Hawaii Bankers Association

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HOUSE OF
REPRESENTATIVES

Presentation to the House Committee on Consumer Protection & Commerce

Monday, January 31, 2011, at 2:00 pm

Testimony on House Bill 802 Relating to Taxation

TO: The Honorable Robert N. Herkes, Chair
The Honorable Ryan I. Yamane, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

My name is Neal Okabayashi of the Hawaii Bankers Association (HBA), and HBA opposes HB 802, which proposes to increase the tax paid by banks on income by approximately 5.0% from 7.92% to 8.32%.

In effect, this is the equivalent of repealing the banks' exemption from paying the 4.5% general excise tax, which exemption is provided in recognition of the fact that the banks' actually pay the general excise tax by paying a current franchise tax rate that is 23.75% higher than the corporate tax rate. If this bill is passed, banks will pay a tax rate that is 30% higher than the corporate rule.

Banks are essential to economic growth which acts as a rising tide which lifts all boats. Borrowings from banks are the fuel for our economic engine. The central rôle of borrowing and lending in our economy was reflected in the recent economic downturn from which we have yet to fully recover. The downturn started in the subprime lending market and spread like contagion to other borrowing sectors. A record number of banks failed in recent history, and while Hawaii banks are fortunate to have survived, an all-clear signal has yet to be given. The central economic role of the credit market (borrowing and lending) was reflected in the need for the TARP, the stress test, and the Dodd-Frank financial regulatory reform bill, all designed to strengthen and stabilize our financial system and provide protections against future systemic risk.

Actions that will further erode the economic stability of banks by increasing its tax rate to be 30% higher than the corporate rate and in effect, impose a shadow general excise tax on banks will not produce any net gain because any increase in revenue will likely be offset by a diminution in the economy.

Because of the economic crisis, there is an emphasis on increasing bank capital and establishing proper amounts of loan loss reserves. Unless a bank ventures successfully into the capital markets, increasing capital and loan loss reserves can only come from internally generated revenue. The imposition of an additional tax on such revenue is an additional roadblock to increasing capital which, serves as a safety net against losses which can endanger a bank's future, provide support for loans, and our economic future.

Every dollar of capital supports ten dollars of loan and thus, any increase in taxes hampers the ability of banks to increase capital which can support more loans. Raising taxes means less money for loans at a time the government is urging banks to lend. Thus taking money out of banks is counterproductive to our economic recovery.

Hawaii banks are also being challenged to maintain profitability but unlike other businesses, banks have also been subject to several federal initiatives which have and will reduce bank income, all to the detriment of the bank's ability to lend. Besides the impact of the need for more capital and loan loss reserves, banks are subject to the regulatory requirements of the Dodd-Frank bill which have not only increased its regulatory burden, but also the cost of compliance. Dodd-Frank contained an interchange fee cap which did not benefit consumers but only retailers. That cap will severely impact bank income. Other federal banking regulatory measures have also hurt bank fee income. The FDIC recently required that banks prepay their deposit insurance assessment for the next three years, another blow to bank income. The proposed FDIC plans for calculating deposit insurance premiums may also hurt some banks but the larger your capital basis, the less a bank will pay. So it is best for a bank to raise capital and an increased tax will hurt that effort. At a time when banks and our economy are still struggling to recover our footing, to avoid the piling on destabilizing effect, we urge you to avoid increasing the franchise tax.

We believe we pay our fair share of taxes/fees on any income we earn in contributing to Hawaii's economy and urge you not to pass this bill which would only increase the disparity between tax paying financial institutions and some of our brethren who are able to pass on any tax increase, or are less burdened by taxes.

We thank you for allow us to testify and for your consideration of this matter.

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January 31, 2011

Senator Robert N. Herkes, Chair
and members of the House Committee on Consumer Protection & Commerce
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **House Bill 802 (Taxation)**
<u>Hearing Date/Time: Monday, January 31, 2011, 2:00 P.M.</u>

I am the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is the trade association for Hawaii's financial services loan companies which make mortgage and other loans and which are regulated by the Hawaii Commissioner of Financial Institutions.

The HFSA **opposes** this Bill as drafted.

This Bill temporarily increases the tax rate for banks and other financial corporations, effective from July 1, 2011 until December 31, 2015.

The Hawaii franchise tax is paid by various financial institutions such as banks, savings and loan associations, financial services loan companies, and other entities.

Under Section 2 of this Bill, the tax would increase ten percent from 7.92% to 8.32% until December 31, 2015.

The HFSA understands Hawaii's challenging fiscal situation. However, the increase in the franchise tax and the anticipated increase in fees will financially burden Hawaii financial institutions which need to maintain capital levels and add to reserves. Any added costs of doing business in Hawaii could ultimately be passed on by the financial institutions (lenders) to Hawaii consumers (borrowers). All these increases will hinder Hawaii's economic recovery.

We incorporate by reference the testimony separately submitted by the Hawaii Bankers Association opposing this Bill.

Thank you for considering our testimony.

Marvin S.C. Dang

MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)

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HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 802 RELATING TO TAXATION

TESTIFIER:	**FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)**
COMMITTEE:	**CPC**
DATE:	**JANUARY 31, 2011**
TIME:	**2PM**
POSITION:	**COMMENTS**

This measure temporarily increases the franchise tax from 7.92% of net income, to 8.32% of net income from January 1, 2011 to December 31, 2015.

The Department of Taxation (Department) **does not oppose** the tax increase contained in this measure and **encourages that this bill be passed out of committee to further discussion**.

NOT OPPOSED TO A TAX INCREASE ON THE FINANCIAL SERVICES INDUSTRY—Given the current budget crises facing the State's general fund, the Department is not opposed to the tax increase contained in this measure.

At a time when policymakers are asking all taxpayers—whether businesses or individuals—to increase their tax burden to some degree, the banking industry should not escape consideration of a tax increase.

The franchise tax is a net income tax for the privilege of conducting banking business in Hawaii. Unlike other business taxes, the financial industry generally pays franchise tax in lieu of both income tax and general excise tax. As a net tax, financial institutions enjoy a smaller tax base than other businesses subject to both the general excise tax and net income tax.

It is fair, in the current fiscal situation facing the State, to debate increasing the taxes on this industry that enjoys a single net income tax rather than both a gross receipts and net income tax.

As such, the Department suggests that this measure be forwarded for continued debate.

REVENUE GAIN—This measure will result in the following revenue gains:

- $181,328 in FY2012,
- $140,117 in FY2013,
- $151,450 in FY2014,
- $159,178 in FY2015, and
- $86,637 in FY2016.

L E G I S L A T I V E

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SUBJECT: BANKS AND FINANCIAL INSTITUTIONS, Increase rate

BILL NUMBER: HB 802

INTRODUCED BY: Say

comments

BRIEF SUMMARY: Amends HRS section 241-4 to provide that the tax on banks and other financial institutions shall be increased from 7.92% to 8.32%, between January 1, 2011 to December 31, 2015.

Amends HRS section 241-4.3 to increase the alternative tax on banks and other financial institutions from 4% to 4.2%, between January 1, 2011 to December 31, 2015.

Amendments made by this act shall apply to the entire net income received for the calendar year preceding January 1, 2012; provided, in the case of a taxpayer operating on a fiscal year basis, the amendments made by this act shall apply to the entire net income received for the fiscal year in which January 1, 2012 occurs.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: It appears that this measure temporarily increases the tax rates on banks and other financial institutions in an attempt to generate additional revenues to address the state's financial crisis. The state needs additional revenues and the easiest thing to do is increase taxes on businesses, in this case the financial institutions are targeted. Any increase in costs to a business will, no doubt, be passed on to taxpayers in the form of higher prices of goods and services. In a down economy, taxpayers are examining their spending priorities and paring back their spending - a concept that state government has to adopt to regain control of their finances.

It should be remembered that the bank franchise tax is imposed on financial institutions in lieu of the general excise tax and corporate net income tax. When the 1990 Tax Review Commission made recommendations to restructure the Hawaii tax on banks and other financial institutions, it had intended to eliminate many of the exceptions the financial institutions enjoyed under the general excise tax so that it could bring the franchise tax rates into line with the net corporate income tax rates. However, because the banks did not want to give up their preferences under the general excise tax which were not bank unique, the rate could not be reduced to the top corporate income tax rate of 6.4%. This effort was intended to prepare Hawaii banks to be able to compete in the multi-state banks movement that was sweeping the nation at the time. Thus, consideration might be given to eliminating the general excise tax preferences and then adjusting the bank franchise tax rate in accordance with any adjustment to the corporate income tax rates.

That said, if lawmakers do not increase corporate net income tax rates or the general excise tax rate, this proposal would discriminate against these particular taxpayers with a higher tax burden than other businesses.

Digested 1/28/11