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HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS & MILITARY AFFAIRS
TESTIMONY REGARDING HB 2368
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 2, 2010
TIME: 8:30AM
ROOM: 312

This measure, among other things, increases the general excise tax by 1% for 6 years; reduces the general excise tax for certain businesses for 4 years; phases out the corporate income tax; among other changes.

The Department of Taxation (Department) supports the concept of reviewing overall tax policy; however **recommends that this bill be held for further study**.

GENERAL OPPOSITION TO TAX INCREASES—The Department opposes tax increases, especially during times when the economy is slowing and cannot handle the added financial burden. This measure seeks to increase the general excise tax. Though there are offsetting tax cuts, additional review is needed.

GENERAL SUPPORT FOR REVISITING HAWAII TAX POLICY—As a general matter, the Department supports the concept of evaluating the overall tax structure in Hawaii. There are many provisions that the Department supports in this measure, including eliminating the corporate income tax; however the changes are so broad-sweeping, the Department is reluctant to support movement of this measure without independent study of these impacts during the current economy.

LET THE TAX REVIEW COMMISSION STUDY THESE POLICIES IN LIGHT OF THE CURRENT ECONOMY—This legislative session, the Governor will be appointing members to the next Tax Review Commission. The Department suggests that this proposal be vetted by the Tax Review Commission for the overall effect of major tax policy shifts during the current economy. The Department would prefer to defer to the tax policy experts on the Commission and have the opportunity to consider further study of the issues.

L E G I S L A T I V E

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SUBJECT: INCOME, GENERAL EXCISE, Increase rate, reduce tax liability, increase food/excise tax credit; phase out corporate income taxes

BILL NUMBER: HB 2368

INTRODUCED BY: Keith-Agaran, McKelvey, Nakashima, Yamashita

BRIEF SUMMARY: **PART I:** Adds a new section to HRS chapter 237 to provide that between July 1, 2011 and June 30, 2015, the general excise tax liability of eligible businesses shall be reduced by 10%. An "eligible business" means a business: (1) that is subject to HRS chapter 237; (2) that has been located in the state for the past five or more consecutive years; (3) that is in good standing and is current with all taxes owed and other tax obligations under HRS title 14; and (4) where at least seventy-five per cent of the business' employees are residents of the state.

Amends HRS sections 237-13, 237-16.5, 237-18, 238-2, 238-2.3 to increase the general excise and use tax rate to 5% beginning on January 1, 2011 and ending on December 31, 2016.

Amends HRS section 235-55.85(b) to increase the food/excise tax credit by $15 for each income category.

This part shall be applicable to tax years beginning after December 31, 2010.

PART II: Amends HRS section 235-71 to provide that for taxable years beginning after December 31, 2010, and ending December 31, 2011, the tax on all taxable income of a corporation, regulated investment company, shareholder of a regulated investment company, and real estate investment trust, shall be at the rate of:

3.3% up to $25,000;
4.05% over $25,000 but not over $100,000; and
4.8% over $100,000.

For taxable years beginning after December 31, 2011, and ending December 31, 2012, the tax on all taxable income shall be at the rate of:

2.2% up to $25,000;
2.7% over $25,000 but not over $100,000; and
3.2% over $100,000.

For taxable year beginning after December 31, 2012, and ending December 31, 2013, the tax on all taxable income shall be at the rate of:

1.1% up to $25,000;
1.35% over $25,000 but not over $100,000; and
1.6% over $100,000.

For taxable year beginning after December 31, 2013, no tax shall be levied.

This part shall be applicable to tax years beginning after December 31, 2009.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: The proposed measure: (1) increases the general excise tax to 5% between January 1, 2011 and December 31, 2016; (2) increases the food/excise tax credit by $15 across the board; and (3) phases out the corporation income tax, and taxes on regulated investment companies, and real estate investment trusts. It appears that this measure is proposed to address the state's financial shortfall by increasing the general excise tax rate to 5% while reducing its impact on taxpayers by increasing the food/excise tax credit and reducing the general excise tax liability of eligible businesses by 10%. While the measure proposes to reduce the general excise tax liability to eligible businesses by 10%, it is questionable whether the businesses will pass along this "tax savings" to its customers.

It should also be remembered that any increase in the general excise tax rate will translate into higher prices of goods and services as evidenced by the imposition of the 0.5% surcharge on the state tax in the City and County of Honolulu that is set aside for the mass transit project. Unfortunately, this proposal reflects the lack of understanding of how insidious the general excise tax is and how pervasive its impact is on the state's economy. Often believed to be Hawaii's "sales tax," the general excise tax is imposed on each and every transaction in Hawaii and is not limited to sales for final consumption and is imposed on services as well as goods. Where the tax is imposed on purchases by business for consumption be it a mop or a display case or a filing cabinet, the cost of the tax has to be recovered in the price of the goods or services sold by that business. Thus, a hike in the general excise tax rate will be imbedded in the overhead of the business which then must be recovered in the selling prices of the goods or services sold by that business. Although it would seem that there is some tax relief as the bill reduces the amount of general excise tax due by 10% for "eligible" businesses (those who have done business in Hawaii for five or more consecutive years), but the period of the relief does not track the period during which the hike in the excise tax rate takes place. Thus, for some 198 months, businesses will pay the full freight of the higher rate. There is also the mechanics if lawmakers assume the "cost savings of 10%" will be passed on to their customers.

Even though this measure proposes to allow a reduction in the general excise tax liability, the cost of the increased tax rate will have been passed on to customers and, therefore, must be recovered in some manner. Thus, even when the rate goes back to 4%, the added cost will continue for years to come as part of the cost of the goods and services sold during that time period.

As lawmakers learned with the imposition of the transit surcharge, one cannot just make a straight line projection of the increase burden of the tax. Because the general excise tax is imposed on both goods and services and at all stages, the tax tends to pyramid even though the lesser 0.5% is imposed on sales for resale. The cost of the full retail rate applies to businesses as well as individuals on their purchases for consumption. Thus, businesses must build the added cost of the additional rate into their overhead and, therefore, it must be recovered in the cost of the goods and services they sell. The general excise tax is perhaps the worse tax to increase as far as rates because of its broad-based application. If there is any component of this bill that will drive more and more businesses out of operation and with them the jobs Hawaii's people need, it is the general excise tax.

The measure also proposes to phase-out the corporate income tax, the tax on regulated investment companies, and the tax on real estate investment trusts by December 31, 2013. While this is a recommendation by the most recent Tax Review Commission, it should be remembered that corporations in Hawaii would still need the services provided by state government so those services must be paid for by someone else. Thus, the enactment of this measure may result in an increase in individual income tax rates or other taxes to make up the loss of revenues to pay for basic services provided by government unless a commensurate reduction in spending is also undertaken. More importantly, it should be recognized that the corporate income tax is paid only when businesses realize profits. If a business makes no taxable profits, no tax is due. While it might sound attractive that Hawaii does not have a corporate income tax law, want is more telling is that Hawaii taxes the gross proceeds of a business which is imposed regardless of whether or not those sales of goods or services generate a profit. Thus, while this part of the proposal may be well intended, it reflects a lack of understanding of the difference between the gross income tax and the net income tax on businesses.

If the intent of this measure is to improve the perception of Hawaii as a place to do business, then repealing the corporate net income tax would certainly make Hawaii stand out among all the other states which impose a net income tax on corporate profits. However, it should be remembered that not all businesses pay the net income tax under HRS 235 but some pay an in-lieu tax such as the banks which pay the financial institutions tax under HRS 241 and insurance companies which pay the insurance premiums tax under HRS 431 in-lieu of the net income and general excise tax.

Digested 2/1/10

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February 1, 2010

The Honorable Angus L.K. McKelvey, Chair
House Committee on Economic Revitalization, Business & Military Affairs
State Capitol, Room 312
Honolulu, Hawaii 96813

RE: H.B. 2368 Relating to Taxation

HEARING: Tuesday, February 2, 2010 at 8:30 a.m.

Aloha Chair McKelvey, Vice Chair Choy and Members of the Committee:

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR **strongly opposes** H.B. 2368 to the extent it increases the General Excise Tax (GET) and Use Tax by 1% for 6 years.

The GET is paid by businesses. If businesses cannot pass on the increased GET to their customers, they will simply incur a greater expense and may sustain greater losses in these tough economic times.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.