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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Tuesday, March 21, 2017
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 713, S.D. 1, Relating to Budget Documents

The Department of Taxation (Department) appreciates the intent of S.B. 713, S.D. 1, and provides the following comments for your consideration.

S.B. 713, S.D.1, requires the Department of Budget and Finance (B&F) to include information on "tax expenditures" by kinds of taxes made in the last completed fiscal year and estimated to be made in the fiscal year in progress, in each of the next six fiscal years in the State's six-year program and financial plan and budget.

As defined in S.B. 713, S.D. 1, "tax expenditures are an exemption, deduction, credit, exclusion, or other deviation from normal tax structure, as determined by the department of taxation." It excludes amounts lost due to compromises, settlements, closing agreements, or amounts in income taxes due to conformity to provisions in the Internal Revenue Code. The measure authorizes B&F to obtain tax expenditure data from the Department and is effective on July 1, 2018.

First, the Department notes that Acts 245 and 261, Session Laws of Hawaii 2016 (Acts 245 and 261), requires the State Auditor to study certain credits, exclusions, and deductions under the income tax and financial institutions tax; and certain exemptions, exclusions, and credits under the general excise and use taxes, public service company tax, and insurance premium tax. The additional reporting required by this measure would be encompassed by the reports required by Acts 245 and 261. Because these reports overlap, the Department is willing to assume the responsibility of the reports required by Acts 245 and 261.

S.B. 100, S.D. 2, which has been referred to this Committee, proposes amendments to Acts 245 and 261. The Department requests that the S.B. 100, S.D. 2, be amended to require the Department of Taxation to prepare the tax expenditure reports that the State Auditor is required to prepare under current law.

Second, the Department notes that there are several important limitations to the data that must be considered. First, tax data is generally compiled and analyzed by tax year, not by fiscal year. Further, the Department does not start compiling the data until approximately 15 months after the close of the tax year because it is common for taxpayers to file tax returns late. This practice allows the Department to compile the most complete data possible for the tax year.

Third, it is very important to keep in mind that the revenue loss due to tax expenditures as defined in this measure cannot be equated with a revenue estimate for repealing any such tax expenditure. Changes in tax law and policy will usually elicit some kind of change in taxpayer behavior or tax planning to avoid taxation under the new law or policy. As a result, there is a great degree of uncertainty in estimating the actual change in revenue; we caution that "revenue loss" due to tax expenditures as defined in this measure may not be appropriate for the purpose of State budget planning.

Fourth, the Department notes that it already publishes information on certain tax expenditures, such as an annual report on tax credits claimed by Hawaii taxpayers (individuals, corporations, financial corporations, insurance underwriters, fiduciaries, and exempt organizations). The Department also publishes an annual report on Hawaii individual income tax statistics, which contains data on deductions and exemptions from Hawaii income taxes. However, it should be noted that most of the exemptions and deductions analyzed in this report would not be considered a tax expenditure as defined by this measure.

Fifth, the earliest available data on General Excise/Use and Transient Accommodations Tax exemptions and deductions will reflect data for tax year 2016, based on taxpayers' annual reconciliation data. We note, however, that while some the reconciliation data will be available, not all taxpayers file a reconciliation; thus, these data sets may not be complete.

Finally, the Department is able to comply with the current effective date of July 1, 2018.

Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

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

SUBJECT: MISCELLANEOUS, Add Tax Expenditures to Budget

BILL NUMBER: SB 713, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: This bill requires information on tax expenditures to be included in the budget. Such information will promote transparency and accountability.

SYNOPSIS: Amends HRS section 37-62 by adding a definition of "tax expenditures" to mean an exemption, deduction, credit, exclusion, or other deviation from normal tax structure, as determined by the department of taxation, except for: (1) amounts lost due to compromises, settlements, or closing agreements; or (2) tax expenditures that are present in Hawaii's income taxes by reason of Hawaii's conformity to provisions in the Internal Revenue Code.

Amends HRS section 37-69 to require the State's six-year financial plan to include, by kinds of taxes, the amount of tax expenditures made in the last completed fiscal year and estimated to be made in the fiscal year in progress and in each of the next six fiscal years.

Amends HRS section 37-71 to require financial summaries displaying the State's receipts and revenues to include similar information on tax expenditures to that required in section 37-69.

EFFECTIVE DATE: July 1, 2018.

STAFF COMMENTS: As aptly stated by the Center on Budget and Policy Priorities (CBPP) in a 2011 report:

> Each year states spend tens, maybe hundreds, of billions of dollars through "tax expenditures." Tax expenditures are tax credits, deductions, and exemptions that reduce state revenue. They can include everything from poverty-reducing tax credits, to middle-class benefits, to corporate subsidies. Tax expenditures cost state treasuries money in much the same way as direct spending for schools, health care, or road construction. And like direct spending, tax expenditures are a tool states can use to accomplish policy goals.
>
> There is a key difference, however, between direct spending and tax expenditures. States typically require extensive documentation of how much direct spending they do each year, and their budget processes entail evaluation of each item. Tax expenditures usually receive far less scrutiny. For the most part, policymakers do not regularly examine tax expenditures, nor do states document their effectiveness the same way they do for on-budget expenditures.
>
> This is a serious problem. Most tax expenditures are written into the tax code and thus will continue indefinitely — regardless of how costly they may become over time — unless the legislature acts to discontinue them. (Appropriated expenditures, by contrast,

> typically last only as long as the one- or two-year budget cycle.) Without information on a particular tax expenditure's costs and benefits, lawmakers cannot make an informed decision on whether its continuation is in the state's interest.
>
> More broadly, if policymakers, the media, and the general public lack information about tax expenditures, they cannot fully participate in decisions about how to allocate state resources. In fact, in many states the policy debate encompasses little more than half of the state's total expenditures because expenditures made through the tax code are not part of the conversation.
>
> A state can address this lack of transparency by regularly publishing a tax expenditure report, also called a tax expenditure budget. A tax expenditure report lists the state's tax breaks and how much each one costs, along with other relevant information that helps policymakers and others evaluate them.
>
> If properly designed and produced, a tax expenditure report makes tax expenditures more transparent by telling policymakers and the public how the state is spending its money and what it is accomplishing through those expenditures. A tax expenditure report also encourages accountability by enabling policymakers and voters to evaluate individual tax expenditures and decide whether to continue them. In addition, a tax expenditure report saves money by enabling policymakers to monitor the costs of tax expenditures and rein in their cost if necessary.

M. Leachman, D. Grundman, N. Johnson, *Promoting State Budget Accountability Through Tax Expenditure Reporting* (updated May 24, 2011) (available at http://www.cbpp.org/research/state-budget-and-tax/promoting-state-budget-accountability-through-tax-expenditure#_ftnref1). The report studies the issue in great detail and provides recommendations for budget reporting.

CBPP classified Hawaii as having a tax expenditure report, but one that omitted at least one major tax imposed by the state. The report it identified was "Report on Tax Credits Claimed by Hawaii Taxpayers," available at http://tax.hawaii.gov/stats/a5_4credits/. That report was published annually for tax years 1994 and 2005, and then resumed annual publication beginning with tax year 2011. The latest available report is for tax year 2014, which was published in December 2016.

Digested 3/17/2017

THE HAWAII STATE HOUSE OF REPRESENTATIVES
The Twenty-Ninth Legislature
Regular Session of 2017

COMMITTEE ON FINANCE
The Honorable Representative Sylvia Luke, Chair
The Honorable Representative Ty J.K. Cullen, Vice Chair

DATE OF HEARING: Tuesday, March 21, 2017
TIME OF HEARING: 2:00 p.m.
PLACE OF HEARING: State Capitol, Rm. 308
415 South Beretania Street

TESTIMONY ON SB 713, SD1 RELATING TO BUDGET DOCUMENTS

By DAYTON M. NAKANELUA,
State Director of the United Public Workers,
AFSCME Local 646, AFL-CIO ("UPW")

My name is Dayton M. Nakanelua, State Director of the United Public Workers, AFSCME, Local 646, AFL-CIO (UPW). The UPW is the exclusive bargaining representative for approximately 14,000 public employees, which include blue collar, non-supervisory employees in Bargaining Unit 01 and institutional, health and correctional employees in Bargaining Unit 10, in the State of Hawaii and various counties. The UPW also represents about 1,500 members of the private sector.

The purpose of this bill is to require the state six-year program and financial plan and budget to include information on tax expenditures including the amount of revenue lost due to tax credits, exemptions, deductions and abatements. This would promote transparency. The term "tax expenditures" does not include compromises, deductions or any exclusions in conformity with provisions of the Internal Revenue Service.

The UPW believes that this bill would establish good public policy and provide transparency in the granting of millions of dollars in tax credits. The public has the right to know whether tax credits are achieving their intended purpose.

The UPW supports this measure and asks the committee to pass it out. Thank you for the opportunity to submit this testimony.

Thank you for the opportunity to submit this testimony.

DAVID Y. IGE
GOVERNOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY
TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 713, S.D. 1

March 21, 2017
2:00 p.m.
Room 308

RELATING TO BUDGET DOCUMENTS

Senate Bill (S.B.) No. 713, S.D. 1, requires that the State six-year program and financial plan and budget include information on tax expenditures, such as the amount of revenue lost due to tax credits, exemptions, deductions, and abatements.

The Department of Budget and Finance (B&F) appreciates the intent of S.B. No. 713, S.D. 1, and offers the following comments for your consideration.

The department prepares the State's six-year program and financial plan and budget and does not anticipate problems with inclusion of Department of Taxation (TAX) prepared information on "tax expenditures" by kinds of taxes made in the last completed fiscal year, estimates for the fiscal year in progress, and estimates for each of the next six fiscal years.

B&F defers to TAX on their ability to provide the information required for the applicable period to be included in the State's six-year program and financial plan and budget document and within the timeframe necessary to meet the statutorily submittal deadline.

Thank you for your consideration of our comments.