

HACBED

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February 21, 2008

Senate Committee Ways and Means
Thursday, February 21, 2008 at 9:30 a.m.
CR 211
SB 2838 SD1 – Support

Dear Chair Baker and Committee Members:

The Hawai'i Alliance for Community Based Economic Development (HACBED) is submitting testimony supporting **SB 2838 SD1** that would allow state tax filers to split their state tax refund into more than one account.

Hawai'i needs a comprehensive public policy to help people build assets. This should include a package of programs, tax incentives, regulatory changes, and other mechanisms to help people earn more, save more, protect hard earned assets, start businesses and become homeowners.

Assets are essential for three reasons:

1. To have **financial security** against difficult times
2. To create **economic opportunities** for oneself
3. To **leave a legacy** for future generations to have a better life

For many households, an annual tax refund is the only opportunity to do something with a lump sum amount of cash. This is particularly the case for low-income households.

Allowing refunds to be automatically deposited into more than one account accomplishes two main public policy goals:

1. **Convenient opportunity to save** – Refund splitting allows the taxpayer to easily assign “money to save” and “money to spend” rather than receiving a check or electronically directing all of the refund into a single spending account.
2. **Encouraging asset-building** – This simple administrative adjustment shows government's commitment to encourage all people to accumulate the necessary financial assets they need.

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We feel SB 2838 SD1 is an important asset building measure for the following reasons:

- ▶ **The best and often only opportunity to save.** Research shows that an individual is more likely to make a decision to save when faced with an unusually large lump sum of money.¹ There is also less temptation to spend and a greater likelihood of saving when money is not in a person's hand.²
- ▶ **Refund splitting is a critical part in a system that encourages asset building.** Refund splitting creates a direct link between the largest pot of potential savings and financial accounts. This, along with quality tax preparation services and accessible financial products, make up a system for tax savings.
- ▶ **Research shows refund splitting encourages saving.** The D2D Fund did a pilot study in the 2004 tax season and found that those who utilized refund splitting directed an average of \$538, or 47%, of their refunds to savings. 75% of those who participated had no prior savings.³
- ▶ **The IRS has adopted refund splitting.** Based in part on the D2D findings, beginning with the 2007 tax year, the IRS will allow tax payers to split their refunds between up to three accounts
- ▶ **California has adopted refund splitting.** In July of 2006, California became the first state to allow refund splitting. The state was motivated by the fact that it has the 4th highest rate of asset poverty in the country.⁴

Thank you for your consideration.

Sincerely,

Justin Fanslau
Associate Director
HACBED

¹ Hersh M. Shefrin and Richard H. Thaler. "Mental Accounting, Saving, and Self-Control," in G. Loewenstein and J. Elster, eds., *Choice Over Time* (New York: Sage Foundation), 1992; Richard H. Thaler, "Psychology and Savings Policies," *American Economic Review* 84 (May 1994), pp. 186-92.

² http://www.phil.frb.org/cca/spring06_2.html

³ <http://www.d2dfund.org/ra/work.htm>

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Refund splitting

BILL NUMBER: SB 2838, SD-1

INTRODUCED BY: Senate Committees on Human Services and Public Housing and Economic Development and Taxation

STAFF COMMENTS: Adds a new section to HRS chapter 235 to require the department of taxation to revise its return forms to allow an individual taxpayer who files electronically to designate up to three checking or savings accounts at financial institutions for direct deposit of a taxpayer's refund.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: On the federal level, taxpayers are permitted to designate up to two or three accounts at financial institutions into which they can have their income tax refund deposited quicker than by opting to receive a check, thereby eliminating the additional processing time and resources it takes to process a paper check. On the state level, only one account may be designated.

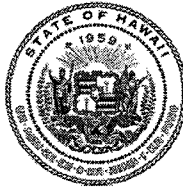
The proposed measure would require the department of taxation to revise its individual income tax forms to allow taxpayers who file their tax forms electronically to have their income tax refunds directly remitted to up to three accounts at one or more financial institutions. While this may result in more processing time by the department of taxation since routing, depositing and tracking information must be verified, the additional time it takes to process the tax refund to be deposited at more than one financial institution may be lost, thereby eliminating any advantage to utilize a direct deposit. At the federal level, in order to split the refund, an additional form must be filed thereby increasing the amount of paperwork. Thus, there is additional cost incurred for the splitting of the refund. One must ask whether or not the cost of doing so at the state level is worth the convenience.

In addition, lawmakers need to consider the liability exposure of having the department assuming the responsibility to split a refund as requested should some error occur. At this point, the only exposure is to insure the amount of the refund is correct. Should the taxpayer dispute how much went into one bank versus a savings and loan or a credit union, that would raise the exposure of the state for being held responsible for the correct split of the refund. One also has to question the personal responsibility of the taxpayer of assuming the management of his or her funds. At this point, the only thing that the state tax department should be held responsible for is a correct amount of a refund.

Digested 2/20/08

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SENATE COMMITTEE ON WAYS & MEANS

TESTIMONY REGARDING DECISION MAKING AGENDA FOR FEBRUARY 21, 2008

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

DATE: FEBRUARY 21, 2008

TIME: 9:30AM

ROOM: 211

Contained in this testimony are the Department of Taxation's (Department) comments on the Senate Committee on Ways & Means' decision-making agenda for February 21, 2008. Because each measure is before the Committee for decision-making only, the Department's comments are in summary fashion for your convenience—

I. SB 2829, SD 1, RELATING TO TAXATION (SSTP)

This bill provides implementing legislation for the Streamlined Sales & Use Tax Agreement (SSUTA).

The Department takes **no position on the merits of the SSUTA** and stands on its prior testimony submitted to the Committee on Economic Development & Taxation. However, the Department **opposes the redirection** of general excise tax receipts from the general fund to a special fund. The Department points out the following comments:

Delayed Effective Date—The delayed effective date of the bill is appreciated, but the delay may not be long enough to allow these changes to be fully integrated into the computer systems of the Department. A longer delayed effective date would give time for practitioners and businesses to adjust to these changes. Given the challenges the Department would face integrating such large, wholesale changes into its operations, longer than two years may be more realistic of a time frame. The delayed effective date would also provide time to obtain approval from the National SSTP Governing Board to assure that Hawaii's amendments conform to the SSUTA. This is very important since Hawaii's general excise tax is not a sales tax.

Frequent Changes to the SSUTA Will Require Legislative Action—The legislature needs to be aware that the SSUTA is not a static document. It has undergone substantial and frequent

changes since it was adopted on November 12, 2002. It has been amended 11 times.¹ Each change requires member States to possibly amend its law in order to remain in conformity with the SSUTA.

Revenue Impact—The bill would increase revenues by about \$10 million annually. However, joining the SSUTA would entail start-up costs and annual recurring costs. The Department is presently re-examining SSTP implementation costs. The expansion of the GET exemption for blind, deaf, and disabled taxpayers would cost about \$500,000 annually.

II. **SB 2838, SD 1, RELATING TO TAXATION (ELECTRONIC REFUND DEPOSIT)**

This legislation requires the Department to implement necessary procedures to allow e-filing taxpayers to request a direct deposit of refunds to up to three accounts. The Department has **concerns** with this legislation and provides the following comments—

Bill Must Allow Deposit Only Into Certain Accounts—The Department requests that the bill be amended to allow an electronic deposit into only those bank accounts that receive an electronic refund request at the federal level. The amendments made to this measure based upon comments by the Department rely heavily upon federal electronic tax information. If a taxpayer is allowed to insert different accounts than those provided to the IRS, this legislation could have a much greater impact on Department resources and could cost much more to implement.

Appropriation—An appropriation to finance the computer and form costs associated with this measure is necessary. At this time, the Department requests an appropriation in the amount of \$89,000 to carry out the purposes of this proposal.

III. **SB 2819, SD 1, RELATING TO INTRA-COUNTY FERRY SERVICE (Fuel Tax Exemption)**

This legislation exempts sales of fuel to an intra-county ferry service from the fuel tax. The Department takes **no position** on this legislation and offers the following comment for technical correctness

Inappropriate Statutory Placement— The current mechanics of this bill are counterintuitive and it does not make sense to include an exemption section within the assessment section of the license tax. The Department still believes that an exemption for an intra-county ferry service should be included within the current exemption section provided at HRS § 243-7.

Revenue Estimate—The Department's updated revenue estimate provided to the Committee on Economic Development & Taxation was not incorporated into its committee report, which was cited as \$13,500. This legislation will result in no impact to general fund. Highway fund annual revenue will be decreased by \$21,200, starting FY2009.

¹ November 19, 2003, November 16, 2004, April 16, 2005, October 1, 2005, January 13, 2006, April 18, 2006, August 30, 2006, December 14, 2006, June 23, 2007, September 20, 2007, and December 12, 2007

IV. SB 2816, SD 1, RELATING TO TAXATION (Foreign Trade Zone Exemption)

This legislation exempts fuel purchased from a Foreign Trade Zone by a common carrier that flies interisland from the general excise and use taxes.

The Department takes **no position** on this measure and offers one comment—

Definition of "Interstate Air Transportation"—For consistency throughout the proposal, this term should be defined as: **"Interstate air transportation" includes the transportation of passengers or property by aircraft between two points in the State."**

Revenue Impact— It is the Department's position that this legislation will result in a revenue loss of approximately:

- \$5.1 million loss, FY2009.
- \$5.3 million loss, FY2010.
- \$5.5 million loss, FY2011.

110 million gallons of fuel was sold on Oahu in FY2007. From previous estimates, it was found that approximately 55% of this was of non-exempt fuel. GE revenue from fuel was calculated to be (110 million gallons) * (55% non-exempt) * (\$2.00 / gallon) * (4.00% excise tax rate) = \$4.8 million. This was inflated for the relevant fiscal years.

V. SB 3149, SD 2, RELATING TO HIGHWAYS (Requires GET Deposit)

This legislation, among other things, requires a deposit of general excise tax revenues generated from the manufacture and sale of fuels to be deposited to the highway fund. The Department has **strong concerns** with this legislation.

GET Redirect—The Department is always cautious about policy that redirects general excise tax revenue away from the general fund and into specific special funds. The Department is concerned because the general excise tax represents over one-half of the State's overall operating revenue stream. The Department strongly prefers that a direct appropriation be the means for funding this program so that the amount may be budgeted and prioritized just as any other program.

Administrative Issues—The Department also points out that tracking the specific fuel revenues as contemplated by this measure is likely unworkable. The Department does not track the gross proceeds of sales of fuel to the extent requested in this measure. The Department would need an appropriation for computer and form enhancements, as well as additional time, in order to capture the data requested in this measure.

Revenue Estimate—This legislation will result in the following general fund losses:

- **FY2009 (loss): \$36.8 million**
- **FY2010 (loss): \$78.0 million**

- **FY2011 (loss): \$79.1 million**

The taxable gallonage from fiscal year 2007 was used to derive the excise tax receipts derived from the selling of these fuels. Note that gasoline was mostly subject to the GE exemption for alcohol-based fuels, and that oil and gas refining has a special GE exemption for multiple refineries in multi-step refining processes. The revenue impact of each fuel was calculated by:

$(\text{Gallons sold in FY07}) * [(\text{Avg retail price}) * (\text{Retail GE } \{4\% \text{ or } 0\% \}) + (\text{Avg wholesale price}) * (\text{Wholesale GE})]$. The impacts of the individual fuels were summed to get the total revenue impact.

For FY 2010 / FY 2011, the repeal of the GE exemption for ethanol-blended fuels was added to the total.

VI. SB 2455, SD 1, RELATING TO RENEWABLE ENERGY TECHNOLOGIES (Extends Credit to Hydrogen)

This legislation extends the current Renewable Energy Technologies Income Tax Credit to include hydrogen energy systems. The Department has **no additional comments** on this measure.

This bill's revenue estimate is estimated to be minimal. There is no marketed product known that would provide power via hydrogen for residential or commercial use. This leaves commercial R&D as the only probable user of the credit. However previous department rulings regarding this credit dictate that "all additions adding to an existing system shall be treated as one installation" (TIR 07-02). This minimizes the impact due to the \$35,000 limit. With the further consideration that the device must be powered by a renewable energy source, the number of adopters would probably be very low, if any.

VII. SB 2623, RELATING TO RENEWABLE ENERGY TECHNOLOGIES (Extends Credit to Solar)

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "solar electric energy systems." The Department **does not like this additional definition** and prefers that a definition in this credit focus on what is put into a machine rather than an approach based upon what the machine creates.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

VIII. SB 2764, SD 2, RELATING TO ETHANOL FACILITY TAX CREDIT (Removes Caps)

This legislation provides the Ethanol Facilities Tax Credit to large and small refineries for the first 15 million gallons of ethanol produced and eliminates certain caps. The Department of Taxation (Department) takes **no position** on this legislation.

This legislation will currently result in an indeterminate revenue estimate because the credit caps are blank. The amount of revenue loss is dependent upon the change in the annual credit limit. This is currently unspecified.

IX. SB 2986 SD 1, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT (Makes Renewable Energy Technologies Tax Credit Refundable)

This measure amends the Renewable Energy Technologies Income Tax Credit by allowing the credit to be refundable for those that have little Hawaii taxable income. The Department of Taxation (Department) **strongly supports** this Lingle-Aiona Administration measure as a policy to encourage additional investment in renewable energy technologies.

Annual revenue loss is estimated to be \$41,000, starting in fiscal year 2009.

X. SB 3215, SD 2, RELATING TO BIODIESEL (Biodiesel Production Incentives)

This legislation, among other things, provides tax incentives for biodiesel production facilities. The Department of Taxation (Department) provides **comments** on this legislation.

Income Tax Exemption—The Department notes that the income tax exemption is vague. It is unclear whether the tax exemption applies to 100% of income derived from the processing of oil seed produced in the State or to 100% of all income from any facility that processes any amount of oil seed produced in the State.

Revenue Impact—Due to the blanks, this bill will result in an indeterminate revenue loss.