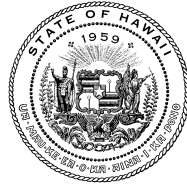


DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
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MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

JOSEPH K. KIM
DEPUTY DIRECTOR

To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: February 10, 2016
Time: 9:20 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2547, Relating to Taxation.

The Department of Taxation (Department) offers the following comments regarding S.B. 2547 for your consideration.

S.B. 2547 requires the Auditor to review certain exemptions and deductions from the general excise and use taxes, public service company tax, and insurance premium tax, and assess a surcharge on taxpayers claiming those exemptions and deductions to fund the audit revolving fund. S.B. 2547 is effective on July 1, 2016.

First, the Department notes that it will fully cooperate with the Auditor as proposed by this measure, provided that all disclosures to the Auditor are in compliance with applicable confidentiality statutes set forth in sections 23-5(a) and 237-34 of the Hawaii Revised Statutes (HRS).

Second, S.B. 2547 provides that the surcharge of an unspecified amount per taxpayer who claims an exemption or a deduction shall be either: (1) added to the taxes remitted with the annual return; or (2) deducted from any tax refund or credit if the taxpayer has made excess payments for that taxable year. The Department notes that the bill is unclear as to whether the surcharge amount is applied per applicable exemption, or deduction, when a taxpayer is claiming more than one exemption, or deduction (as opposed to a flat amount regardless of the number of exemptions, or deductions claimed by the taxpayer).

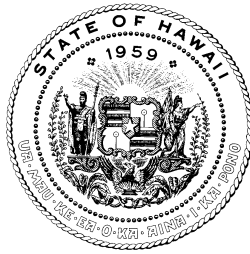
Third, the Department notes that the mechanism to fund the audit revolving fund may be difficult to administer. The Department suggests instead, that the bill be amended to replace the surcharge with a fee to be added after calculating all taxes, penalties and interests.

Department of Taxation Testimony
WAM SB 2547
February 10, 2016
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Fourth, the Department notes that chapter 431, HRS, insurance premium tax, is administered by the Insurance Division within the Department of Commerce and Consumer Affairs (DCCA). The Department suggests that the surcharge, or the fee, on the insurance premium tax be administered by the Insurance Division within DCCA, rather the Department.

Finally, the Department requests that the effective date be amended to be effective January 1, 2017, to provide the Department with sufficient time to implement the form, instruction and computer system changes proposed in this bill.

Thank you for the opportunity to provide comments.



**TESTIMONY OF JAN K. YAMANE, ACTING STATE AUDITOR,
ON SENATE BILL NO. 2547
RELATING TO TAXATION**

Senate Committee on Ways and Means

February 10, 2016

Chair Tokuda and Members of the Committee:

Thank you for the opportunity to offer comments on this bill. SB 2547 would require the State Auditor to periodically review certain tax exemptions, exclusions, and credits under the general excise and use taxes, public service company tax, and insurance premium tax, among other purposes.

Although the bill requires the Director of Taxation to cooperate with the Auditor's request for information when the Auditor conducts a review of an exemption, exclusion, or credit, the Attorney General's opinion is that the Auditor is prohibited by law from accessing confidential taxpayer information. Much of the work this bill requests of the Auditor would require access to such information.

Thank you again for the opportunity to provide comments on SB 2547. I am available to answer any questions you may have.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, USE, PUBLIC SERVICE COMPANY, INSURANCE PREMIUM, Periodic Review of Exemptions, Deductions, and Credits, Surcharge on Beneficiaries of Tax Benefits

BILL NUMBER: SB 2547

INTRODUCED BY: TOKUDA, BAKER, DELA CRUZ, ENGLISH, GALUTERIA, INOUYE, KEITH-AGARAN, KIDANI, NISHIHARA, SHIMABUKURO

EXECUTIVE SUMMARY: This bill would require the State Auditor to periodically review the myriad exemptions, deductions, and other tax benefits now provided under chapters 237, 238, and 239. The cost of the review would be recovered by a surcharge on those who now take the exemptions. This type of review, however, should already be within the purview of the Tax Review Commission that is provided for in our constitution and is supposed to be appointed this year (given that it wasn't appointed last year when it was supposed to happen). In addition, the surcharge would be unfair to the recipients of income that is exempt by design of the tax system.

BRIEF SUMMARY: Amends HRS chapter 23 to add a new part providing that specified deductions, exemptions, and credits be reviewed once every ten years. The bill specifies the credits to be reviewed on a rolling scale. A large number, but not all, of the existing deductions, exemptions, and credits are included.

Specifies that the auditor shall do the following in the course of the review:

- (1) Determine the amount of tax expenditure for the exemption, exclusion, or credit for each of the previous three fiscal years;
- (2) Estimate the amount of tax expenditure for the exemption, exclusion, or credit for the current fiscal year and the next two fiscal years;
- (3) Determine whether the exemption, exclusion, or credit has achieved and continues to achieve the purpose for which it was enacted by the legislature;
- (4) Determine whether the exemption, exclusion, or credit is necessary to promote or preserve tax equity or efficiency;
- (5) If the exemption, exclusion, or credit was enacted because of its purported economic or employment benefit to the State:
 - a. Determine whether a benefit has resulted, and if so, quantify to the extent possible the estimated benefit directly attributable to the exemption, exclusion, or credit; and
 - b. Comment on whether the benefit, if any, outweighs the cost of the exemption, exclusion, or credit; and
- (6) Estimate the annual cost of the exemption, exclusion, or credit per low-income resident of the State, which means an individual who is a resident of the State and:

- a. Is the only member of a family of one and has an income of not more than eighty per cent of the area median income for a family of one; or
- b. Is part of a family with an income of not more than eighty per cent of the area median income for a family of the same size.

The cost shall be estimated by dividing the annual tax expenditure for the exemption, exclusion, or credit for each fiscal year under review by the number of low-income residents of the State in the fiscal year. The estimate determined pursuant to this paragraph is intended to display the effect on low-income residents of the State if they directly receive, either through tax reduction or negative tax, the dollars saved by elimination of the exemption, exclusion, or credit.

Requires the director of taxation to cooperate with the auditor's request for information when the auditor conducts a review of an exemption, exclusion, or credit; provided that the director of taxation shall not disclose to the auditor any information prohibited from disclosure by law.

Amends chapters 237, 238, 239, and article 7 of chapter 431 to provide that the cost of the review shall be recovered through a charge of \$_____ on each taxpayer that benefits from an exemption, exclusion, or credit, whether or not the particular tax benefit the taxpayer is taking is scheduled for review in that year. The charge shall not exceed the exemption, exclusion, or credit. Taxpayers who are not required to file an annual return shall not be assessed a charge, even if the person benefited from an exemption, exclusion, or credit. Amends HRS section 23-3.6 to provide that the charges shall be deposited into the audit revolving fund.

EFFECTIVE DATE: July 1, 2016.

STAFF COMMENTS: Article VII, Section 3 of the Hawaii Constitution and HRS chapter 232E provide for a tax review commission to be appointed every five years. One was supposed to have been appointed in 2015, but because that didn't happen one is supposed to be appointed this year. One of the statutory objectives of the commission, as set forth in section 232E-3(a), is a review of the State's tax structure, using such standards as equity and efficiency. Exemptions, deductions, and credits directly impact equity because they by definition treat taxpayers differently depending on what the taxpayer does or doesn't do, or the type of income earned or realized by the taxpayer, so it would certainly be appropriate to task the TRC with some or all of the requested reviews. That would be more efficient than requiring the auditor to engage in the complex process of evaluation of tax exemptions, for which the auditor does not necessarily have institutional expertise (most accounting firms are divided into at least two groups, with Audit being separate from Tax; personnel in the State Auditor's office come from the former rather than the latter side of the house).

What the auditor or the commission is likely to find is that some of the items reviewed are appropriate and are required by the design of the tax system. For example, proposed section 23-D(c)(1) questions the exemptions in the GET set forth in HRS section 237-3(b), for the sale of securities, commodity futures, evidences of debt, real estate in fee simple, and dividends. Some of these exemptions derive from the structure of the GET as a tax for the privilege of carrying on business, and such types of income are commonly realized by individuals whether or not they are

in business. For this type of exemption, it is difficult to justify a surcharge against the individuals “benefited.”

In addition, it should be noted that the Department of Taxation made an initial cut of GET exemptions for which it did not believe review and specific tracking was necessary. This list is in Tax Information Release 2010-05, relating to the General Excise Tax Protection Act (Act 155, SLH 2010). The Legislature may wish to obtain information from the Department as to why this decision was made as to the items set forth in the bill. For example, item 3 on page 3 of the TIR sets forth all of the exclusions in HRS section 237-3(b), most of which were discussed in the previous paragraph.

Digested 2/6/16

Comments regarding SB 2547

It is difficult to adequately comment on the proposed rule if one has no idea of what the amount of the surcharge will be; however, the following is submitted for consideration:

Disability Provisions (237-24(13)):

1. My husband is 100% disabled and has an exemption under 237-24(13) for the long-term rental of a condo unit we own. I do not have an exemption, yet we file jointly an annual return. Why should I have to pay the surcharge when I do not claim the exemption for my half of the income?
2. Usually in the annual reconciliation (we report semi-annually), we do not have to pay an additional amount; therefore, we would be paying the surcharge only, plus the \$1.00 administrative fee that is charged for submitting the surcharge via the eFile method.
3. Hawaii needs more low-cost housing and we are providing that benefit through the long-term rental of our condo unit.

Maintenance Fees (237-24.3(2) and 237-24(16)):

1. Our AOA gets an exemption for maintenance fees paid by its members (unit owners). These fees are merely accumulated from owners to then be applied to pay for repairs, maintenance, utilities, salaries of resident managers, grounds, etc. Why should a surcharge be applied for an account that is merely established for the AOA to pay for bills and maintain the property? An individual homeowner would not be similarly charged; therefore, this is an unfair tax.

I recommend the Disability Provisions and Maintenance Fees (described above) be excluded from the required reviews as well as excluded from the requirement to pay the surcharge.

It is unclear as to whether the surcharge applies to every year a taxpayer meets the qualifications of 237- ___(a)(1) and (2) or only in the years it is being reviewed.

GLADYS SHERLEY BLODGETT
3823 Lwr Honoapiilani Rd, Apt 317
Lahaina, HI 96761-8911

TO: Members of the Committee on Ways and Means

FROM: Natalie Iwasa, CPA, CFE
Honolulu, HI 96825
808-395-3233

HEARING: 9:20 a.m. Wednesday, February 10, 2016

SUBJECT: SB 2547 Relating to Taxation (Surcharge on Credits) - **OPPOSED**

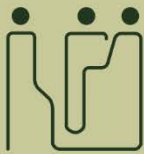
Aloha Chair Tokuda and Senators,

Thank you for allowing me to provide testimony on SB 2947, which would require reviews of certain exemptions, exclusions and credits related to the general excise/use tax, public service tax and insurance premium tax. While I think it is a good idea to review costs associated with tax benefits, I **oppose instituting a surcharge for them.**

In the preamble to the bill, it states that it is necessary to “promote tax equity and efficiency,” but this bill would not be equitable or efficient. Smaller businesses that have small credits or benefits could lose those credits entirely, while larger firms could more easily be able to absorb the additional tax as a cost of doing business.

The surcharge would add to the workload of our already overburdened tax department, which takes about four weeks to deposit tax payments. It would also make our tax system more complex, and creates a dog-chasing-its-own-tail system whereby a taxpayer has to pay a tax for the benefit of a tax credit.

Please work toward simplifying our tax laws, and please **vote “no”** on this bill.



Richard Paul McClellan III
LAWYER

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Thomas Square Centre, 846 S. Hotel Street, Suite # 308
Honolulu, HI 96813

February 8, 2016

Senator Honorable Jill N. Tokuda, Chair
Members of the Senate Committee On Ways & Means

Re: S. B. 2547
Hearing Date: 2/10/2016, 9:20 a.m.

Dear Chair Tokuda & Honorable Members:

I recommend that you reject the “surcharge” component of this measure.

Studies of the benefits and burdens of various legislatively-created exclusions and exemptions are appropriately funded through the budget process rather on a “user-fee” concept such as a surcharge.

Taxpayers will not benefit from additional complexity in tax matters that will result from this measure. This includes taxpayers that will not be required to pay a sort of surcharge.

The Department of Taxation should be asked about its ability to impose the surcharge on the rolling basis proposed by the bill, and the expense to the Department of complying with this measure.

Sincerely,

Richard McClellan