here is what we get if we try to extrapolate for the rest of the year based on the first five months.
- First, we need to adjust the cumulative November collections for the unusual GET allocations (CS and Hurricane Relief Fund) in the first months of FY 2014. (The adjustments I used give collections of $2.23 billion for FY 2014 through November.)
- Secondly, we need to select a figure for the share of collections as of the end of November in the fiscal year total. I used the high, low, and average of this share over the past decade.
- Finally, we need to extrapolate to the fiscal year total and then subtract the adjustments that were added in the second step.
- This yields low, high and average estimates for General Fund tax revenue growth in FY 2014 of -6.8%, positive 6.5%, and positive 0.6%.
- The exercise shows that forecasting is not easy. The following table shows the Council's General Fund tax revenue forecast for FY 2014 through FY 2020.

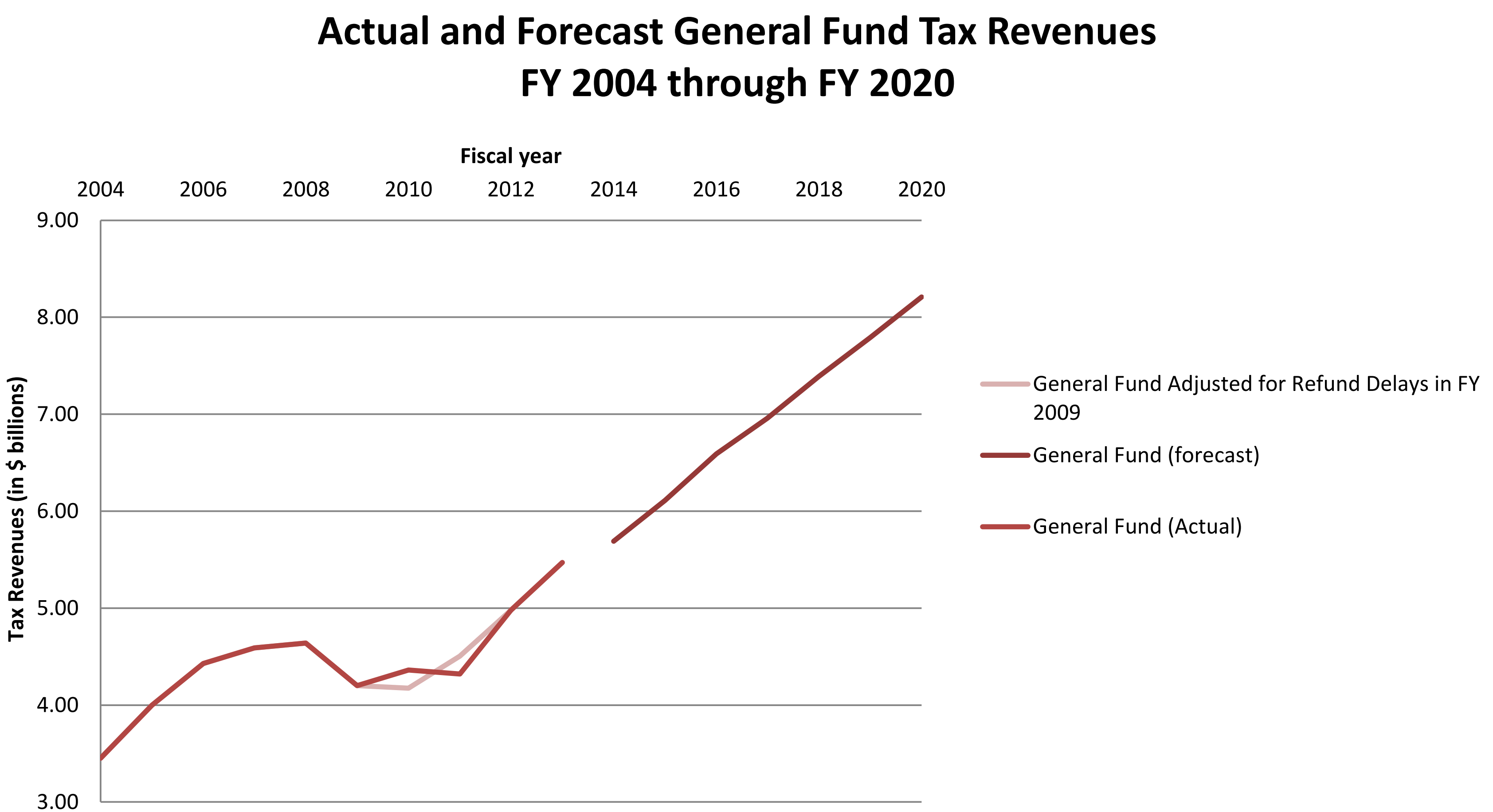
Here are the Council's forecasts for FY 2014 and beyond

Fiscal Year	General Fund tax revenues ($ billions)	Growth from previous year
2014	$5.69	4.1%
2015	$6.11	7.4%
2016	$6.59	7.7%
2017	$6.96	5.7%
2018	$7.39	6.1%
2019	$7.79	5.5%
2020	$8.21	5.4%

Here’s how the Council’s forecasts performed in the Past Decade

Council's Last Forecast vs Actual General Fund Collections					
Fiscal Year	**Period**	**Forecast**	**Fiscal Year**	**Period**	**Forecast**
2004	May ’04	5.20%	2009	May ’09	-9.00%
	Actual	**8.30%**		**Actual**	**-9.50%**
2005	May ’05	14.60%	2010	May ’10	4.00%
	Actual	**16.00%**		**Actual**	**3.90%**
2006	May ’06	9.50%	2011	May ’11	-1.60%
	Actual	**10.90%**		**Actual**	**-0.90%**
2007	May ’07	4.00%	2012	May ’12	12.00%
	Actual	**3.40%**		**Actual**	**15.00%**
2008	May ‘08	3.30%	2013	May ‘13	6.70%
	Actual	**1.20%**		**Actual**	**9.90%**

The chart below shows General Fund tax revenues over the past decade (with and without the refund delays in FY 2009) and the forecasts for FY 2014 through FY 2020.



Effects of Legislation

- The Council adopted specific adjustments recommended by the Department of Taxation to reflect effects on General Fund tax revenues of tax law changes, including the following:
- Act 89, SLH 2013, increases the tax credit rates for the motion picture digital media and film production tax credit, increases the cap on the amount of the credit per production, and moves the expiration date from January 1, 2016 to January 1, 2019. The Act is estimated to raise the annual cost of the tax credit by about $21 million over the level in FY2013.
- Act 160, SLH 2013, eliminates the GET exemption for liquor, tobacco and food sold to common carriers. The Act is estimated to raise GET collections by about $6 million per year.
- Act 161, SLH 2013, makes permanent the Transient Accommodations Tax rate of 9.25% and caps the TAT allocations to the special funds. The Act is estimated to reduce General Fund revenues by $11 million in FY2014 and FY2015, but to increase them by amounts ranging from $177 million in FY 2016 to $246 million in FY2020.

Effects of Legislation (Cont.)

- Act 163, SLH 2013, makes permanent the GET exemption for certain expenses paid by hotel operators and timeshare projects and removes the cap on the aggregate amount of the exemptions that can be claimed. The Act is estimated to reduce GET collections by about $20 million in FY2014 and by about $13 million annually thereafter.
- Act 105, SLH 2011, eliminated certain GET exemptions and expired June 30, 2013. Its expiration is estimated to reduce GET collections by about $70 million annually relative to the level in FY 2013.
- Act 62, SLH 2011, allocates GET revenues directly to the Hurricane Relief Fund to replace amounts that were taken from the Fund in prior years. The Act will reduce GET allocations to the General Fund by $55.5 million in each of FY 2014 and FY 2015.