

DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

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

Date: Tuesday, March 3, 2015
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 92, S.D. 1, Relating to Taxation

The Department of Taxation (Department) supports the intent of S.B. 92, S.D. 1, and offers the following comments.

S.B. 92, S.D. 1, amends section 231-3.4, Hawaii Revised Statutes (HRS), by: (1) modifying the requirement to publish a report on tax credits; (2) adding a new requirement to publish a report on certain general excise tax exemptions; and (3) repealing expired reporting requirements.

First, the Department notes that current section 231-3.4 (a) (3), HRS, broadly requires a report on tax credits. The current report includes income tax credits, as well as some other tax credits which are not income tax-related. Unless it is the Committee's intent to more narrowly focus the report to just income tax credits, the Department recommends leaving section 231-3.4 (a) (3), HRS, unamended.

Second, for consistency, the Department suggests the following amendment to section 231-3.4 (a) (2), HRS:

"§231-3.4 Publication of reports. (a) The department of taxation shall publish reports on the following:

- (1) Hawaii income patterns--individuals;
- (2) Hawaii income patterns--businesses [~~corporations, proprietorships, and partnerships~~];
- (3) Tax credits..."

Lastly, the Department supports the intent to provide a report on general excise tax exemptions as set forth in S.B. 92, S.D. 1.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Evaluation of state income tax credits and excise tax exemptions

BILL NUMBER: SB 92, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: This measure requires the department of taxation to publish reports on tax expenditures. This is a good first step toward evaluating the myriad of incentives we now have on the books.

BRIEF SUMMARY: Amends HRS section 231-3.4 to require the department of taxation to publish reports on: (1) income tax credits; and (2) general excise tax exemptions that: (a) are tax expenditures at the wholesale rate; (b) are tax expenditures at the retail rate; and (c) may be foregone opportunities to export taxes; provided that the department shall have the discretion to determine the exemptions that fit within each of the categories and shall not be required to publish reports on exemptions that do not fit into any of the categories.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The proposed measure would require the department of taxation to submit a report on income tax credits and general excise tax exemptions at both the retail and wholesale level, but the measure does not specify the time frame within which the department has to produce the report, nor does the measure provide any additional appropriations and staff to perform the additional duties.

Obviously this measure is meant to provide data that would be important in judging targeted tax incentives that now exist. When judging targeted tax incentives generally, other criteria that may be taken into account are those proposed by the 2001-2003 Tax Review Commission:

(i) *Cost-benefit studies.* Cost-benefit studies should be required prior to inaugurating new or revised tax credit programs. Policy makers should use only those programs with quantifiable and demonstrable benefits over costs. Such costs and benefits should not only look at fiscal and economic effects, but should examine social ones as well.

(ii) *Periodic evaluations* of all tax incentive programs should be required.

(iii) *Truth and disclosure reporting* separate and apart from a taxpayer's tax returns should generally be required of all taxpayers benefitting from tax incentive programs, making public all aspects of these subsidies for private investment.

(iv) *Strategic planning.* Embed tax incentives in strategic plans, leveraging as much of the State's scarce resources as possible. Rather than promoting diverse incentives in search of a cohesive strategy, the State should employ only incentives that make strategic sense.

(v) *Public participation.* Encourage public participation in and comment on tax incentive use to foster public accountability. There should at least be as much public discussion over generous multi-million dollar business incentive tax credits as there is over \$50,000 renovations to school libraries.

(vi) *Sunset provisions* should be required to ensure that the above processes will be implemented before an incentive can be extended. It should be demonstrated to the Legislature that the targeted benefit to the State was in fact received, what the tax cost of that benefit was, and whether the continuation of the tax incentive is appropriate and necessary.

(vii) *Enforcement.* Given the magnitude and the complexity of these business incentive tax credits, the small chance of audit, ambiguous statutory requirements as to what can be claimed as a credit, there must be legislative oversight of these credits. In addition, the Department of Taxation must be given sufficient resources to police these credits.

Given that these tax incentives are a back door expenditure of public dollars, the granting of these tax preferences should be subjected to the same scrutiny to which appropriation and expenditure of tax dollars are subjected. Policymakers need to consider retiring tax incentives for which there is no means by which to measure the costs (revenue loss) and the benefits (such as jobs, economic stimulation, or growth in the industry).

Although it will take resources, at the very least, the tax department should begin examining such incentives as they have a substantial impact on the revenue base and tax collections.

Digested 3/2/15