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To: The Honorable Donna Mercado Kim, Chair
and Members of the Senate Committee on Government Operations

Date: February 9, 2016
Time: 1:15 P.M.
Place: Conference Room 414, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2548, Relating toTaxation.

The Department of Taxation (Department) offers the following comments regarding S.B. 2548 for your consideration.

S.B. 2548 requires the Auditor to review certain income tax credits, exclusions, and deductions, and assesses a surcharge on taxpayers claiming those income tax credits, exclusions, and deductions to fund the audit revolving fund. S.B. 2548 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 235-116 of the Hawaii Revised Statues.

Second, S.B. 2548 provides that the surcharge of an unspecified amount per taxpayer who claims a credit 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 credit, exclusion, or deduction, when a taxpayer is claiming more than one credit, exclusion, or deduction (as opposed to a flat amount regardless of the number of credits, exclusions, or deductions claimed by the taxpayer). In addition, the bill is unclear as to whether the surcharge applies to carry-over credit claims as well (as opposed to the surcharge applying only to the initial credit claim).

Third, the Department notes that the mechanism to fund the audit revolving fund may be problematic as written in S.B. 2548. For example, if the surcharge is added to the tax liability of a taxpayer who claims a nonrefundable credit that exceeds the income tax liability for the tax year there would be no surcharge revenue as contemplated by this measure. The same result would occur if the surcharge amount was deducted from a credit, but the credit amount still exceeded the tax liability. 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.

Finally, the Department requests that the effective date be amended to taxable years beginning after December 31, 2017 to provide the Department with sufficient time to implement the form and instruction changes proposed in this measure.

Thank you for the opportunity to provide comments.

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TESTIMONY OF JAN K. YAMANE, ACTING STATE AUDITOR, ON SENATE BILL NO. 2548 RELATING TO TAXATION

Senate Committee on Government Operations

February 09, 2016

Chair Kim and Members of the Committee:

Thank you for the opportunity to offer comments on this bill. SB 2548 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 2548. I am available to answer any questions you may have.

LEGISLATIVE TAX BILL SERVICE
TAX FOUNDATION OF HAWAII
126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, FRANCHISE, Periodic Review of Exemptions, Deductions, and Credits, Surcharge on Beneficiaries of Tax Benefits

BILL NUMBER: SB 2548

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 235 and 241. 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 five years. The bill specifies the credits to be reviewed on a rolling scale. A large number, but not all, of the existing credits, exclusions, or deductions 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 credit, exclusion, or deduction for each of the previous three fiscal years;
(2) Estimate the amount of tax expenditure for the credit, exclusion, or deduction for the current fiscal year and the next two fiscal years;
(3) Determine whether the credit, exclusion, or deduction has achieved and continues to achieve the purpose for which it was enacted by the legislature;
(4) Determine whether the credit, exclusion, or deduction is necessary to promote or preserve tax equity or efficiency;
(5) If the credit, exclusion, or deduction 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 credit, exclusion, or deduction; and
   b. Comment on whether the benefit, if any, outweighs the cost of the credit, exclusion, or deduction; and
(6) Estimate the annual cost of the credit, exclusion, or deduction 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 credit, exclusion, or deduction 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 credit, exclusion, or deduction.

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

Amends chapters 235 and 241 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.

Provides that no surcharge is applicable for beneficiaries of: (1) section 235-15, credit for purchase of child passenger restraint system; (2) section 235-55.6, credit for employment-related expenses for household and dependent care services; (3) section 235-55.7, credit for a low-income household renter; and (4) section 235-55.85, credit for food and excise tax.

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-F(c)(4) questions the credit for taxes paid to another state set forth in HRS section 235-55, and is constitutionally necessary for the State to be able to tax residents on income from whatever source derived. For this type of exemption, it is difficult to justify a surcharge against the individuals "benefited."

Digested 2/8/16