July 8, 2008

The Honorable Colleen Hanabusa, President
and Members of the Senate
Twenty-Fourth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

Dear Madam President and Members of the Senate:

I am transmitting herewith HB1412 HD1 SD1 CD1, without my approval, and with the statement of objections relating to the measure.

HB1412 HD1 SD1 CD1 A BILL FOR AN ACT RELATING TO THE DEPARTMENT OF TAXATION'S BENEFITS-FUNDED REVENUE-GENERATING COMPUTER INITIATIVES.

Sincerely,

LINDA LINGLE
STATEMENT OF OBJECTIONS TO HOUSE BILL NO. 1412

Honorable Members
Twenty-Fourth Legislature
State of Hawaii


The purpose of this bill is to require the Department of Taxation to enter into a “benefits-funded” contract with a vendor to increase tax collections, to further automate tax collections, and to require electronic filing of tax returns.

While the general objectives in this measure are laudable, the bill is objectionable because it would set questionable, unrealistic, and inappropriate parameters under which the department would have to implement these programs.

The bill fails to provide sufficient time for the Department of Taxation to execute performance-based contracts by artificially establishing an October 1, 2008 deadline to do so. It is not clear whether the contracts must be fully performed by this deadline or simply fully signed by the Department and the contractor, but if it is the latter, then the bill's October 1, 2008 deadline does not allow sufficient time to go through the State's legally mandated, established procurement process.

Also, it is not clear whether the other improvements and operational efficiencies to be achieved by the Department of Taxation under the bill must also be fully performed by October 1, 2008.
Section 12 of the bill appropriates $2,900,000 out of the general revenues for fiscal year 2008-2009 to be deposited in the new Integrated Tax Services and Management Special Fund and section 13 of the bill appropriates $2,900,000 out of that special fund to be used for the purposes of that new special fund. However, section 14 of the bill requires the Department of Taxation to repay the $2,900,000 appropriated from the general revenues for fiscal year 2008-2009 no later than June 30, 2009. There is no appropriation of $2,900,000 out of that special fund or from other moneys that can be used to repay the general fund for the original $2,900,000 appropriated out of general revenues.

The Administration is pleased with the excellent work the Department of Taxation has undertaken to implement more effective tax collections and ensure aggressive collection of delinquent taxes. This bill would divert important department resources to a project that has not been realistically defined in this legislation and could adversely impact the current efforts of the State Tax Department.

For the foregoing reasons, I am returning House Bill No. 1412 without my approval.

Respectfully,

LINDA LINGLE
Governor of Hawaii
A BILL FOR AN ACT

RELATING TO THE DEPARTMENT OF TAXATION'S BENEFITS-FUNDED
REVENUE-GENERATING COMPUTER INITIATIVES.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

PART I

SECTION 1. The purpose of this Act is to improve the
department of taxation's collection capabilities through the
efficient allocation of resources, simplified taxpayer filings,
and a more user friendly interface with the public.

The legislature finds that in 2006, the department of
taxation collected $4,400,000,000. Of that amount, almost
$2,500,000,000 was generated through the general excise tax,
$1,600,000,000 from individual income taxes, $216,000,000
through the transient accommodations tax, and the balance was
collected from miscellaneous taxes.

In 2006, only twenty-seven per cent of all individual
income tax returns were filed electronically, leaving
seventy-three per cent as paper forms and payments to be
processed manually. During tax season, it is not unusual for
the department of taxation to receive one ton of mail a day.
The legislature further finds that in 2006, only four per cent (or 60,000) of all business returns processed were filed electronically, with an astounding ninety-six per cent requiring manual processing of paper forms and payments. Business returns may also require further monthly income tax withholding and general excise and transient accommodations tax payments, resulting in over 1,500,000 filings by businesses in Hawaii, again ninety-six per cent being processed manually.

Overall, only fifteen per cent of Hawaii tax returns are filed electronically, and the $2.50 convenience fee imposed by the eHawaii.gov portal is perceived as a barrier for many people who might consider filing electronically.

The legislature finds that in other states, electronic filing grew by roughly twenty-five to thirty per cent from 2000-2004, and those states with electronic filing mandates have experienced higher growth rates than those without mandates. As a result, many states have used electronic filing applications as an opportunity to improve taxpayer services and reduce their operating costs (e.g., electronic payments, online account access, electronic forms and instructions), as well as increasing their collections without undue burdens to taxpayers.
SECTION 2. The purpose of this part is to provide revenue generating initiatives that will be benefits-funded, meaning the vendor will be paid when measurable increases in revenues resulting from the initiatives are collected by the State. The revenues will be used by the department of taxation to enhance its computer system, called the integrated tax services and management system, and to streamline related operational procedures.

SECTION 3. Chapter 231, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"§231- Integrated tax services and management special fund. (a) There is established in the state treasury the integrated tax services and management special fund to improve customer services and taxpayer fairness, and increase cost savings, with an emphasis on electronic filings.

(b) Notwithstanding any other law to the contrary, the source of funding of any appropriations to the integrated tax services and management special fund for the purposes of funding initiatives under subsection (c) shall come from the tax revenues collected pursuant to chapters 235, 237, and 238."
(c) Moneys in the special fund may be expended upon legislative appropriation by the department to pay for:

1. The integrated tax services and management system's performance-based contracts and administrative and operating expenses related to the integrated tax services and management system's post-implementation revenue-generating initiatives;

2. The improvement of tax collection capabilities and achieving the operational efficiencies that are the department's responsibilities under this section;

3. The department's implementation, administration, and compliance of the Streamlined Sales and Use Tax Agreement when state legislation mandating implementation, administration, and compliance is enacted, including but not limited to computer software and hardware costs, technical assistance of contractors for any necessary fiscal or legal matters resulting from the adoption and implementation of the Streamlined Sales and Use Tax Agreement, and for the support of any committees established in conjunction with the Agreement; and
(4) The improvement of the department's operation and staffing requirements."

SECTION 4. Section 36-27, Hawaii Revised Statutes, is amended to read as follows:

"§36-27 Transfers from special funds for central service expenses. Except as provided in this section, and notwithstanding any other law to the contrary, from time to time, the director of finance, for the purpose of defraying the prorated estimate of central service expenses of government in relation to all special funds, except the:

(1) Special out-of-school time instructional program fund under section 302A-1310;

(2) School cafeteria special funds of the department of education;

(3) Special funds of the University of Hawaii;

(4) State educational facilities improvement special fund;

(5) Convention center enterprise special fund under section 201B-8;

(6) Special funds established by section 206E-6;

(7) Housing loan program revenue bond special fund;

(8) Housing project bond special fund;

(9) Aloha Tower fund created by section 206J-17;
(10) Funds of the employees' retirement system created by section 88-109;
(11) Unemployment compensation fund established under section 383-121;
(12) Hawaii hurricane relief fund established under chapter 431P;
(13) Hawaii health systems corporation special funds and the subaccounts of its regional system boards;
(14) Tourism special fund established under section 201B-11;
(15) Universal service fund established under chapter 269;
(16) Emergency and budget reserve fund under section 328L-3;
(17) Public schools special fees and charges fund under section 302A-1130(f);
(18) Sport fish special fund under section 187A-9.5;
(19) Neurotrauma special fund under section 321H-4;
(20) Deposit beverage container deposit special fund under section 342G-104;
(21) Glass advance disposal fee special fund established by section 342G-82;
(22) Center for nursing special fund under section 304A-2163;

(23) Passenger facility charge special fund established by section 261-5.5;

(24) Solicitation of funds for charitable purposes special fund established by section 467B-15;

(25) Land conservation fund established by section 173A-5;

(26) Court interpreting services revolving fund under section 607-1.5;

(27) Trauma system special fund under section 321-22.5;

(28) Hawaii cancer research special fund;

(29) Community health centers special fund; and

(30) Emergency medical services special fund; and

(31) Integrated tax services and management special fund under section 231- ;

shall deduct five per cent of all receipts of all other special funds, which deduction shall be transferred to the general fund of the State and become general realizations of the State. All officers of the State and other persons having power to allocate or disburse any special funds shall cooperate with the director in effecting these transfers. To determine the proper revenue base upon which the central service assessment is to be
calculated, the director shall adopt rules pursuant to chapter
2 91 for the purpose of suspending or limiting the application of
3 the central service assessment of any fund. No later than
4 twenty days prior to the convening of each regular session of
5 the legislature, the director shall report all central service
6 assessments made during the preceding fiscal year."
7
SECTION 5. Section 36-30, Hawaii Revised Statutes, is
8 amended by amending subsection (a) to read as follows:
9
"(a) Each special fund, except the:
10 (1) Transportation use special fund established by section
11 261D-1;
12 (2) Special out-of-school time instructional program fund
13 under section 302A-1310;
14 (3) School cafeteria special funds of the department of
15 education;
16 (4) Special funds of the University of Hawaii;
17 (5) State educational facilities improvement special fund;
18 (6) Special funds established by section 206E-6;
19 (7) Aloha Tower fund created by section 206J-17;
20 (8) Funds of the employees' retirement system created by
21 section 88-109;
(9) Unemployment compensation fund established under section 383-121;

(10) Hawaii hurricane relief fund established under chapter 431P;

(11) Convention center enterprise special fund established under section 201B-8;

(12) Hawaii health systems corporation special funds and the subaccounts of its regional system boards;

(13) Tourism special fund established under section 201B-11;

(14) Universal service fund established under chapter 269;

(15) Emergency and budget reserve fund under section 328L-3;

(16) Public schools special fees and charges fund under section 302A-1130(f);

(17) Sport fish special fund under section 187A-9.5;

(18) Neurotrauma special fund under section 321H-4;

(19) Center for nursing special fund under section 304A-2163;

(20) Passenger facility charge special fund established by section 261-5.5;
(21) Court interpreting services revolving fund under section 607-1.5;
(22) Trauma system special fund under section 321-22.5;
(23) Hawaii cancer research special fund;
(24) Community health centers special fund; [and]
(25) Emergency medical services special fund; and
(26) Integrated tax services and management special fund under section 231-

shall be responsible for its pro rata share of the administrative expenses incurred by the department responsible for the operations supported by the special fund concerned."

SECTION 6. Section 235-119, Hawaii Revised Statutes, is amended to read as follows:

"§235-119 Taxes, state realizations. (a) Except as provided in subsection (b), all income taxes shall be for the use of the State and shall be paid into the state treasury at such times as the director of finance shall direct.

(b) The director of taxation shall pay the income taxes into the state treasury as a state realization; provided that a sum, not to exceed the amount necessary to meet the obligations of the integrated tax services and management system's performance-based contracts and other purposes of the integrated
tax services and management special fund, may be retained and
deposited into the state treasury to the credit of the
integrated tax services and management special fund. The sum
retained by the director of taxation for deposit into the
integrated tax services and management special fund shall be
limited to amounts appropriated by the legislature."

SECTION 7. Section 237-31, Hawaii Revised Statutes, is
amended to read as follows:

"§237-31 Remittances. All remittances of taxes imposed by
this chapter shall be made by money, bank draft, check,
cashier's check, money order, or certificate of deposit to the
office of the department of taxation to which the return was
transmitted. The department shall issue its receipts therefore
to the taxpayer and shall pay the moneys into the state treasury
as a state realization, to be kept and accounted for as provided
by law; provided that:

(1) The sum from all general excise tax revenues realized
by the State that represents the difference between
$90,000,000 and the proceeds from the sale of any
general obligation bonds authorized for that fiscal
year for the purposes of the state educational
facilities improvement special fund shall be deposited
in the state treasury in each fiscal year to the
credit of the state educational facilities improvement
special fund for public school capital improvement
program needs; [and]

(2) A sum, not to exceed $5,000,000, from all general
excise tax revenues realized by the State shall be
deposited in the state treasury in each fiscal year to
the credit of the compound interest bond reserve
fund[[-]; and

(3) A sum, not to exceed the amount necessary to meet the
obligations of integrated tax services and management
system's performance-based contracts and other
purposes of the integrated tax services and management
special fund, may be retained and deposited into the
state treasury to the credit of the integrated tax
services and management special fund. The sum
retained by the director of taxation for deposit into
the integrated tax services and management special
fund shall be limited to amounts appropriated by the
legislature."

SECTION 8. Section 238-14, Hawaii Revised Statutes, is
amended to read as follows:

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§238-14 Taxes state realizations. [All] (a) Except as provided in subsection (b), all taxes collected under this chapter shall be state realizations.

(b) The director of taxation shall pay the use taxes into the state treasury as a state realization; provided that a sum, not to exceed the amount necessary to meet the obligations of the integrated tax services and management system's performance-based contracts and other purposes of the integrated tax services and management special fund, may be retained and deposited into the state treasury to the credit of the integrated tax services and management special fund. The sum retained by the director of taxation for deposit into the integrated tax services and management special fund shall be limited to amounts appropriated by the legislature."

SECTION 9. The department of taxation shall execute the performance-based contracts and work assignments authorized under this part in a timely manner; provided that the integrated tax services and management system's enhancements and services authorized by this Act shall be executed no later than October 1, 2008.

PART III
SECTION 10. (a) Notwithstanding any other law to the contrary, including any law requiring oversight of an executive department's decisions relating to on-line portals or internet-based access, the department of taxation shall utilize performance-based contracts to enhance or acquire automated tax systems, or both, including computer hardware and software, for the implementation and administration of the taxes under title 14, Hawaii Revised Statutes, including:

(1) The city and county of Honolulu surcharge authorized under section 46-16.8, Hawaii Revised Statutes, and adopted by ordinance; and


(b) For the purposes of this part:

"Performance-based contract" means a contract under which compensation to the vendor shall be computed according to performance standards established by the department of taxation. Any performance-based contract entered into by the department of taxation for the purposes established under subsection (a) shall provide for the payment of fees:
(1) Based on a contractually specified amount of the increase in the amount of taxes, interest, and penalties collected and attributable to the implementation of the integrated tax services and management system post-implementation revenue-generating initiatives; or

(2) On a fixed-fee contract basis to be paid from the increase in the amount of taxes, interest, and penalties collected and attributable to the implementation of the integrated tax services and management system post-implementation revenue-generating initiatives.

(c) The State shall receive a permanent license to use the enhanced or automated tax systems upon full payment to the vendor.

(d) Notwithstanding any other law to the contrary, the department of taxation shall award the performance-based contract pursuant to the requirements of chapter 103D, Hawaii Revised Statutes.

SECTION 11. The director of taxation shall report to the legislature, no later than twenty days prior to the convening of every regular session, beginning with the 2009 regular session,
with respect to the status of the performance-based contract and shall provide an accounting of all moneys appropriated. The report shall include:

(1) Detailed information on the costs, benefits, and features of implementing the integrated tax services and management system post-implementation revenue-generating initiatives;

(2) The amount of increased tax, interest, and penalties collected that is attributable to the integrated tax services and management system post-implementation revenue-generating initiatives;

(3) The amount paid to the vendor or vendors contracted under this Act; and

(4) Any additional staffing, staffing shifts or savings in staffing or resource requirements generated through implementation of the integrated tax services and management system post-implementation revenue-generating initiatives.

The report shall also include any other information from the preceding fiscal year that may assist the legislature in determining the efficacy of a contract executed under this Act, beginning with the fiscal year immediately preceding the fiscal

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year commencing on the effective date of this Act and continuing until two complete fiscal years have elapsed following the full implementation of the integrated tax services and management system post-implementation revenue-generating initiatives.

SECTION 12. There is appropriated out of the general revenues of the State of Hawaii the sum of $2,900,000 or so much thereof as may be necessary for fiscal year 2008-2009 to be deposited into the integrated tax services and management special fund established pursuant to section 231- , Hawaii Revised Statutes, contained in section 3 of this Act.

SECTION 13. There is appropriated out of the integrated tax services and management special fund the sum of $2,900,000 or so much thereof as may be necessary for fiscal year 2008-2009 for the purposes of the integrated tax services and management special fund established pursuant to section 231- , Hawaii Revised Statutes, contained in section 3 of this Act, to assist the department of taxation in upgrading its operations, workforce, skills of its employees, or other purposes authorized under section 231- , Hawaii Revised Statutes, contained in section 3.

The sum appropriated shall be expended by the department of taxation.
SECTION 14. The department of taxation shall repay the general fund for the appropriation made under section 12 to the integrated tax services and management special fund established pursuant to section 231- , Hawaii Revised Statutes, no later than June 30, 2009.

PART IV

SECTION 15. The increased use of computers for personal purposes and in daily business operations has led to an increase in electronic and computer-based interactions with government. The department of taxation interacts with nearly every person in Hawaii on a regular basis. The department of taxation also regularly interacts with nonresident taxpayers and mainland-based businesses that routinely file tax information.

In response to the increase in interactions with out-of-state taxpayers and the increase in electronic tax filings, the legislature, in 1997, made electronic filing an acceptable means of carrying out a taxpayer's obligations under the law. Since this law was enacted, the ability to interact electronically has grown considerably, especially for businesses, nearly all of which have a computer and access to the Internet.
Within the next decade, a majority, if not all, of tax filings are predicted to be filed electronically. This will result in greater efficiencies for both the taxpayer and the State. In addition, the legislature, which is charged with the responsibility of overseeing the effectiveness of tax incentives and the efficacy of the tax system as a whole, will have access to more specific data on Hawaii taxes if the tax data is captured electronically.

The amendments in this part will also ensure that taxpayers will be provided with sufficient notice and an opportunity to comment by requiring compliance with chapter 91, Hawaii Revised Statutes.

The purpose of this part is to increase electronic filing by requiring that the department of taxation, by rule, require electronic filing. It is the intent of the legislature, that within this broader mandate, the department of taxation shall:

(1) Focus its initial rulemaking on those taxes paid by businesses that the Internal Revenue Service requires to be filed electronically; and

(2) Address increased voluntary electronic filing through the integrated tax services and management software upgrades.
SECTION 16. Section 231-8.5, Hawaii Revised Statutes, is amended to read as follows:

"[+J§231-8.5[†] Electronic filing of tax returns. The department may allow, or require by rule adopted pursuant to chapter 91, filing by electronic, telephonic, or optical means of any tax return, application, report, or other document required under the provisions of title 14 administered by the department. The date of filing shall be the date the tax return, application, report, or other document is transmitted to the department in a form and manner prescribed by departmental rules adopted pursuant to chapter 91. The department may determine alternative methods for the signing, subscribing, or verifying of a tax return, application, report, or other document that shall have the same validity and consequences as the actual signing by the taxpayer. A filing under this section shall be treated in the same manner as a filing subject to the penalties under section 231-39."

SECTION 17. Section 231-9.9, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) The director of taxation is authorized to require every person whose tax liability for any one taxable year exceeds:
(1) $100,000 or less if required by rule adopted pursuant to chapter 91; and who files a tax return for any tax, including consolidated filers, to remit taxes by one of the means of electronic funds transfer approved by the department; provided that for withholding taxes under section 235-62, electronic funds transfers shall apply to annual tax liabilities that exceed $40,000."

PART V

SECTION 18. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 19. This Act shall take effect on June 29, 2008; provided that the amendment made to section 237-31, Hawaii Revised Statutes, by this Act shall not be repealed when that section is reenacted on June 30, 2008, by section 4 of Act 304, Session laws of Hawaii 2006.