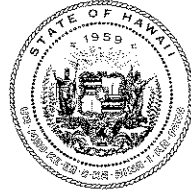


LINDA LINGLE  
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**JOINT SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION  
AND WAYS & MEANS**

**TESTIMONY REGARDING HB 1412 HD 1  
RELATING TO THE DEPARTMENT OF TAXATION'S BENEFITS-FUNDED  
REVENUE-GENERATING COMPUTER INITIATIVES**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: APRIL 2, 2008**

**TIME: 10:35AM**

**ROOM: 211**

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This bill provides for the Department of Taxation (Department) to contract with third party vendors on a benefits-funded basis to create revenue-generating initiatives that increase revenue collections, collect outstanding liabilities, expand volume capacity, and improve customer service.

The Department **supports the intent** of this proposal; however **requests budgetary amendments to ensure this measure's viability**.

**I. BENEFITS-FUNDED MEASURES, GENERALLY**

In 1996, Act 273 authorized the Department to enter into a performance-based contract to acquire the Integrated Tax Information Management System (ITIMS). A performance-based contract is one in which the State is liable to pay the vendor only if the promised "performance" is achieved. In this case, the "performance" consisted of the State collecting more tax revenue than it would have collected if the vendor's services were not used. If the expected benefits are not in fact produced, the vendor does not get paid.

As a result of Act 273, Session Laws of Hawaii, Regular Session 1996, and the incredible hard and diligent work of its staff, the Department saw an outstanding increase in performance of Department responsibilities. The Department has successfully proven its ability to increase revenues for the State general fund. The initial ITIMS initiatives were certified to have increased revenues by more than \$252 million during the five year project. This is revenue that was deposited into the State's general fund and represents a 375 percent return on investment.

For the past three legislative sessions, the Department has attempted to increase collections of delinquent tax revenues through high-tech, computer-generated initiatives. This legislation serves as

the foundation of one means of accomplishing increased revenue collection through computer-generated means.

## **II. THE DEPARTMENT NEEDS ADDITIONAL AUTHORITY TO EXPAND THE REVENUE STREAM AND ITS CURRENT DELINQUENT COLLECTIONS PROJECT.**

The Department has advised the Committee in the past about the Department's use of its existing authority in order to ensure a robust, consistent revenue stream for the State. Due to economic uncertainty for the past few months, the Department utilized its current authority to enter into a contract to identify and collect delinquent accounts.

However, the Department's delinquent collection project has limitations. The Department has narrow authority that allows the Department to pursue the assessment and collection of taxes through traditional means. The delinquent collections project, for example, does not allow the Department to explore additional "front-end" enhancements to the Department's computer-aided processes that will provide a more enhanced "customer service" experience in complying with Hawaii tax laws. To the extent the Department can invest in "front-end" improvements that allow taxpayers to be compliant upfront, this will continue to bolster the collection of Hawaii taxes in an even more consistent, efficient, and predictable manner.

The Department very much supports the implementation of additional customer service features available as a result of this legislation that the existing project will not allow. The additional customer service features include:

- 1) **Enhanced electronic filing, which minimizes the budget impact of paper, as well as processing and storage costs;**
- 2) **Enhanced electronic payment, which results in increased cash flow available for the General Fund expenditures. Electronic payment also ensures valid payment and avoids "bounced checks;"**
- 3) **Customer service experiences that will assist with compliance, such as:**
  - a. **Computer access (e.g., Internet portals of tax accounts); and**
  - b. **Online tax clearances that will free up additional resources**
- 4) **Capturing additional information and leveraging that information as a component of other delinquent projects, such as:**
  - a. **Matching important Federal data with State data;**
  - b. **Crosschecking State data with other State business data; and**
  - c. **Studying important trends in Hawaii tax law in a more time efficient manner, which will benefit the Department, the Department of Business, Economic Development & Tourism, the Council on Revenues, the Tax Review Commission, and the Legislature.**

**III. INFORMATION TECHNOLOGY MODERNIZATION EFFORTS WILL FURTHER ENHANCE REVENUE AND PROVIDE BETTER SERVICE TO TAXPAYERS AND THE STATE.**

While the initial ITIMS initiatives were of significant value to the State and its taxpayers, the Department has researched and identified additional technology initiatives that have proven to generate even more increased revenue. **These initiatives would allow the Department to accomplish the following with a likely significant return on investment:**

- 1) Expand the Department's capabilities to identify areas of additional noncompliance, beyond what the Department is currently targeting (e.g., non-filing, un-reporting, and non-payment);**
- 2) Improve collections of outstanding liabilities, beyond what the Department is currently targeting;**
- 3) Expand Department capacity to process increasing volumes of returns;**
- 4) Enhance the Department's ability to utilize Federal tax information; and**
- 5) Improve customer service capabilities to make it easier for taxpayers to comply with Hawaii Law.**

Based upon results in other States, this additional set of technology initiatives that are beyond what the Department can currently accomplish would cost \$26.0 million in vendor expenses to implement.

The Department also supports this legislation because it will last indefinitely. The prior ITIMS initiative lasted for a set period of time and had to be revisited legislatively. This legislation allows for a permanent vehicle to authorize the Department to enter into benefits-funded contracts to continuously enhance the revenue stream as the needs arise. This reality is even more important as the Department may begin considering an entire computer system overhaul in the near future due to recent technological developments that could benefit the State.

**IV. BY PERFORMANCE-BASED CONTRACTING, THE STATE BENEFITS.**

Since these new initiatives represent a significant revenue-generating potential, the Department is respectfully requesting a benefits-funded approach for the contract structure. As was the case in the five-year ITIMS project, benefits funding establishes mandatory performance targets that the vendor must achieve to be paid.

As measurable revenues attributable to the new initiatives are realized and certified, these revenues will be distributed between the ITIMS special fund and the general fund. In this way, the ITIMS special fund will provide a self-sufficient model to fund ITIMS revenue-generating initiatives and related tax processing and capacity improvements, **while providing the general fund with an estimated \$46.0 million to \$125.0 million over a five-year period. See below for detail:**

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Cumulative
Projected Gross ITIMS Benefits	4,475,000	17,700,000	29,900,000	34,900,000	37,500,000	124,475,000
Benefits Fund to Vendor	4,027,500	7,512,600	8,241,500	4,040,000	2,166,900	25,988,500
Projected Net Benefits to State General Fund	447,500	10,187,400	21,658,500	30,860,000	35,333,100	98,486,500

In order to accomplish these benefits, however, it is necessary for the legislature to appropriate a certain amount in order to initiate the benefits-funded contract.

With the current economic uncertainties facing the State, it is important that the focus of existing revenues be directed at increasing the revenue stream. Increasing the revenue stream can only come from investment in technological enhancements that provides a significant return-on-investment, as well as in the people that make the increased collection a reality.

**V. FAILURE TO RESTORE THE DEPARTMENT'S BUDGET WILL IMPACT THIS LEGISLATION AND THE DEPARTMENT'S CURRENT EFFORTS.**

This hearing provided the Department with the opportunity to advise the Legislature of the critical role the Department plays in times of economic downturn. As the one agency whose primary function is making money for the State, it is imperative to withstand economic uncertainties by investing in tax collection to ensure a robust stream for the entire State's fiscal priorities. Without money to fund an initiative, the initiative can never occur. It is the Department that assesses, collects, and enforces the tax laws to ensure the State's programs are not jeopardized in times of economic uncertainty.

**THE BUDGETS OF REVENUE-GENERATING AGENCIES SHOULD NOT BE CUT**—At this point in the session, the Department's budget is facing cuts to its divisions, including the compliance division that oversees the substantial revenues collected by the Department. The Department's budget is comprised of revenue generating positions such as auditors and collectors. The importance of departmental compliance positions is demonstrated as follows—

*Auditor IV, whose salary is budgeted at \$36,048 per year, is estimated to average \$1.5million per year in assessments.*

Funding for revenue generating agencies should not be cut due to decline in economic growth. Given current indications that Hawaii's robust economy is beginning to slow, maximizing revenue and accelerating cash deposits are equally, if not more important, than cost savings. The proposed \$1,026,979 (4%) reduction plus the reduction of six revenue-generating positions and an additional \$206,124 in related funds will have a severe impact on the Department's ability to generate, collect and expeditiously process the maximum tax revenues.

The Department respectfully requests exemption from the across the board four percent reduction and requests reinstatement of six revenue collecting positions and related funds.

**BUDGET CUTS WILL GREATLY IMPACT THE EXISTING DELINQUENT TAX COLLECTION PROJECT AND THIS MEASURE**—Full funding of the Department's base budget is needed to implement the delinquent tax collections project, which is anticipated to generate more than \$50 million in new tax revenues. Moreover, proper funding of the Department's compliance personnel is necessary to ensure this measure's viability. Without proper funding, both the current and proposed initiatives will suffer.

The delinquent tax collections project is a major initiative that was entered into **with no additional appropriation of funds**. The contract specifically stipulates that the Department is responsible for dedicating twelve (12) FTE Compliance personnel to the project. In addition, Senior Management (including the Deputy Director, Special Assistant, Division Administrators and Staff Officers), Branch Chiefs, Line Supervisors, Information Technology, Systems Administration, Tax Services and Processing and other staff will be required to support the project on a dedicated or ad-hoc basis.

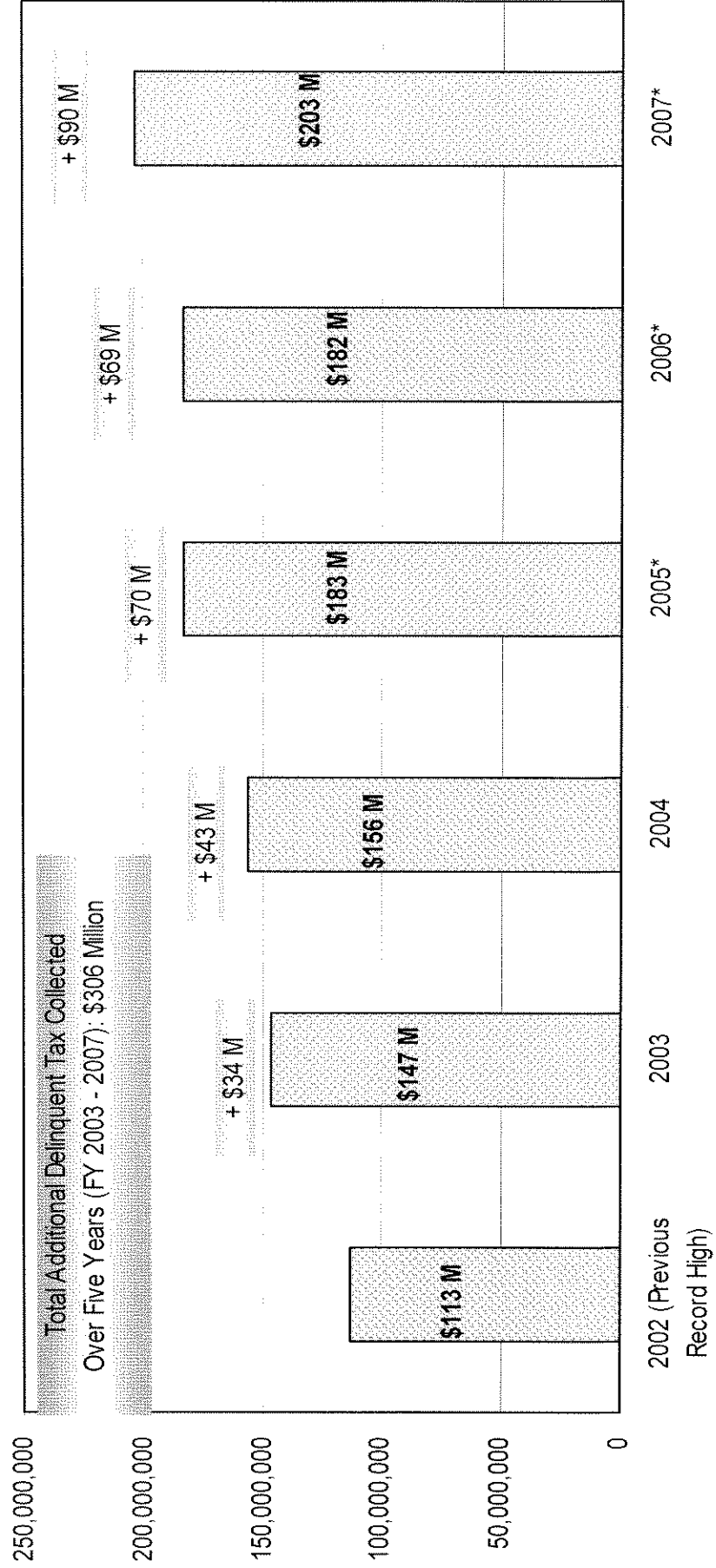
Without full funding of our base budget, it is highly probable that the Department will not be able to fulfill its contractual obligations for this project and as a result, will not be able to generate, collect and deposit in excess of \$50 million in new tax revenues.

# Department of Taxation

## Major Accomplishments

### *Delinquent Cash Collections*

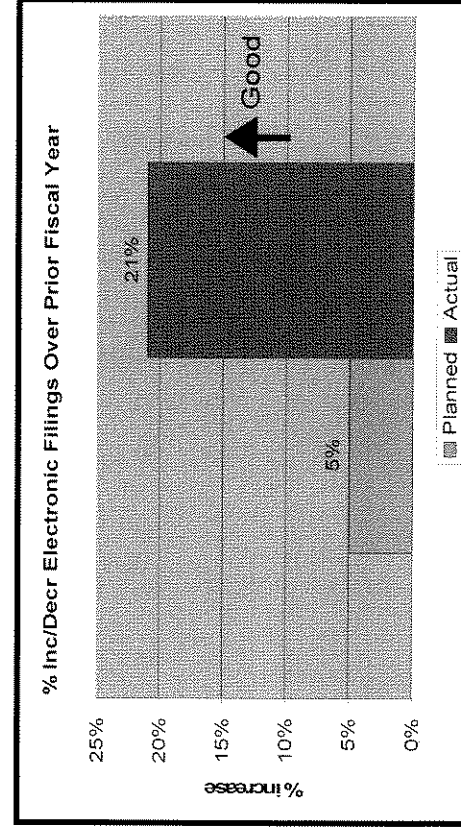
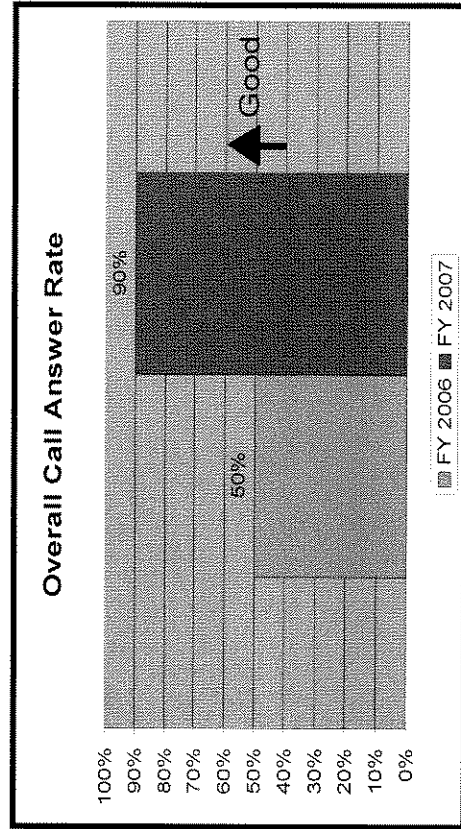
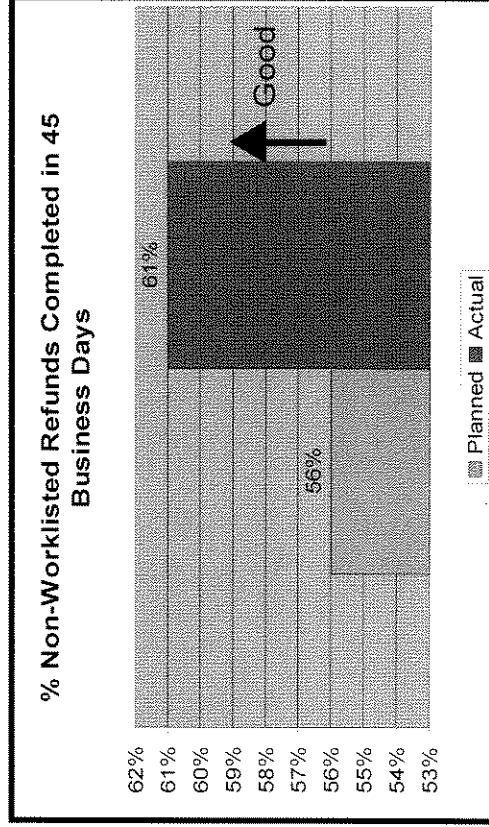
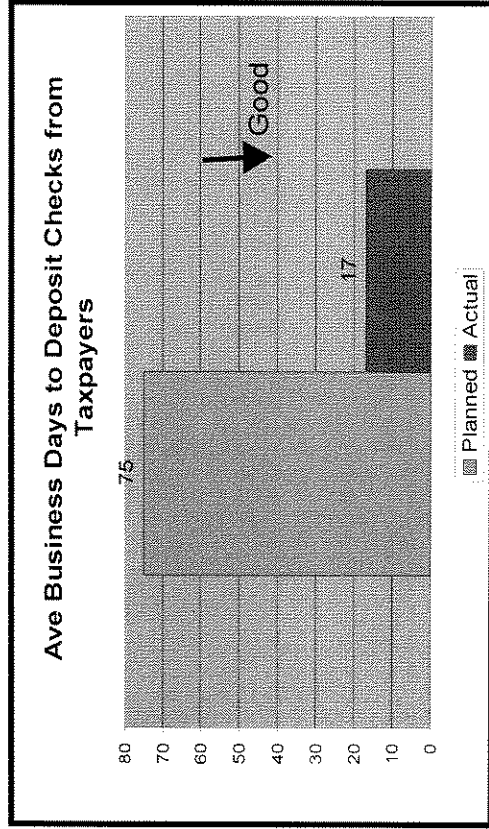
Figure 1. Delinquent Cash Collections (FY 2002 - 2007)



\*Updated as of 8/20/07

# Department of Taxation

## Improvement in Key Tax Services and Processing Metrics



# Department of Taxation

## Paper vs. Electronic Processing

Figure 4. All Income Returns Processed in  
CY 2006

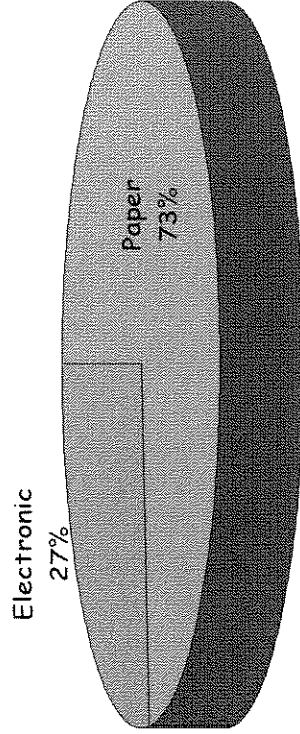


Figure 4a. All Income Returns Processed in CY  
2007

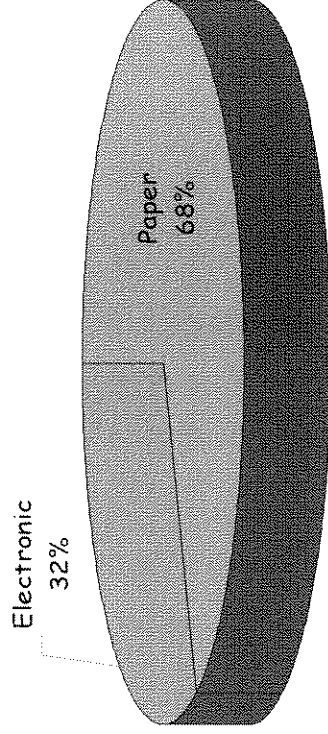


Figure 5. All Business Returns Processed in  
CY 2006

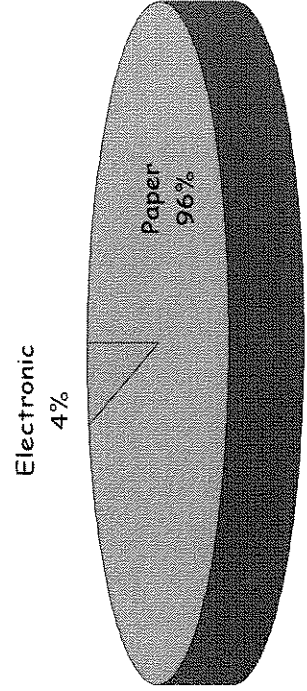
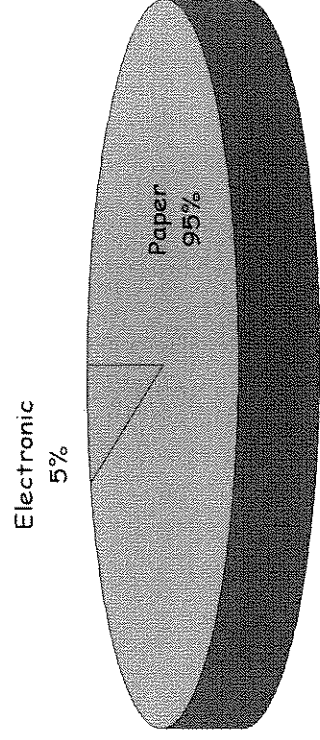


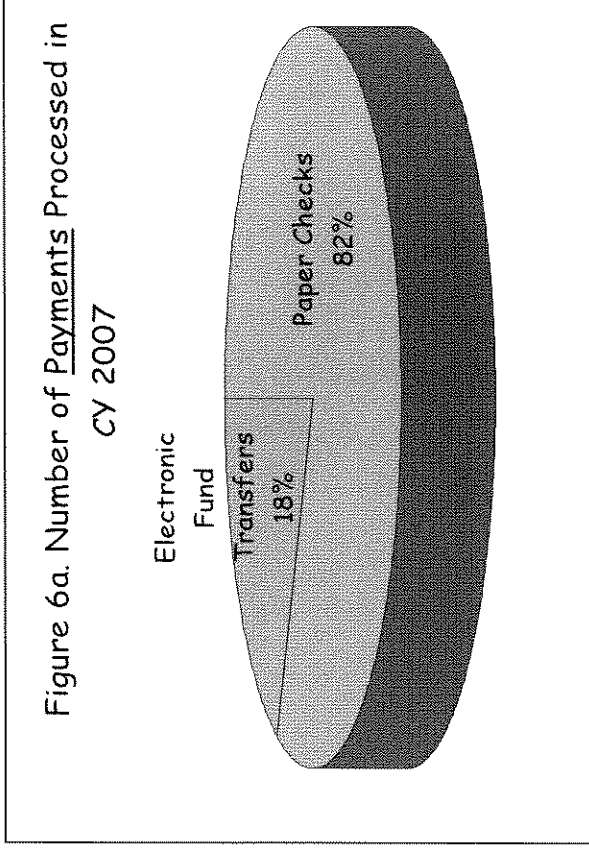
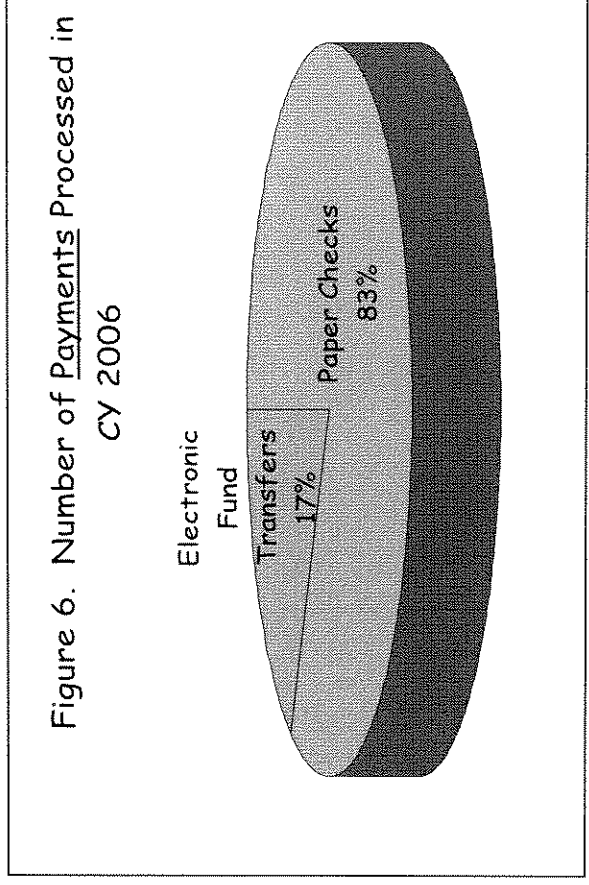
Figure 5a. All Business Returns Processed in  
CY 2007





# Department of Taxation

## Paper vs. Electronic Processing



- ▶ 21% overall increase in electronic filings.
- ▶ Majority of tax returns and payments are still filed/paid via paper which requires extensive manual labor.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** ADMINISTRATION, GENERAL EXCISE, Integrated tax management system special fund

**BILL NUMBER:** HB 1412, HD-1

**INTRODUCED BY:** House Committee on Finance

**BRIEF SUMMARY:** Adds a new section to HRS chapter 231 to establish an integrated tax information management systems special fund into which shall be deposited tax revenues provided by HRS sections 235-119, 237-31, and 238-14. Permits the director of taxation to retain and deposit the amount necessary to meet the obligations of the integrated tax information management system performance-based contracts as well as administrative and operating expenses of the management systems. All other receipts shall be deposited in the general fund.

Allows the department of taxation to enter into performance-based contracts to enhance and/or acquire automated tax systems including computer hardware and software to assist in the administration of the tax laws.

Defines "performance-based contract" for the purposes of the proposal. The department will award such contract under the procurement laws and the department shall report annually to the legislature with respect to the status of the performance-based contract and shall account for all moneys appropriated, the costs and benefits, amount of increased taxes, interest and penalties collected as a result of the integrated tax management system and amounts paid to the vendor or vendors, and any information from the preceding fiscal year.

Amends HRS 237-31 relating to the remittance of general excise taxes to provide that a sum of the receipts necessary to meet the obligations of the integrated tax information management systems performance-based contract may be retained and deposited to the credit of this special fund and the amount shall be limited to the amounts appropriated by the legislature for this project.

Makes conforming amendments to HRS sections 235-119 and 238-114.

Repeals Act 273, SLH 1996, which established an automated tax system for the department of taxation.

Exempts the new special fund from the 5% central surcharge and the pro-rata share of the department's administrative expenses under HRS sections 36-27 and 36-30.

Appropriates an unspecified sum of general funds to be deposited into the integrated tax information management systems special fund for fiscal year 2008. Appropriates an unspecified sum out of the integrated tax information management systems special fund for fiscal 2008 for purposes of the integrated management systems special fund.

This act shall not be repealed when HRS section 237-31 is reenacted on June 30, 2008 pursuant to Act 304, SLH 2006.

EFFECTIVE DATE: July 1, 2020

STAFF COMMENTS: This is an administration measure submitted by the department of taxation TAX-13(07). The proposed measure provides for the creation of the integrated tax information management systems special fund. This measure would restore the special fund that had been set up for the initial integrated tax information management contract that was to integrate the information reported on the gross income tax or general excise tax return with the information reported on the net income tax return. That performance-based contract has proven to be highly successful. Apparently, the department has learned of other initiatives implemented in other states that have also yielded very good results and wishes to embark on a second phase to update the department's technology.

Given the successful track record of the department's first project, lawmakers should give serious consideration to further modernizing the department's integrated tax information management systems. It should be recalled that a similar measure was introduced in 2006 but failed in the waning days of the session because the Senate had attached the Streamlined Sales Tax project proposal to it. As a result, the department did not have any funding mechanism with which to implement the added duties of administering and collecting the county surcharge for Honolulu.

Digested 4/1/08