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To: The Honorable Sylvia Luke, Chair;
The Honorable Kyle T. Yamashita, Vice Chair;
and Members of the House Committee on Finance

From: Isaac W. Choy, Director
Department of Taxation

Date: Wednesday, April 6, 2022
Time: 2:45 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2379, S.D. 2, H.D. 1, Relating to the Special Enforcement Section

The Department of Taxation (Department) strongly supports S.B. 2379, S.D. 2, H.D. 1, and offers the following comments for the committee's consideration.

S.B. 2379, S.D. 2, H.D. 1, amends sections 231-81 and 231-82, Hawaii Revised Statutes (HRS), to expand and clarify the authority of the Department's Special Enforcement Section (SES), which is charged with carrying out civil tax enforcement as authorized by the Director of Taxation. The measure authorizes SES to examine any sector of Hawaii's economy and initiate civil investigations in order to ensure all taxpayers pay their fair share of taxes, and to prevent tax non-compliance through enforcement, education, and deterrence. It also empowers SES to refer cases dealing with any segment of the economy to appropriate auditors within the Department. The measure is effective upon approval.

The Department notes that the Committees on Ways and Means and Judiciary amended the previous version of this measure to replace references to specific audit branches of the Department with a reference to "appropriate auditors" within the Department, to accommodate administrative changes within the Department. The Department appreciates this change and requests that it remain intact.

Clearly delineating and codifying the SES' legal authority would greatly help the Department's efforts to ensure compliance with state tax laws and promote fairness and transparency for Hawaii's taxpayers. The Department is in strong support of this bill and is able to implement the measure as drafted.

Thank you for the opportunity to testify in support of this measure.

TAX FOUNDATION OF HAWAII

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SUBJECT: ADMINISTRATION, Powers of Special Enforcement Section

BILL NUMBER: SB 2379 HD 1

INTRODUCED BY: House Committee on Economic Development

EXECUTIVE SUMMARY: Authorizes the Special Enforcement Section of the Department of Taxation to examine any sector of Hawaii's economy, initiate civil investigations, and refer and recommend cases or examinations of segments of the economy to the auditors within the Department for auditing.

We see no need for this bill because the Department can already do these things and the Special Enforcement Section is part of the Department. The bill, rather, appears to be an artifice to pad the Department's budget through the Tax Administration Special Fund. Although other departments do that as well, this move lessens the transparency of the budgeting process and should be approached with great caution.

SYNOPSIS: Amends section 231-81, HRS, to add that the special enforcement section may examine any sector of Hawaii's economy and initiate civil investigations in order to ensure all taxpayers pay their fair share of taxes, and through enforcement, education, and deterrence prevent non-compliance with Hawaii's tax laws.

Amends section 231-82, HRS, to allow the special enforcement section to refer and recommend cases or examination of any segment of the economy to the office audit and field audit branches of the department of taxation for auditing. Repeals the priority given regarding the cash economy.

EFFECTIVE DATE: Upon Approval

STAFF COMMENTS: In our view, the "added powers" given to the special enforcement section by this bill are no different from the powers of the Department generally. It should be remembered that the Department is the dog and the special enforcement section is an appendage, like a tail. The dog wags the tail, not the other way around.

We fail to see the necessity for a bill such as this. Moreover, this bill appears to be a budgetary artifice to allow the Department to pad its budget with the Tax Administration Special Fund, which now funds the Special Enforcement Section.

The Tax Administration Special Fund was established by Act 215 of 2004, one of the major purposes of which was to rein in the High Technology Business Investment Credit, a whopping incentive for the high technology industry and others that was rapidly spiraling out of control. The thought at the time was that because the Department of Taxation was spending a lot of time issuing rulings on the applicability of the credits, the Department should be allowed to charge user fees for the rulings and thereby pay for a few more bodies to review the cases and pump out

the rulings. The special fund was enacted for that purpose. Its authorizing statute was placed in the Income Tax Law because the high technology credit was an income tax credit.

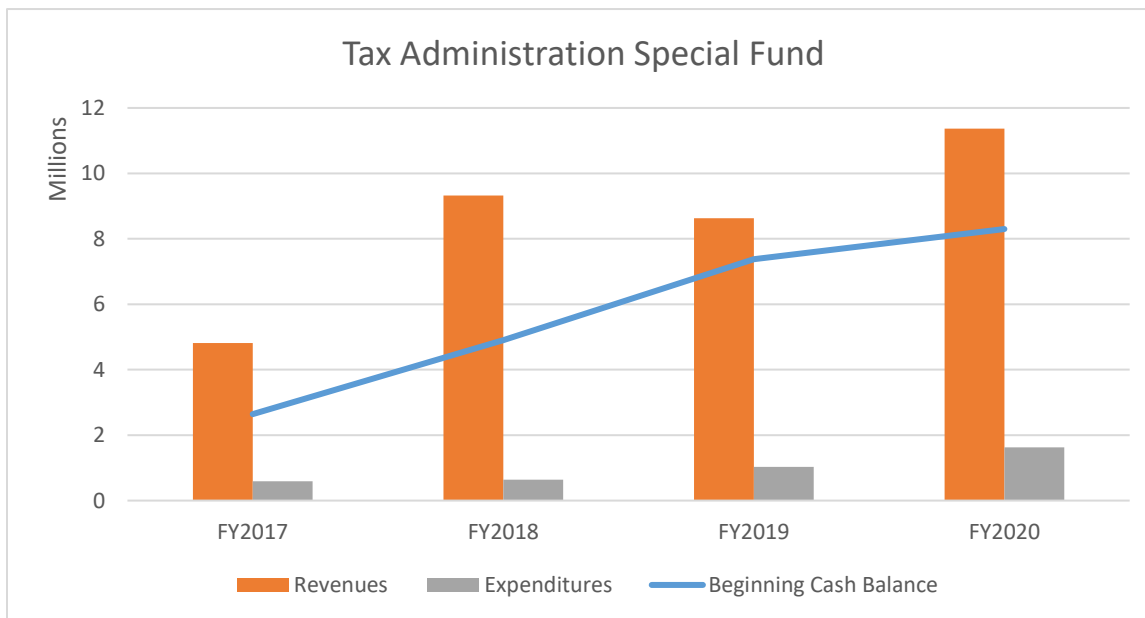
In 2009, Act 134 created a special enforcement section within the Department that was primarily targeting “cash economy” transactions, typically those where the buyer pays in cash and the seller “conveniently forgets” to pay General Excise Tax (GET). This Act amended the special fund statute so that whatever the special enforcement section brought in the door, up to \$500,000, would go to the special fund; any more would go to the general fund like most tax collections. The fund was then allowed to pay for the employees in the special enforcement section.

In 2015, Act 204 enacted new compliance requirements aimed at transient vacation rentals, such as bed and breakfast operators who “conveniently forget” to pay both GET and transient accommodations tax (TAT). The bill imposed fines upon those who failed to comply, and allowed those fines to go into the special fund.

At this point, the fund was fed by activity relating to the income tax, the GET, and the TAT, but the statute authorizing the fund remained in the Income Tax Law.

On the expense side, the Department apparently found itself with too much money in the special fund, so it asked the legislature for authority to spend the fund money on taxpayer education programs and publications. That bill breezed through the legislature and became Act 89, SLH 2014. In the meantime, different acts through the years allowed DOTAX to hoard more money and fund more positions, increasing the special enforcement section collection threshold from \$500,000 to \$700,000 (Act 204, SLH 2015) to \$2 million (Act 123, SLH 2018).

In the Office of the Auditor Report No. 17-10, the Auditor reviewed the Tax Administration Special Fund and found that its ending balance had started rising significantly, from just under \$1 million in FY2013 to \$5.7 million in FY2017. After 2017 it swelled even further:



Source: Department of Budget and Finance, Report on Non-General Fund Information for Submittal to the 2021 Legislature, available at <https://budget.hawaii.gov/wp-content/uploads/2020/12/TAX.pdf>.

In Act 87, SLH 2021, the Legislature found that this fund had accumulated significant monies in excess of its requirements and authorized raiding the fund to the tune of \$15 million.

Allowing this “slush fund” to grow further is not good policy. Tax collections, from whatever source, are government realizations under the law imposing the tax. Penalties and fines are treated as additional taxes (see, for example, section 231-39(b), HRS, providing that penalties “shall be added to and become a part of the tax imposed by such tax or revenue law, and collected as such”). These tax collections rightfully belong to the general fund. Allowing them to get swept into special funds, no matter which department, program, or service “owns” the special fund, is a subversion of the budgeting and appropriation processes. Special funds should not be allowed to spiral out of control. The fact that this fund was deemed worthy of a \$15 million raid just last year indicates that it was out of control and should be reined in, not allowed to spiral further and faster.

Digested: 4/4/2022

SB-2379-HD-1

Submitted on: 4/4/2022 2:27:22 PM

Testimony for FIN on 4/6/2022 2:45:00 PM

Submitted By	Organization	Testifier Position	Testify
Gerard Silva	Individual	Oppose	Written Testimony Only

Comments:

Taxes are illegal under the Constitution. We are not a Comunist State either!!