

Honolulu, Hawaii

MAR 19 2010

RE: H.B. No. 2877  
H.D. 1  
S.D. 1

Honorable Colleen Hanabusa  
President of the Senate  
Twenty-Fifth State Legislature  
Regular Session of 2010  
State of Hawaii

Madam:

Your Committees on Economic Development and Technology and  
Commerce and Consumer Protection, to which was referred H.B.  
No. 2877, H.D. 1, entitled:

"A BILL FOR AN ACT RELATING TO TAXATION,"

beg leave to report as follows:

The purpose of this measure is to suspend, from July 1, 2010,  
through June 30, 2015, the general excise, use, and public service  
company tax exemptions for certain amounts received by certain  
persons and, instead, require those persons to pay the applicable  
tax on those amounts at a one per cent rate.

Testimony in support of this measure was submitted by the  
Hawaii Council of Mayors; Hawaii County Council; and Hawaii  
Government Employees Association, AFSCME Local 152, AFL-CIO.  
Testimony in opposition of this measure was submitted by the  
Hawaii Housing Finance and Development Corporation; Hawaii Tourism  
Authority; Hawaii Hotel and Lodging Association; Maui Hotel and  
Lodging Association; Aloha Society of Association Executives;  
Marriott Ko Olina Beach Club Resort; Marriott International, Inc.;  
Marriott Waiohai Beach Club Resort; Wailea Beach Resort & Spa;  
Kauai Lagoons; Pono Kai Resort; Starwood Vacation Ownership; Aston  
Hotels & Resorts, LLC; Outrigger Hotels; AT&T Services, Inc.;  
Altres, Inc.; Hawaii Transportation Association; Hawaii  
Cattlemen's Council; Faith Action for Community (FACE); CTIA The  
Wireless Association; Hawaii Island Contractors Association;  
Isemoto Contracting Co. Ltd; Building Industry Association-Hawaii;



Sprint Nextel; Ship Repair Association of Hawaii; Honua Landscaping, Inc.; Hawaiian Airlines; Alexander & Baldwin, Inc.; Hawaii Credit Union League; Hawaii State Bar Association; Retail Merchants of Hawaii, American Institute of Architects - Hawaii Chapter; Wyndham Worldwide; American Resort Development Association-Hawaii; General Contractors Association of Hawaii; Gentry Homes and Gentry Builders; Hawaii Association of Independent Schools; Hawaiian Telcom, Distilled Spirits Council of the United States; Hawaii Science and Technology Council; Puko'a Scientific; ProService Hawaii; William C Loeffler Construction, Inc.; NovaSol; Land Use Research Foundation of Hawaii; Airlines Committee of Hawaii; The Queen's Health Systems; Complete Construction Service Corporation; and Subcontractors Association of Hawaii. Comments for this measure were submitted by the Department of Taxation, a member of the Hawaii County Council, Hawaii Crop Improvement Association, Hawaii Alliance of Nonprofit Organizations, Hawaii Harbors Users Group, The Chamber of Commerce of Hawaii, Hawaii Food Industry Association, Hawai'i Association of REALTORS, and Society for Human Resource Management - Hawaii Chapter.

Written testimony presented to the Committees may be reviewed on the Legislature's website.

Your Committees have heard numerous concerns regarding this measure, and have concluded that it represents a short-term financial "fix" for the State, but with significant long-term negative implications for economic recovery. The Department of Taxation estimates that this measure would raise general fund revenues of nearly \$575,000,000 over the five years of the general excise tax (GET) exemptions suspension, but that it may have serious long-term consequences.

Your Committees are particularly concerned that suspension of exemptions that were crafted to address specific industry problems will greatly impede Hawaii's economic recovery. For example, as pointed out by testifiers from the visitor industry, removal of the exemption for amounts received by hotel operators or sub operators from a hotel owner or timeshare association for employees' wages and benefits would likely lead to a restructuring of businesses. The net effect is that hotel employees will likely become employed by individual hotel owners in the future rather than by large management company systems, which would correspondingly result in fewer benefits and less stability for employees when properties change hands between hotel owners. The



purpose of granting the exemption almost twenty years ago was to protect Hawaii employees, especially when international market forces have increasingly dictated changes in hotel ownership.

Similar concerns were expressed regarding exemptions to address specific problems affecting construction, real property leases, low-income housing projects, ship repairs for defense-related industries, and other industries.

As such, your Committees have evaluated the potential tax revenue gains from this measure against the likely adverse consequences upon vital sectors of Hawaii's economy. Your Committees believe that, given the \$1,200,000,000 revenue shortfall the State faces in 2010, there are only three basic choices for the Legislature to select from:

- (1) Cut government spending - e.g., in the form of additional cuts to general-funded programs by an additional \$1,000,000,000 in the current biennium;
- (2) Modify tax credits or exemptions that affect the viability of all Hawaii business sectors - e.g., in the form of exemptions being suspended in this measure, reductions of allowable credits to eighty per cent, or impose premium taxes upon health insurance providers; or
- (3) Temporarily increase the general excise tax, the State's most broad-based tax.

Your Committees believe that, given the public outcry over government spending cuts imposed in 2009 and 2010, reducing state services by an additional \$1,000,000,000 will have permanent, devastating consequences for the State's economy. As pointed out by a recent panel of economists, deep cuts to state programs will have large multiplier effects upon the rest of the State's economy (citing a multiplier effect of 1.5-2 per cent for federal government spending cuts, *"Alternative Means of Addressing the State Budget Shortfall,"* Byron Gangnes, Ph.D, PHOCUSED Forum, Hawaii State Capitol, March 10, 2010).

Additionally, your Committees are concerned that the changes to tax credits and exemptions or new taxes imposed upon Hawaii businesses through four tax measures presently before our Committees will lead not only to business closures and job losses, but also to considerable hardships upon consumers, who will



ultimately bear increased costs in selected areas like health care services or insurance expenses, reduced access to affordable housing, or air transportation cost increases. These cost increases will, moreover, be for amounts that may be substantially higher than the levels projected for the tax exemption suspension, since smaller segments of the community will bear the cost of the changes in tax policy.

Accordingly, to provide the Senate's fiscal committee with an alternative that has not been fully evaluated with other revenue shortfall solutions in this legislative session, your Committees believe that it is appropriate to advance a proposal for a temporary increase of the State's general excise tax (GET), coupled with provisions for a state earned income tax (EITC) to reduce regressivity of the excise tax upon lower-income taxpayers for further review and debate.

Your Committees note that, among its features, the State's general excise tax possesses a broad base among Hawaii taxes; Hawaii collected almost fifty per cent of its tax revenues from the GET in 2004, whereas other states collect only about thirty-three per cent of tax revenues from their sales tax. Hawaii's rate of four per cent (with a .05 per cent transit surcharge added to the GET on Oahu sales) is among the lowest in the country. Among sales-taxing states, only Colorado has a lower rate (2.9 per cent); Hawaii's state and local rate is the lowest among sales-taxing states when the state rate is combined with the maximum local rate. At the same time, Hawaii's taxation of food and nearly all services has resulted in thirty-eight per cent of its impacts being borne by non-state residents. From a state tax policy perspective, visitors thus contribute a fair share towards the maintenance of critical state programs and services that they utilize while visiting the State.

Your Committees have therefore replaced the language in this measure with portions of the language from S.B. No. 1346, S.D. 2, and S.B. No. 790, tax measures heard during the 2009 Regular Session. As amended, this measure:

- (1) Increases the general excise tax, the use tax, and the public service company tax from four to five per cent for the period of October 1, 2010, through September 30, 2012 (Part I);

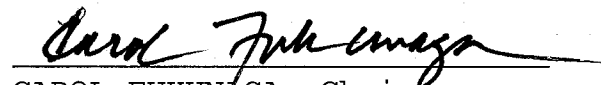


- (2) Provides a refundable state earned income tax credit equivalent to twenty per cent of the federal earned income tax credit (Part II); and
- (3) Takes effect October 1, 2010, in order to give the Department of Taxation sufficient time to prepare for collection of these tax increase.

As affirmed by the records of votes of the members of your Committees on Economic Development and Technology and Commerce and Consumer Protection that are attached to this report, your Committees are in accord with the intent and purpose of H.B. No. 2877, H.D. 1, as amended herein, and recommend that it pass Second Reading in the form attached hereto as H.B. No. 2877, H.D. 1, S.D. 1, and be referred to the Committee on Ways and Means.

Respectfully submitted on  
behalf of the members of the  
Committees on Economic  
Development and Technology and  
Commerce and Consumer  
Protection,

  
ROSALYN H. BAKER, Chair

  
CAROL FUKUNAGA, Chair



The Senate  
Twenty-Fifth Legislature  
State of Hawaii

**Record of Votes**  
**Committee on Economic Development and Technology**  
**EDT**

Bill / Resolution No.:* <b>HB 2877 HD1</b>	Committee Referral: <b>EDT/CPN, WAM</b>	Date: <b>3/16/2010</b>		
<input type="checkbox"/> The committee is reconsidering its previous decision on this measure. If so, then the previous decision was to: _____				
The Recommendation is: <div style="display: flex; justify-content: space-between; align-items: flex-start;"> <div style="text-align: center;"> <input type="checkbox"/> Pass, unamended 2312         </div> <div style="text-align: center;"> <input checked="" type="checkbox"/> Pass, with amendments 2311         </div> <div style="text-align: center;"> <input type="checkbox"/> Hold 2310         </div> <div style="text-align: center;"> <input type="checkbox"/> Recommit 2313         </div> </div>				
Members	Aye	Aye (WR)	Nay	Excused
FUKUNAGA, Carol (C)	✓			
BAKER, Rosalyn H. (VC)	✓			
HEE, Clayton				✓
IGE, David Y.	✓			
SLOM, Sam				✓
<b>TOTAL</b>	<b>3</b>			<b>2</b>
Recommendation: <div style="display: flex; justify-content: space-around; margin-top: 10px;"> <input checked="" type="checkbox"/> Adopted         <input type="checkbox"/> Not Adopted         </div>				
Chair's or Designee's Signature: <div style="text-align: center; margin-top: 10px;"> </div>				
Distribution: <div style="display: flex; justify-content: space-between; margin-top: 10px;"> <div style="text-align: center;">Original File with Committee Report</div> <div style="text-align: center;">Yellow Clerk's Office</div> <div style="text-align: center;">Pink Drafting Agency</div> <div style="text-align: center;">Goldenrod Committee File Copy</div> </div>				

\*Only one measure per Record of Votes

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**Record of Votes**  
**Committee on Commerce and Consumer Protection**  
**CPN**

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Members	Aye	Aye (WR)	Nay	Excused
BAKER, Rosalyn H. (C)	✓			
IGE, David Y. (VC)	✓			
ESPERO, Will	✓			
GREEN, M.D., Josh		✓		
IHARA, Jr., Les	✓			
SAKAMOTO, Norman	✓			
HEMMINGS, Fred				✓
TOTAL	5	1		1
Recommendation: <div style="display: flex; justify-content: space-around; margin-top: 5px;"> <input checked="" type="checkbox"/> Adopted           <input type="checkbox"/> Not Adopted         </div>				
Chair's or Designee's Signature: 				
<b>Distribution:</b> <div style="display: flex; justify-content: space-between; font-size: small;"> <div>Original File with Committee Report</div> <div>Yellow Clerk's Office</div> <div>Pink Drafting Agency</div> <div>Goldenrod Committee File Copy</div> </div>				

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