Council on Revenues

KURT KAWAFUCHI

CHAIR

COUNCIL ON REVENUES

JAN 10, 2023

Constitutional Refund

The Constitutional Refund (Act 115 SLH 2022) remitted either $100 or $300 per exemption depending on Federal Adjusted Gross Income.

The refund has a revenue impact that was not mentioned in the September 2022 meeting.

The refund will only impact FY 2023. Nearly all the refund was disbursed in the first six months of the fiscal year

The estimated revenue impact is:

Amount	% Change FY 2022
-$334.6 million	3.6%

UNOFFICAL

PRELIMINARY COMPARATIVE STATEMENT OF STATE GENERAL FUND TAX REVENUES
December 2022

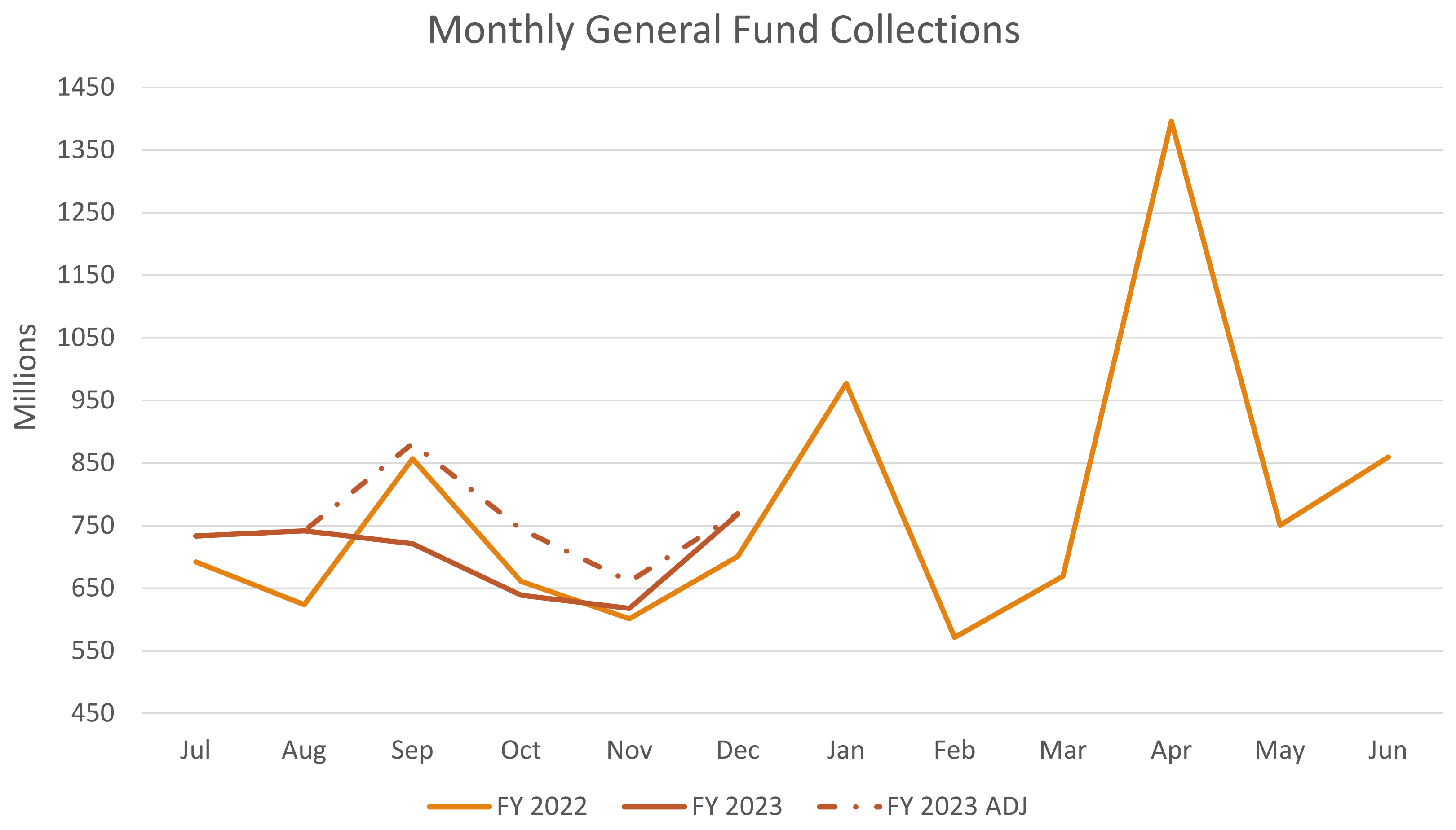
(Dollars in Thousands)

		CUMULATIVE TOTALS		DIFFERENCE		WITHOUT CONSTITUIONAL REFUND ADJUSTED	
	Dec 2022	2022-2023	2021-2022	AMOUNT	%CHANGE	AMOUNT	%
GE/Use Taxes	**$345,687**	**$2,155,369**	**$1,899,687**	**255,682**	13.5%		**13.5%**
Income Tax - Corp.	**51,187**	**146,806**	**121,776**	**25,030**	20.6%		**20.6%**
Decl. Est. Taxes	48,465	147,141	149,032				
Payment w/ Returns	3,638	17,118	21,633				
Refunds	(916)	(17,453)	(48,890)				
Income Tax - Ind.	**250,363**	**1,245,235**	**1,509,194**	**(263,960)**	**-17.5%**	**309,836**	**3.0%**
Decl. Est. Taxes	44,057	353,619	384,732		-8.1%		
Payment w/ Returns	11,577	140,046	119,331		17.4%		
WH Tax on Wages	211,505	1,256,012	1,164,050		7.9%		
Refunds Sub-Total	(16,776)	(504,442)	(158,907)		217.4%		
Refunds	(15,854)	(194,606)	(158,907)				
Constitutional Refunds	**(921)**	**(309,836)**	**0**				
Special Fund	0	0	(12)				
Trans. Accom. Tax	59,793	419,078	326,934	92,144	28.2%		
Turtle Bay Conservation Fund	0	(1,500)	(1,500)				
Convention Ctr. Enterprise Fund	0	(11,000)	(11,000)				
Tourism Emergency Special Fund	0	0	0				
Land & Development Fund	0	(3,000)	(3,000)				
Mass Transit Fund	(5,808)	(40,741)	(31,576)				
SUB-TOTAL	**53,985**	**362,837**	**279,857**	**82,980**			
All Others	**67,216**	**310,733**	**324,976**	**(14,243)**	**-4.4%**		**4.4%**
Collected by DOTAX	33,349	184,170	162,713				
Collected by Other Departments*	33,867	126,563	162,263				
TOTAL GENERAL FUND	**$768,438**	**$4,220,980**	**$4,135,490**	**$85,490**	**2.1%**	**309,836**	**9.6%**

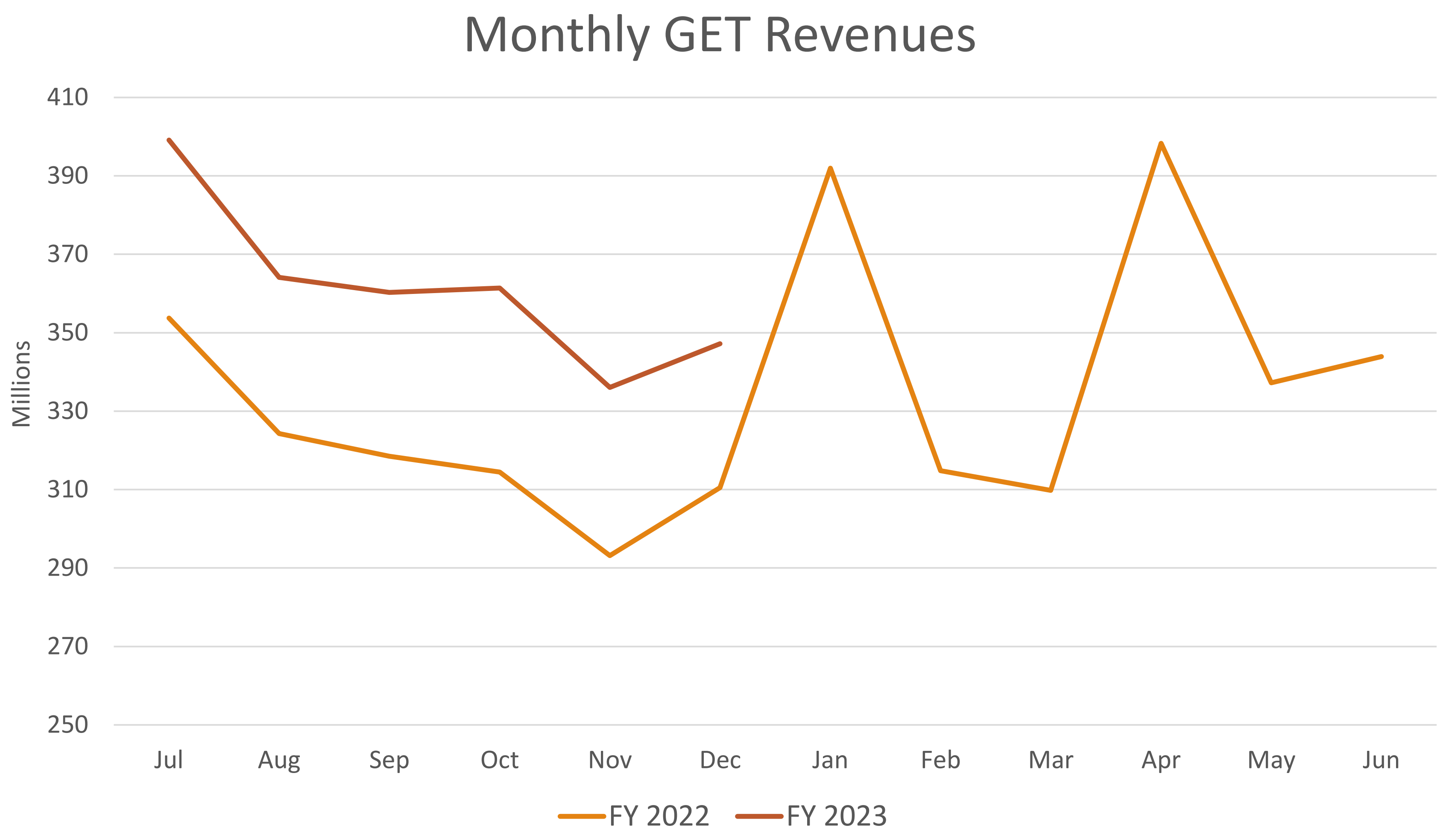
Note: General Fund allocations are in bold print.

*Includes Conveyance Tax and Insurance Premium Tax.

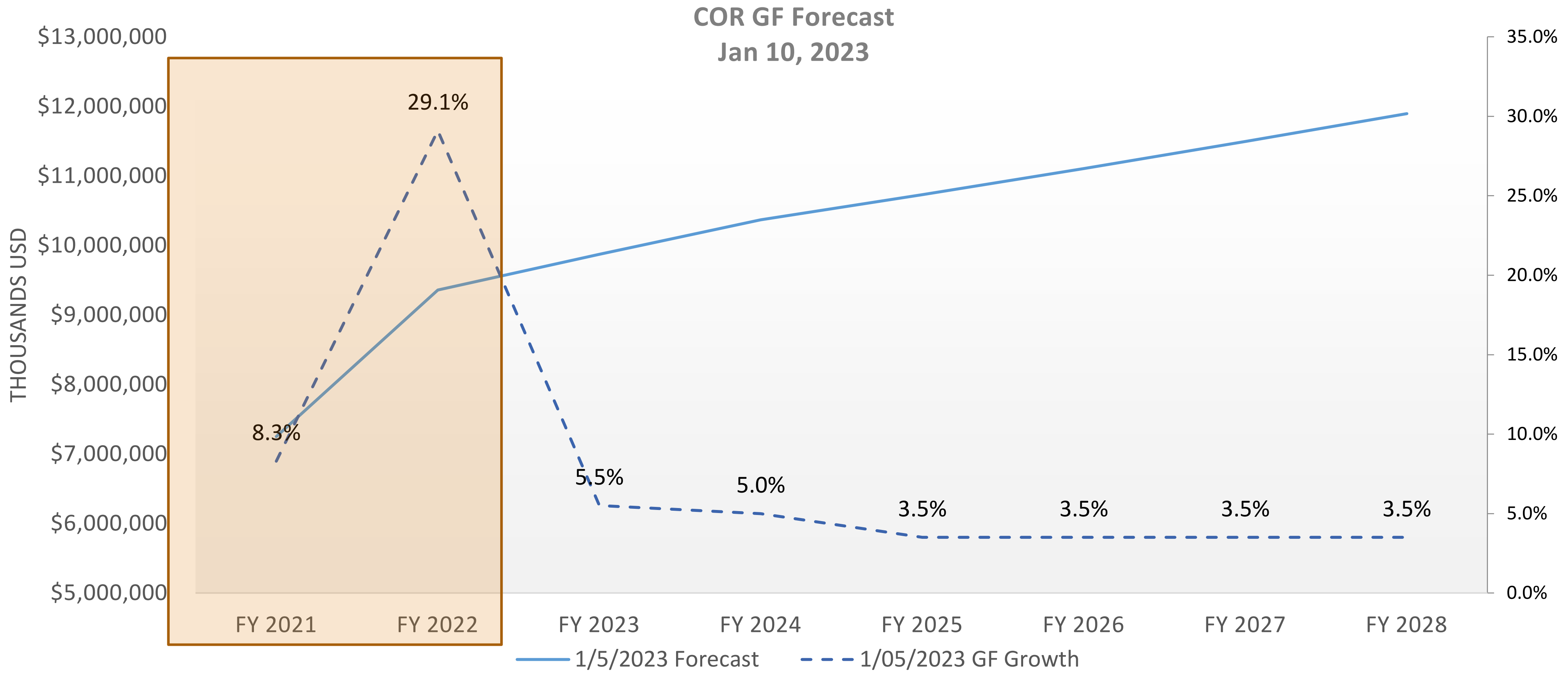
The Constitutional Refund had the biggest impact on General Fund Collections in September, October, and November



Monthly GET Collection Growth Continues to be Strong



Current Council on Revenues Forecast



Jan 1, 2024 Forecast

FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
$ 7,250,261	$ 9,358,848	$9,873,585	$10,367,264	$10,730,118	$11,105,672	$11,494,371	$11,896,674
8.3%	29.1%	5.5%	5.0%	3.5%	3.5%	3.5%	3.5%

The Council maintained a very similar forecast even with the Constitutional Refund

	BASE		ESTIMATED (thousands)						
	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
9/06/2022 Forecast	$7,250,261	$9,358,848	$9,967,173	$10,365,860	$10,728,665	$11,104,168	$11,492,814	$11,895,063	$12,311,390
	8.3%	29.1%	6.5%	4.0%	3.5%	3.5%	3.5%	3.5%	3.5%
	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
1/5/2023 Forecast	$7,250,261	$9,358,848	$9,873,585	$10,367,264	$10,730,118	$11,105,672	$11,494,371	$11,896,674	$12,313,057
	8.3%	29.1%	5.5%	5.0%	3.5%	3.5%	3.5%	3.5%	3.5%
Difference		0	(93,588)	1,404	1,453	1,504	1,556	1,611	1,667

The Council's economic outlook remains largely unchanged from September's forecast

Economic Issues Considered In Forecast

- Impact of Constitutional Refund ($336 million in FY 2023)
- Impact of Inflation on Taxes
- Tighter Monetary Policy/ Federal Reserve
- Domestic Visitor Trends
- Foreign Visitor Trends (specifically Japanese)
- Reduction in Federal Stimulus Spending
- Recession risks
- Covid-19 risks
- High oil and commodity prices
- Geopolitical events like the War in Ukraine

Council On Revenues

According to HRS 37-111, the COR forecasts general fund revenues for each fiscal year of the six-year state program

General Fund Deadlines:

- June 1, September 10, January 10, March 15

Total Personal Income Deadlines (establishes state expenditure ceiling)

- August 5, November 5

Consists of seven members

- 3 appointed by Governor for four-year terms
- 2 appointed by President of Senate for two-year terms
- 2 appointed by Speaker of House for two- year terms

Council On Revenues

Gubernatorial Appointments

- Marilyn Niwao (Vice-Chair)–Term ends: 06-30-2023
- Carl Bonham –Term ends: 06-30-2023
- Jack Suyderhoud –Term ends: 06-30-2023

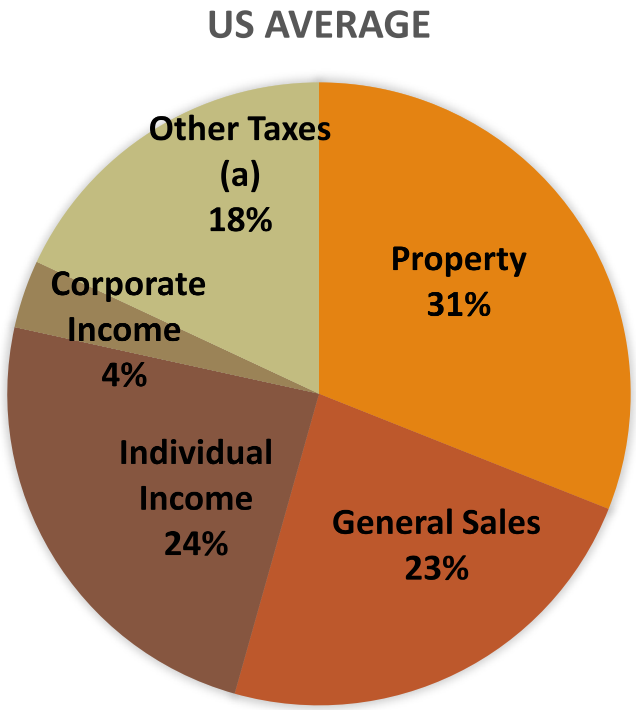
Senate Appointments

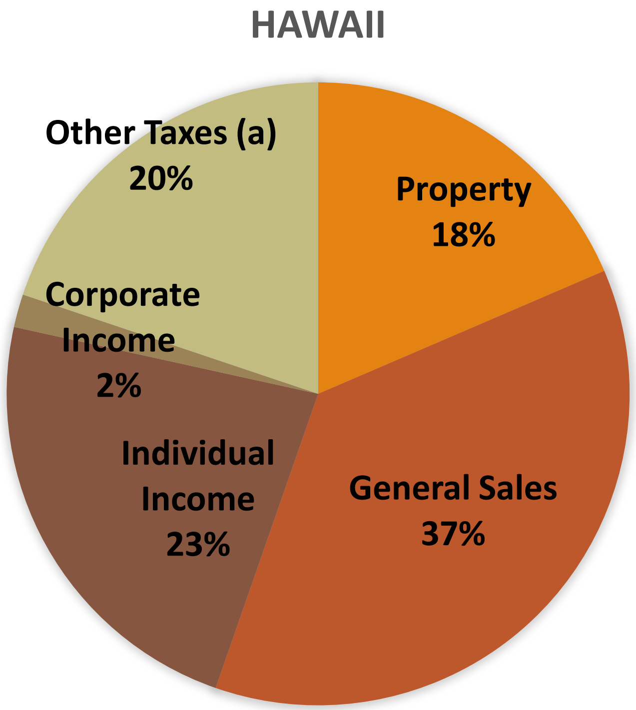
- Kurt Kawafuchi (Chair) –Term ends: 06-30-2023
- Kristi Maynard–Term ends: 06-30-2023

House Appointments

- Wendell Lee–Term ends: 06-30-2023
- Scott Hayashi–Term ends: 06-30-2023

Hawaii's tax system relies more on sales taxes and less on property taxes than the national average

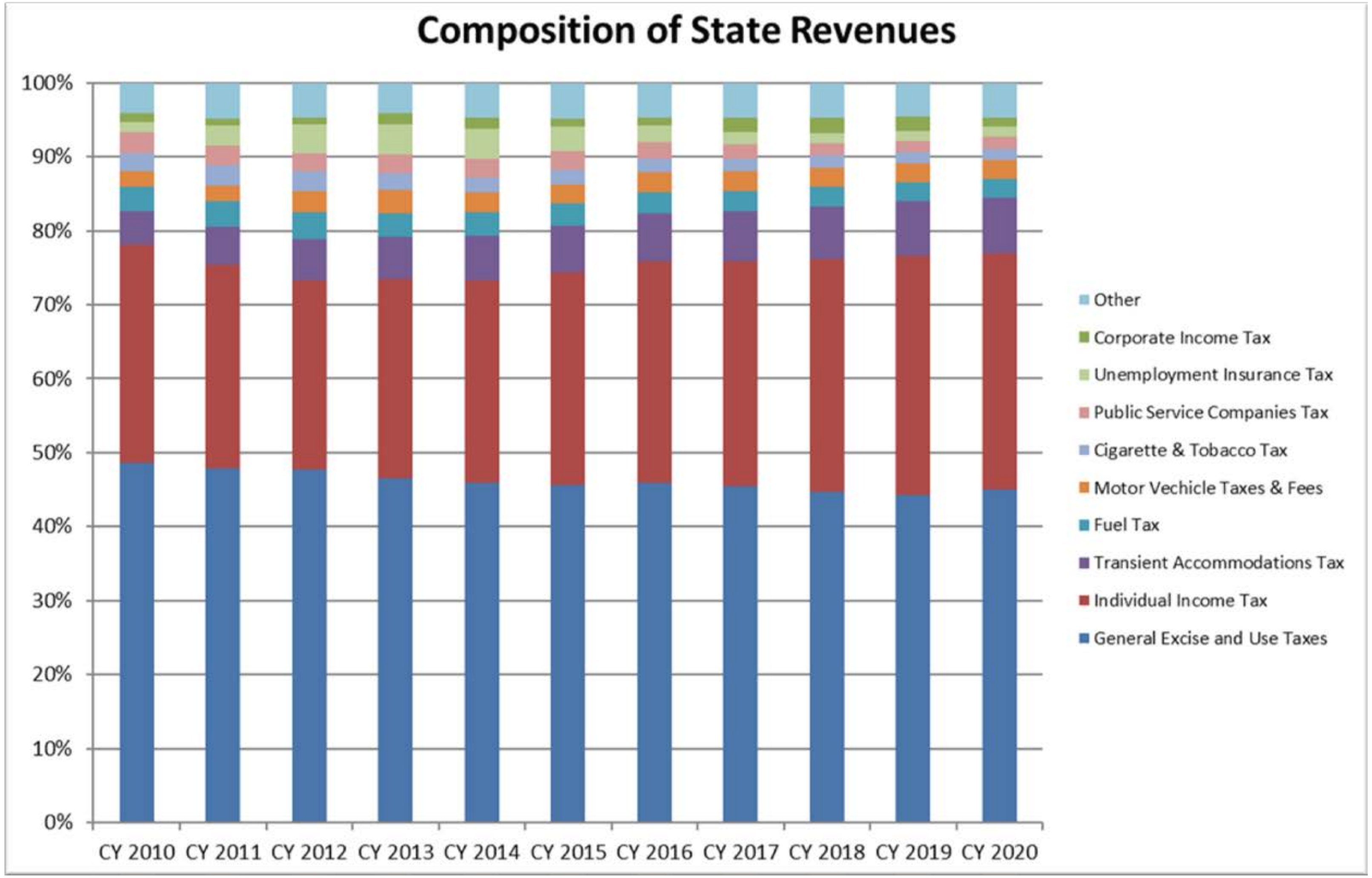




MOST STATE COLLECTIONS COME FROM THREE MAIN TAX TYPES

Tax Type	Amount*	Percent
General Excise and Use Taxes	**3,541**	**44%**
Individual Income Tax	**2,569**	**32%**
Transient Accommodations Tax	**600**	**8%**
Fuel Tax	206	3%
Motor Vechicle Taxes & Fees	196	2%
Corporate Income Tax	164	2%
Public Service Companies Tax	127	2%
Cigarette & Tobacco Tax	113	1%
Unemployment Insurance Tax	110	1%
Other	357	4%

*$ thousands
Fiscal Year 2019
Hawaii Department of Taxation



GET and IIT comprise three quarters of state revenue

Hawaii tax collections are highly centralized

- Hawaii collects more of its tax revenues at the state level than at the local level when compared with other states
- These rankings may overstate Hawaii's tax burden, because Hawaii may be able to export more of its taxes:
  - Federal government (income tax deduction)
  - Tourists and non-resident Military

State tax collections Per capita 2015

State	Collections per Capita	Rank
N.D.	$ 7,583	1
Vt.	$ 4,861	2
Hawaii	$ 4,530	3
Minn.	$ 4,452	4
Conn.	$ 4,438	5
Wyo.	$ 4,020	6
Mass.	$ 3,976	7
N.Y.	$ 3,952	8
Calif.	$ 3,862	9
Del.	$ 3,715	10
N.J.	$ 3,524	11
Md.	$ 3,305	12
Ark.	$ 3,086	13
Maine	$ 3,057	14
Ill.	$ 3,055	15
R.I.	$ 3,026	16
W.Va.	$ 3,018	17
Wis.	$ 2,949	18
Iowa	$ 2,942	19
N.M.	$ 2,882	20
Wash.	$ 2,879	21
Pa.	$ 2,821	22
Mont.	$ 2,753	23
Mich.	$ 2,717	24
Kans.	$ 2,708	25
U.S.	$ 2,694	

State-Local Tax Burden as a Share of State Income 2012

State	%	Rank	Total Tax Burden (per Capita)
N.Y.	12.7%	1	$ 6,993
Conn.	12.6%	2	$ 7,869
N.J.	12.2%	3	$ 6,926
Calif.	11.0%	6	$ 5,237
Ill.	11.0%	5	$ 5,235
Wis.	11.0%	4	$ 4,734
Md.	10.9%	7	$ 5,920
Minn.	10.8%	8	$ 5,185
R.I.	10.8%	9	$ 4,998
D.C.	10.6%	10	$ 7,541
Mass.	10.3%	12	$ 5,872
Ore.	10.3%	10	$ 4,095
Vt.	10.3%	11	$ 4,557
Del.	10.2%	16	$ 4,412
Hawaii	10.2%	14	$ 4,576
Maine	10.2%	13	$ 3,997
Pa.	10.2%	15	$ 4,589
Ark.	10.1%	17	$ 3,519
US	9.9%		$ 4,420
N.C.	9.8%	20	$ 3,659
Ohio	9.8%	19	$ 3,924
W.Va.	9.8%	18	$ 3,331
Utah	9.6%	21	$ 3,556
Ind.	9.5%	22	$ 3,585
Kans.	9.5%	23	$ 4,131
Ky.	9.5%	24	$ 3,298
Mich.	9.4%	25	$ 3,631

Source: Tax Foundation

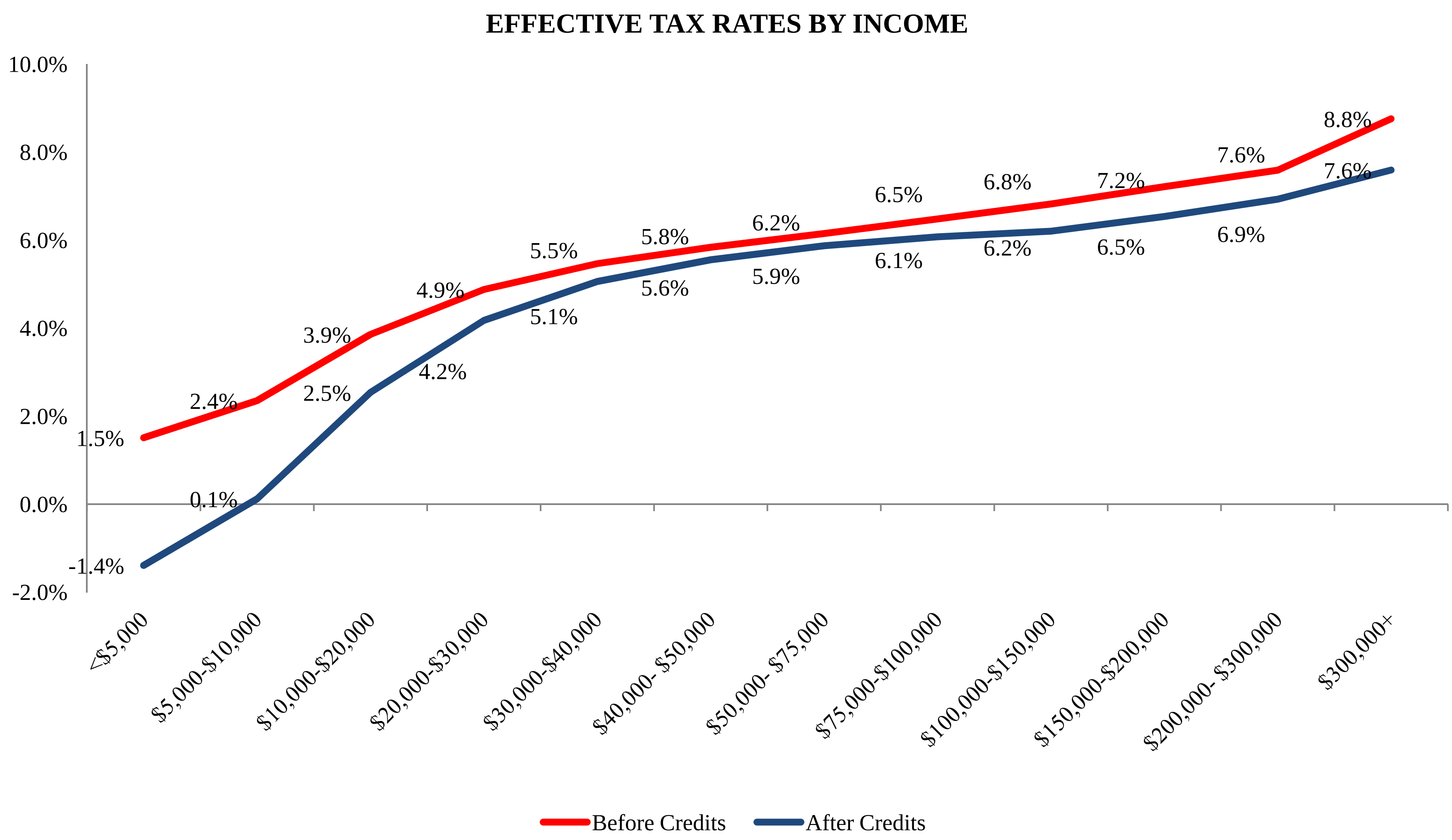
MOST RESIDENT FILERS ARE IN MIDDLE AND UPPER-MIDDLE TAX BRACKETS

2013 JOINT FILERS BY TAX BRACKETS (RESIDENTS)

Status - Joint

Tax Bracket			Marginal Rate	Returns With Taxable Income In the Tax Bracket		
				Number of Returns	% of Total No. of Returns	Amount of Taxable Income
$0	to	$4,800	1.4%	43,029	19.6%	19,151,351
$4,801	to	$9,600	3.20%	8,101	3.7%	58,093,778
$9,601	to	$19,200	5.50%	16,785	7.6%	242,009,824
$19,201	to	$28,800	6.40%	17,147	7.8%	411,129,792
$28,801	to	$38,400	6.80%	16,396	7.5%	550,098,981
$38,401	to	$48,000	7.20%	15,781	7.2%	681,365,652
$48,001	to	$72,000	7.60%	36,390	16.6%	2,169,779,414
$72,001	to	$96,000	7.90%	26,291	12.0%	2,183,916,220
$96,001	to	$300,000	8.25%	35,466	16.1%	5,062,150,292
$300,001	to	$350,000	9.00%	1,058	0.5%	342,401,741
$350,001	to	$400,000	10.00%	703	0.3%	263,097,729
$400,001	&	Over	11.00%	2,505	1.1%	2,678,825,866
ALL				**219,652**	**100.0%**	**$ 14,662,020,640**

LOW INCOME FILERS HAVE LOW TAX LIABILITES AND BENEFIT FROM REFUNDABLE CREDITS



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COUNCIL ON REVENUES

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

January 9, 2023

The Honorable Kyle T. Yamashita, Chair
The Honorable Lisa Kitagawa, Vice Chair
and Members of the House Committee on Finance
State Capitol, Room 306
Honolulu, Hawaii 96813

Dear Chair Yamashita, Vice Chair Kitagawa, and Members of the Committee:

Thank you for inviting the Council on Revenues (Council) to appear before your committee to present its current General Fund tax revenue forecasts for the State of Hawaii. My name is Kurt Kawafuchi, and I am the Chair of the Council on Revenues.

As a starting point, the following is an overview of the Council's process to derive its forecasts followed by a discussion of the Council's recent forecasts.1

Overview

Overview of Sources of Hawaii General Fund Tax Revenues

The bulk of the State of Hawaii's tax revenue comes from consumption taxes, such as the Hawaii General Excise taxes and Transient Accommodation taxes. In addition, income taxes from individuals and corporations also are significant sources of revenue. Estate and conveyance taxes comprise only a small part of the overall state tax revenue.

<u>General Excise Taxes</u>

The General Excise Taxes (GET) is a gross income tax on receipts of sales and other business activities in Hawaii. It is imposed on the privilege of doing business in the State of Hawaii. It raises significant revenue through a low rate and broad base, and because the GET pryamids. Unlike a retail sales tax that is primarily used by other states, the GET is imposed on services and rental income, in addition to tangible goods. As such, it has been remarkably more stable in generating revenue than the sales taxes utilized by other states.

<u>Individual Income Taxes</u>

The Hawaii income taxes are very progressive relative to other states. Refundable credits such as the Food credit, Earned Income Tax Credit, and Renter's credit offset the burden for lower income individuals.

The largest state specific exemptions are pensions and social security, which are expected to grow with time due to state demographics and the aging baby boomers.

Hawaii has one of the highest marginal tax rates in the country. However, the income threshold of the top 1% of filers in Hawaii is relatively very low at $200,000. Although there are many wealthy individuals with residences in Hawaii, they oftentimes choose to be residents in other lower-taxed states, or states with no state income tax. In addition, Hawaii does not have the types of businesses that generally pay more.

Unfortunately, from 2018 through 2025, Federal tax law changes placed a limit on the total personal State and Local (SALT) taxes allowed as itemized deductions to $10,000 ($5,000 if married filing separately). As a consequence, this affects many higher income Hawaii taxpayers, and Hawaii no longer able to export a large portion of the individual income tax burden to the Federal government.

Transient Accommodation Taxes

Transient Accommodation Taxes (TAT) are imposed on transient accommodations for less than 180 consecutive days. After a recent law change, the vast majority of TAT revenue goes into the General Fund.

Factors Considered by the Council in its Forecasts

The Council 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 Council considers:

1. The output of three economic models (the "Regular Model," the "UCLA Model," and "Single Regression Equation Model").

2. Tax laws and tax law changes affecting tax collections.

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

4. Other factors raised and discussed at Council meetings.

Other factors include, but are not limited to, the potential effect of external international and national events, noncompliance with existing tax laws, the effect of possible internet tax fraud in collection efforts, and monthly tax collections. After discussion of various factors and the results of the economic models, the members then decide on the official forecast for the growth in General Fund tax revenue. The forecast may or may not agree with the output of the economic models since the forecast encompasses other considerations not directly incorporated in the economic models.

The Council forecasts only the total General Fund tax collections. To get the implied growth in collections of the individual tax types, the DOTAX Tax Research Planning Office (TRP) staff change the economic variables in the primary model until that model produces a growth rate for total General Fund tax revenues that matches the Council's forecast, so that the forecasts of tax revenue growth for the individual tax types are consistent with the Council's forecast for overall General Fund tax revenue growth.

The State of Hawaii recognizes General Fund Tax Revenue on the cash basis of accounting. The cash basis of accounting records revenues when cash is received, and tax refunds disbursed. This method differs from the accrual basis of accounting which accounts for revenues when earned.

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 the collection of taxes or payment of refunds);
3) errors in estimating the impact of new tax laws or compliance with existing tax laws; or
4) errors in estimating the impact of other factors or external events.

The Council's Forecasts of General Fund Tax Revenues

The Council on Revenues held a meeting to forecast revenue growth for the State General Fund on January 5th, 2023. The Council lowered its forecast to 5.5% from 6.5% for fiscal year (FY) 2023. The Council increased its forecast to 5.0% from 4.0% for FY 2024. The Council maintained its forecast for FYs 2025-2029 at 3.5%.

The 1.0% decrease in the FY 2023 revision is due to the Constitutional Refund, which is expected to reduce revenues by approximately $335 million in the first half of the fiscal year. The Council did not consider the revenue impact of the Constitutional Refund in its September 2022 meeting. As a result, January was the first opportunity that the Council had to adjust its forecast for the Constitutional Refund’s impact on tax revenues. Strong tax collections in the first half of the year mitigated some of the impact of the Constitutional Refund.

Tax collections remain robust due to the recovery of tourist arrivals, renewed consumer spending, and additional tax collections due to inflation. Risks that may inhibit the economic recovery include new variants of the COVID-19 virus, inflation and an aggressive monetary policy response from the Federal Reserve, high oil and commodity prices, geopolitical events including economic disruptions associated with the war in Ukraine, severe labor shortages, supply chain disruptions, sustained travel hesitancy from Asian markets due to the Pandemic, and the reduction in Federal stimulus spending

Due to the recent strength of the U.S. dollar compared to foreign currencies, Hawaii also faces strong competition from international travel destinations, such as Europe. Tourists from Japan may be especially less likely to travel to Hawaii due to unfavorable foreign currency exchange rates for them.

The Council expects visitor spending will plateau in the coming months with an increase in foreign visitors making up for a slight shortfall in domestic visitors. Given the prominent role of tourism in Hawaii's economy, the number of visitors to the State will have major impacts on the economy and tax collections.

The new forecasts for the State General Fund tax revenues FY 2023 through FY 2029 are shown in the table below.

General Fund Tax Revenues

Fiscal Year	Amount (in Thousands of Dollars)	Growth From Previous Year
2023	$9,873,585	5.5%
2024	$10,367,264	5.0%
2025	$10,730,118	3.5%
2026	$11,105,672	3.5%
2027	$11,494,371	3.5%
2028	$11,896,674	3.5%
2029	$12,313,058	3.5%

The Council adopted specific adjustments recommended by the Department of Taxation to reflect effects on General Fund tax revenues due to tax law changes enacted by the 2022 Legislature including the following:

- Act 115, SLH 20222 provides a one-time tax refund of either $100 or $300 per qualifying exemption depending on federal adjusted gross income for Hawaii residents. The act also makes deposits to the emergency and budget reserve fund and pension accumulation fund, pursuant to article VII, section 6, of the Hawaii State Constitution. The Act became effective on July 1, 2022. The estimated loss to the General fund is $334.6 million in FY 2023.

- Act 80, SLH 2022 clarifies the amounts received or accrued for stevedoring services, wharfage, and demurrage services are exempt under the general excise tax law within section 237- 24.3, HRS. The Act became effective on June 27, 2022. The estimated loss to the General Fund is $5.6 million in FY 2023, $6.3 million in FY 2024, $6.5 million in

FY 2025, $6.7 million in FY 2026, $6.9 million in FY 2027, $7.1 million in FY 2028, and $7.3 million in FY 2029.

- Act 114, SLH 2022 makes the State earned income tax credit (EITC) refundable and permanent. The State EITC becomes refundable beginning with the 2023 tax year. All carryforwards of nonrefundable EITC expire at the end of the 2024 tax year. Act 114 also adds new incremental increases to both minimum wages and tip credits beginning on October 1, 2022 and increasing through January 1, 2028. The Act became effective on June 27, 2022. The estimated loss to the General Fund is $0.0 million in FY 2023, $47.1 million in FY 2024, $48.4 million in FY 2025, $49.4 million in FY 2026, $50.5 million in FY 2027, $51.6 million in FY 2028, and $52.7 million in FY 2029.

- Act 216, SLH 2022 reinstates the Renewable Fuels Production Tax Credit (RFPTC), which was previously codified at section 235-110.31, HRS, before its duly scheduled repeal on December 31, 2021. Act 216 also allows the RFPTC to be refunded under certain conditions. The Act became effective on June 27, 2022 and applies to taxable years beginning after December 31, 2021.The estimated loss to the General Fund is $20 million per year from FY 2023 to FY 2029.

- Act 1, SSLH 2021 authorizes the counties to establish and administer their own transient accommodations tax (TAT) at a maximum rate of 3%. The Act reduces the allocation to the convention center special fund from $16.5 million to $11 million. The Act also eliminates the $79 million allocation to the tourism special fund, and the $103 million allocation to the counties. The Act became effective on July 1, 2021. The estimated gain to the General Fund is $187.5 million for FY 2022 through FY 2028.

- Act 226, SLH 2021 relaxes the rules on allocating the low-income housing tax credit (LIHTC). The Act also relaxes the installment method, at-risk, and passive activity loss rules and allows the Hawaii LIHTC to be claimed in the initial year even if Federal Form 8609 has not been received by the taxpayer. The Act prohibits the deductions and expenses claimed by Hawaii taxpayers to exceed the deductions and expenses claimed by all taxpayers on federal returns. The Act extends the shortened credit period provided by Act 129, SLH 2016, from tax year 2022 through tax year 2027. The Act became effective on July 1, 2021 and applies to taxable years beginning after December 31, 2020. The estimated loss to the General Fund is $7.8 million in FY 2022, $24.1 million in FY 2023, $24.9 million in FY 2024, $25.6 million in FY 2025, $26.4 million in FY 2026, $27.2 million in FY 2027, and $28.0 million in FY 2028.

- Act 2, SLH 2019 deems marketplace facilitators the sellers of tangible personal property, intangible personal property, and services sold through the marketplace. The Act also deems sales of tangible personal property and services by sellers to the marketplace facilitator to be sales at wholesale. The Act is effective January 1, 2020. The estimated gain to the General Fund is $4.0 million in FY2020, $9.8 million in FY 2021, $10.1 million in FY 2022, $10.4 million in FY 2023, $10.7 million in FY 2024, $11.0 million in FY 2025, and $11.3 million in FY 2026.

- Act 3, SLH 2019 establishes a new estate tax rate bracket for taxable estates exceeding $10 million. The new bracket is 20%. The Act is effective April 4, 2019 and applies to decedents dying after December 31, 2019. The estimated gain to the General Fund is $1.9 million in FY 2021, $2.0 million in FY 2022, $2.1 million in FY 2023, $2.2 million in FY 2024, $2.3 million in FY 2025, and $2.4 million in FY 2026.

- Act 20, SLH 2019 imposes the transient accommodations tax on resort fees and defines resort fees as "any mandatory charge or surcharge imposed by an operator, owner, or representative thereof to a transient for the use of the transient accommodation's property, services, or amenities." The Act is effective July 1, 2019. The estimated revenue gain to the General Fund is $9.1 million in FY 2020, $10.3 million in FY 2021, $10.7 million in FY 2022, $11.1 million in FY 2023, $11.6 million in FY 2024, $12 million in FY 2025, and $12.4 million in FY 2026.

Thank you for this opportunity to testify. I would like to thank Seth Colby, PhD, Tax Research & Planning Officer, and staff of the TRP for their assistance in providing graphs, data, and assistance in putting together this report.

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

Very truly yours,

KURT KAWAFUCHI
Chair, Council on Revenues