# SB2695

# RELATING TO COUNTY SURCHARGE TAX

# TESTIMONY OF
# THE DEPARTMENT OF THE ATTORNEY GENERAL
# TWENTY-EIGHTH LEGISLATURE, 2016

**ON THE FOLLOWING MEASURE:**
S.B. NO. 2695, RELATING TO COUNTY SURCHARGE TAX.

**BEFORE THE:**

SENATE COMMITTEES ON TRANSPORTATION AND ENERGY AND ON PUBLIC SAFETY, INTERGOVERNMENTAL, AND MILITARY AFFAIRS

**DATE:** Thursday, February 11, 2016 **TIME:** 3:00 p.m.

**LOCATION:** State Capitol, Room 229

**TESTIFIER(S):** Douglas S. Chin, Attorney General, or
Mary Bahng Yokota, Deputy Attorney General

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Chairs Inouye and Nishihara and Members of the Committees:

The Department of the Attorney General provides the following comments.

This bill provides that the Legislature finds that the current 10 percent of the county surcharge retained by the State to reimburse the State for the costs of assessment, collection, and disposition of the county surcharge "is in excess of what is necessary" and that "[c]ollection of the surcharge shall be suspended until an audit of actual expenses incurred by the State for the collection of the county surcharge is complete." Page 1, lines 1-8. The bill proceeds to repeal section 248-2.6, Hawaii Revised Statutes (HRS), in its entirety. Page 2, line 3, through page 3, line 20.

It is unclear whether "[c]ollection of the surcharge shall be suspended" means that the collection of the county surcharge all together shall be suspended or that the retention of the 10 percent by the State shall be suspended. As written, however, the bill appears to achieve neither purpose. If the purpose of this bill is to suspend the collection of the county surcharge all together, it does not presently achieve that purpose since the county surcharge will continue to be collected under sections 237-8.6 and 238-2.6, HRS, which are not amended or repealed by this bill.

If the intent of the bill is to suspend the retention of the 10 percent of the county surcharge by the State, this bill appears to have the opposite effect. As currently drafted, this bill arguably makes ***all*** of the county surcharge collected State realization. This bill repeals section 248-2.6, HRS, which provides for more than just the 10 percent reimbursement to the State. By

repealing section 248-2.6, HRS, in its entirety, the bill deletes the statutory provisions that set forth how the county surcharge collected by the Director of Taxation is paid into the state treasury and paid to each county that has adopted the county surcharge. By repealing section 248-2.6, HRS, in its entirety, county surcharge collected under chapters 237 (general excise tax law) and 238 (use tax law) would all arguably become "state realization" under sections 237-31 and 238-14, HRS. Section 237-31, HRS, relating to general excise tax provides in part:

> **§237-31 Remittances.** All remittances of taxes imposed by this chapter shall be made by money, bank draft, check, cashier's check, money order, or certificate of deposit to the office of the department of taxation to which the return was transmitted. The department shall issue its receipts therefor to the taxpayer and *shall pay the moneys into the state treasury as a state realization*, to be kept and accounted for as provided by law . . . . [Emphasis added.]

Section 238-14, HRS, relating to use tax similarly provides:

> **§238-14 Taxes state realizations.** All taxes collected under this chapter *shall be state realizations*. [Emphasis added.]

County surcharge is a "tax" collected under chapters 237 and 238, HRS.[1]

Under this bill as currently drafted, the county surcharge will continue to be collected by the Director of Taxation and ***all*** of the county surcharge collected arguably will become State realization. If this is not the intent, this bill may not achieve its intended purpose and we recommend that the bill be clarified and/or corrected accordingly.

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[1] The Hawaii Supreme Court has defined the term "tax" as follows:

> Taxes are the enforced proportional contributions from persons and property, levied by the state by virtue of its sovereignty for the support of government, and for all public needs.
>
> Taxes are generally defined as burdens or charges imposed by legislative authority on persons or property to raise money for public purposes, or, more briefly, an imposition for the supply of the public treasury.
>
> The word taxes is very comprehensive, and properly includes, as indicated in the foregoing definition, all burdens, charges and impositions by virtue of the taxing power with the object of raising money for public purposes.

Hawaii Insurers Council v. Lingle, 120 Hawaii 51, 59-60, 201 P.3d 564, 572-73 (2008).

LEGISLATIVE TAX BILL SERVICE

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Repeal State Administrative Fee on County Surcharge

BILL NUMBER: SB 2695

INTRODUCED BY: SLOM, INOUYE, RIVIERE, Nishihara

EXECUTIVE SUMMARY: Deletes the state tax of ten per cent on county surcharge. The bill recites that it is intended to realign with a more accurate sum as determined by department of taxation audit.

BRIEF SUMMARY: Repeals HRS section 248-2.6, which is the section that presently provides for disposition of county surcharge proceeds after deduction of 10% by the State. The bill recites that collection of the surcharge shall be suspended until an audit of actual expenses incurred by the state for the collection of the county surcharge is complete.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: This bill concerns the surcharge on Hawaii General Excise Tax (GET) and Use Tax now imposed by HRS sections 237-8.6 and 238-2.6. Most of us are aware that an extra 0.5% is added to the price of most things that we in Honolulu buy or import. What not all of us are aware of, however, is that 10% of the gross collections go straight to the State's general fund. This is done because HRS section 248-2.6(a) appears to require it.

Section 248-2.6 is part of Act 247, SLH 2005, which allowed the counties to enact a surcharge upon the GET and Use Tax by ordinance. The City & County of Honolulu ("Honolulu") was the only county to do so, enacting Ordinance No. 05-027, codified at Rev. Ord. of Honolulu ("ROH") §§ 6-60.1 to 6-60.3.

The Legislature specified that the purpose of Act 247 was "to authorize counties to levy a county surcharge on state tax by ordinance to fund public transportation systems." No mention whatsoever is made of raising State general fund revenue. From the outset, however, it was apparent that there would be a large disparity between the 10% provided for and the real costs of collection. In testimony for HB 1309 (2005), the bill that became Act 247, the Department of Taxation stated that it would require a one-time appropriation of $3.6 million for hardware, software, and equipment and $2.5 million annually thereafter for recurring staffing and operational costs. At the same time, the Department estimated that a 1% surcharge in Honolulu would generate $296 million in additional revenues. Thus, a 10% "administrative fee" on a 0.5% surcharge would be expected to yield close to $15 million a year, many times the costs projected at the time.

When HB 1309 passed the Legislature, then-Governor Lingle had serious home rule concerns about the bill. News media at the time reported that she, House Speaker Calvin Say, Senate President Robert Bunda, and Mayor Mufi Hannemann agreed that the bill would become law but

that in 2006 legislation would be introduced to turn collection responsibility over to the counties enacting the surcharge. In the ensuing legislative session, the Department of Taxation sponsored a bill to do just that (HB 2420 and SB 2383 of 2006, also known as TAX-12 (2006)). The justification sheet appended to the bill, which was prepared by the Department of Taxation as the sponsoring agency, recited and described the agreement. When the 2006 session started, however, the agreement apparently fell apart; two committees in the Senate jointly heard the bill and voted to kill it. The House did not hear the bill at all.

At the time, David Shapiro, writing in the *Honolulu Advertiser* on March 15, 2006, described what went on in colorful language:

> Lost in the political tiff over who will collect the new excise tax for O'ahu rail transit is the more important matter of rectifying a $15 million-a-year gouging O'ahuans will suffer if this law isn't fixed.
>
> Gov. Linda Lingle, Mayor Mufi Hannemann and the Legislature are arguing about whether it should be the city's responsibility to collect its own tax, as Lingle wants, or the state's role, as Hannemann and the Legislature prefer.
>
> There's little talk about a 10 percent state kickback lawmakers extracted when they approved a half-cent excise tax for O'ahu transit on top of the 4 cents the state already assesses.
>
> The superfluous surcharge was supposed to disappear as part of the deal Lingle reached with legislators and Hannemann last year to allow the transit tax to become law in exchange for promises that her concerns about how the tax is collected would be addressed this year.
>
> But lawmakers discarded bills to enact the agreement before the legislative session was half over.
>
> The dispute about whether the city or the state will collect the tax is mostly politics.
>
> The greedy and ill-timed state surcharge, however, is of real consequence.
>
> Legislators claimed the state needed to take 10 percent off the top of the transit tax to cover its "administrative costs" for collecting the city's excise tax revenues.
>
> None of the money, however, was earmarked for the Department of Taxation, which would bear any administrative costs.
>
> The surcharge all goes to the general fund with no defined purpose, making it a backdoor general tax increase that lawmakers can spend on pet projects unrelated to transit.
>
> The transit tax, which takes effect next year, is expected to raise the city $150 million a year over its life of 15 years, which means the state's 10 percent vigorish would be $225 million over that period.

> Some analysts predict that the city excise tax will ultimately have to double or even triple to yield enough cash to finish the rail project — potentially increasing the state's take to more than a half-billion dollars.
>
> It's unconscionable for lawmakers to stick taxpayers with a gratuitous tax surcharge of such magnitude when the state is running a budget surplus likely to exceed $600 million next year and residents are already being battered by rising costs on all fronts.
>
> And it's grossly irresponsible to increase the immense cost of building a rail line to Leeward O'ahu by 10 percent off the bat for no good public purpose.
>
> Lawmakers are trying to cover their tracks by saying they'll now direct some of the surcharge money to the Tax Department, but it won't likely be anywhere near the total amount the state is collecting.
>
> Tax Director Kurt Kawafuchi's preliminary estimate was that it would cost his department $13.6 million over four years to collect the excise tax for the city — a fraction of the $60 million the state would reap from its surcharge during that time.
>
> And Kawafuchi's cost estimate will probably prove to be high; how much could it cost to calculate the city's fixed share of gross O'ahu excise tax receipts and deliver a check across the street?
>
> Public confidence in rail transit has been shaken by political bickering and allegations of cronyism in the award of the first transit contract.
>
> Lingle, Hannemann and the Legislature need to sit down now to hammer out an agreement that eliminates the odious surcharge and satisfies all parties that faith has been kept with the deal struck last year.
>
> We need assurances that the costliest public works project in O'ahu's history won't be used as cover for a massive siphoning of public money for other purposes.

Shapiro, "Collection Surcharge Looms as Another Tax," Honolulu Advertiser (Mar. 15, 2006) (available at http://the.honoluluadvertiser.com/–article/2006/Mar/15/op/FP603150315.html).

Collection of the county surcharge began on January 1, 2007. At that point, events began unfolding that shed light on how much (or how little) it actually costs to administer the tax.

In the General Appropriations Act of 2007, Act 213, SLH 2007, the Legislature was asked to give the Department of Taxation additional resources to administer and collect the surcharge. As explained in the Senate Ways and Means Committee report, however, those resources amounted to less than $1 million per year:

> On January 1, 2007, the Department of Taxation began collection of the county surcharge tax for the city and county of Honolulu. As a result, the Department required additional funds for its operations. Under Act 247, Session Laws of Hawaii 2005, the Department collects the surcharge on behalf of the county and in return the State retains ten per cent of the collections, to be deposited in the general fund. Because Act 247 did not provide

> positions or funds for the collection activity, an appropriation from the general fund for the Department of Taxation is necessary. Your committee provided nineteen positions and general funds of $944,312 for fiscal year 2007-2008 and $717,944 for fiscal year 2008-2009. Your Committee has included a provision requiring the Department to study and report to the Legislature during the Regular sessions of 2008 and 2009 on the totality of the additional work represented by the county surcharge collection activity.

Senate Stand. Comm. Rep. 1586 (2007). Accordingly, a proviso, section 121 of the appropriations act, was inserted to require the Department to generate such reports.

In response to the budget proviso, the Department issued two reports. Department of Taxation, Annual Report as Required by Act 213, SLH 2007, Section 121 (2007), and Department of Taxation, Annual Report as Required by Act 213, SLH 2007, Section 121 (2008). In the latter report, the Department stated that the budgeted salary for positions dedicated to surcharge collection was approximately $750,000 in FY 2008 and $700,000 in FY 2009, to which should be added a portion of the salaries of existing Compliance Division staff (audit and collection functions) amounting to about $440,000 per year. The Department also noted that its request to the 2008 Legislature for an additional $233,000 for computer support needed to administer the county surcharge tax was denied. So the costs to administer the surcharge in FY 2008 and FY 2009 were approximately $1.2 million and $1.15 million respectively. Even if the $233,000 that the Department wanted but didn't get were added, the total costs would be considerably less than the earlier projected amounts.

Over the ensuing several years, the 10% amount diverted grossly exceeded the $1.2 million per year that the Department reported, and in FY 2014 exceeded the entire budget of the Department of Taxation.

This bill proposes to address the issue by repealing the entire section disposing of the surcharge. The intent of the bill probably could be accomplished without killing the patient by amending the section surgically, such as:

> **[§248-2.6] County surcharge on state tax; disposition of proceeds.** (a) If adopted by county ordinance, all county surcharges on state tax collected by the director of taxation shall be paid into the state treasury quarterly, within ten working days after collection, and shall be placed by the director of finance in special accounts. Out of the revenues generated by county surcharges on state tax paid into each respective state treasury special account, the director of finance shall deduct [~~ten per cent of the gross proceeds of a respective county's surcharge on state tax to reimburse the State for~~] the costs of assessment, collection, and disposition of the county surcharge on state tax incurred by the State. Amounts retained shall be general fund realizations of the State.

(b) The amounts deducted for costs of assessment, collection, and disposition of county surcharges on state tax shall be withheld from payment to the counties by the State out of the county surcharges on state tax collected for the current calendar year.

(c) For the purpose of this section, the costs of assessment, collection, and disposition of the county surcharges on state tax shall include any and all costs, direct or indirect, that are deemed necessary and proper to effectively administer this section and sections 237-8.6 and 238-2.6.

(d) After the deduction and withholding of the costs under subsections (a) and (b), the director of finance shall pay the remaining balance on [~~,~~]a[~~,~~] quarterly basis to the director of finance of each county that has adopted a county surcharge on state tax under section 46-16.8. The quarterly payments shall be made after the county surcharges on state tax have been paid into the state treasury special accounts or after the disposition of any tax appeal, as the case may be. All county surcharges on state tax collected shall be distributed by the director of finance to the county in which the county surcharge on state tax is generated and shall be a general fund realization of the county, to be used for the purposes specified in section 46-16.8 by each of the counties.

Digested 2/4/16