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HOUSE COMMITTEE ON FINANCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 1324, SD 2, HD 1 RELATING TO RENTAL MOTOR VEHICLE SURCHARGE TAX

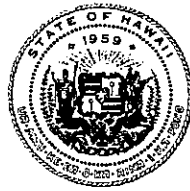
TESTIFIER: FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR
DESIGNEE)
COMMITTEE: FIN
DATE: MARCH 31, 2011
TIME: 3:00PM
POSITION: SUPPORT

This measure proposes to make the \$3 per day rental motor vehicle surcharge tax permanent.

The Department of Taxation (Department) supports this measure.

Currently, there is a rental motor vehicle surcharge of \$3 per day, which will drop to \$2 per day after August 31, 2011. Maintaining the \$3 per day rate will assist greatly with providing a consistent revenue stream for the State Highway Fund.

This measure is projected to result in a revenue gain to the Highway Fund of approximately \$11.2 million for FY 2012 and \$13.5 million for FY 2013.



STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
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March 31, 2011

TESTIMONY OF THE DEPARTMENT OF TRANSPORTATION

SENATE BILL NO. 1324, SD2, HD1

COMMITTEE ON FINANCE

Senate Bill No. 1324, SD2, HD1 will amend Section 251-2(a), Hawaii Revised Statutes, to extend the rental motor vehicle surcharge tax beyond August 31, 2011. The bill also appropriates monies out of the State Highway Fund for fiscal years 2011 - 2012 and fiscal year 2012 -2013 for the operations and maintenance of the state highways program.

Under Section 251-2(a), HRS, the vehicle surcharge tax will be reduced to \$2 per day effective September 1, 2011. The Department of Transportation (DOT) proposes to extend the \$3 per day rental vehicle surcharge beyond August 31, 2011 for the following reasons:

- The extension of this surcharge is needed to maintain the revenue stream to the State Highway Fund.
- A \$1 reduction per day will result in an approximate \$13.4 million revenue reduction that represents approximately 7% of total revenues.
- A \$13.4 million reduction in annual revenues will affect operations and routine maintenance; special maintenance; Capital Improvement Program and affect our ability to fund emergency projects.

OPERATIONS AND ROUTINE MAINTENANCE

The current needs for the routine operation and maintenance of the State Highway System is over \$115,000,000 per year. Without the additional funding, the Highways Division will not be able to properly maintain the State Highway System that is essential to the health, welfare, and safety of our motoring public. The State Highway System includes 2,479.36 miles of lane miles. Although the State has increased the lane miles of the State Highway System, the routine operation and maintenance budget was not increased to properly maintain the additional lane miles.

The funding for the routine operation and maintenance is used for maintaining and repairing the pavement and shoulders; bridges and other structures; fencing and walls; drainage systems; traffic signs; guardrails; highway pavement markings; highway lighting system; sidewalks and wheelchair ramps; landscaping and irrigation systems; cleaning the streets; and restoring State

Highways after slides, storm damages, accidents, and other catastrophic events. Additionally, operations and maintenance activities on Oahu includes a 24-hour, 7-days-a-week schedule, a traffic management center, all mechanical, electrical, electronic, plumbing and drainage, ventilation, traffic monitoring and control, fire control systems in our major tunnels; and managing and monitoring the National Pollutant Elimination System (NPDES) – Municipal Separate Storm Sewer System (MS4) Program.

Also, Federal laws require that the State maintain all State Highways that were constructed with the use of Federal funds. Not properly maintaining our highways may jeopardize our ability to obtain Federal funds.

SPECIAL MAINTENANCE PROGRAM (SMP)

In prior years, when the Highways Division has had its budget cut, the Special Maintenance Program (SMP) was reduced to keep the State Highways Fund in the black.

The Highways Division changed its resurfacing cycle for State Highways from an average of once every 10 years to once every 14 years. Studies have shown that after 10 years the pavement condition deteriorates at an accelerated rate. The overall condition of the State Highway System has deteriorated because of the reduced SMP funding and to date the department has not caught up with its resurfacing program. As the highway pavement deteriorates, the cost increases exponentially. The average cost of preventive maintenance is approximately \$98,000 to \$289,000 per lane mile (\$183,000 average), while the cost for rehabilitation and/or reconstructing the pavement ranges from \$321,000 to \$2,200,000 (\$555,000 average) per lane miles.

In the fiscal year 2005-2006, the SMP state funded budget was \$72,810,487. Due to fiscal constraints, the SMP program has been reduced as follows:

FY 2006-2007	\$67,200,407
FY 2007-2008	\$49,906,862
FY 2008-2009	\$57,577,883
FY 2009-2010	\$57,842,859
FY 2010-2011	\$55,914,860
FY 2011-2012	\$27,000,000*
FY 2012-2013	\$27,000,000*

*proposed FB 11-13 budget request.

A reduction in the Special Maintenance Program will result in a poorer overall condition of the State Highway System and the deferred maintenance significantly increases the future costs to rehabilitate and/or reconstruct our highways.

CAPITAL IMPROVEMENT PROGRAM (CIP)

The State Highway Fund supports the CIP program in the following ways:

1. Direct salary, fringe benefits, and administrative costs for 366 Highways Division project-funded positions are paid from the State Highway Fund. Since fiscal year 2005-2006, the Highways Division budgets \$12,500,000 in state funds for this purpose.

2. The State Highway Fund pays for debt service of Highway Revenue Bonds, the primary state funding source for the CIP program. Debt service includes interest and principal payments for the revenue bonds. Every two years, the Division sells approximately \$80,000,000 in revenue bonds.
3. In addition to the revenue bonds, the State Highway Fund also pays for the debt service of Reimbursable General Obligation (G.O.) bonds. Although Reimbursable G.O. bonds are no longer used by the Highways Division to finance new projects, debt service for Reimbursable G.O. bonds previously issued will continue until 2017.
4. Finally, in the event of emergencies or other unforeseen circumstances, CIP projects may be funded from the State Highway Special Fund. An example of this would be when the heavy rainfall in the months of March and April of 2006 created severe damage to highways on the islands of Kauai and Oahu. Act 118, Session Laws of Hawaii, 2006, appropriated CIP funds to pay for emergency projects. It is estimated that about \$8,171,763 in expenditures as of November of 2009 has been spent for emergency CIP projects for Oahu, and another \$4,213,963 in expenditures as of June of 2010 has been spent for Kauai emergency related CIP projects.

The reduction of the rental vehicle surcharge tax will have a negative effect on the CIP program the following ways:

1. Reductions in revenues may negatively affect the current bond rating. In 2008, the uninsured ratings for the \$60,000,000 bond offering by S&P, Moody's, and Fitch were AA+, AA3, and AA- respectively, the second and third best bond ratings possible. The strong ratings were directly attributed to the fact that revenues were in excess of 4 times the amount needed for bond debt service.
2. Any downgrade in bond ratings caused by revenue reduction will increase the cost of borrowing for the Highways Division. In fiscal year 2009-2010, approximately \$38,600,000 was paid for revenue bond debt service and approximately \$8,000,000 for Reimbursable General Obligation (G.O.R.) Bond debt service. A higher cost of borrowing may restrict the ability for the Highways Division to maintain the current annual \$40,000,000 revenue bond program and may force the Highways Division to reduce future bond offerings from the \$40,000,000 annual levels.
3. The Highways Division will be forced to defer future CIP projects if the revenue bond program is reduced. Current CIP needs outweigh revenue sources.
4. Finally, the projected depletion of the State Highway Fund caused by the revenue reduction will take away the ability for the Highways Division to fund emergency projects or other unforeseen needs with cash. As demonstrated in the past, the Highways Division was able to cope with emergency projects such as:
 - Kalaniana'ole Highway, Emergency Landslide Repairs at Castle Junction;
 - Kailua Road Rockfall Mitigation, Permanent Repairs for Kailua Road;
 - Kauai Emergency Flood Repairs at Various Locations;
 - Emergency Culvert Repair on H-1 at Olopana Street, and
 - Kalaniana'ole Highway Drainage Improvements, Vicinity of Keolu Hills (Emergency Repairs).

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: RENTAL MOTOR VEHICLE AND TOUR VEHICLE SURCHARGE, Make increase permanent

BILL NUMBER: SB 1324, HD-1

INTRODUCED BY: Senate Committee on Transportation

BRIEF SUMMARY: Amends HRS section 251-2 to repeal the provision reducing the \$3 rental motor vehicle surcharge tax to \$2 on September 1, 2011.

Appropriates an unspecified amount out of the state highway fund for fiscal 2012 and the same sum for fiscal 2013 for the operations and maintenance of the state highway program.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: This is an administration measure submitted by the department of transportation TRN-08(11). The legislature by Act 263, SLH 1991, adopted a \$2 per day tax on rental motor vehicles as part of the state administration's plan to bail out the state's ailing highway fund. This action was in contrast to a citizen's task force that had been convened in 1988 to address the looming shortfall in the state highway fund that suggested the fuel and weight tax rates be increased as well as continuing to transfer the collections of the general excise tax imposed on the sale of fuel for highway use from the general fund to the state highway fund. This latter source of revenue provided a relatively accurate gauge of highway use given the ease of administration and compliance and represented a user-based activity charge. However, by the time the issue of sustaining the highway fund garnered the attention of the legislature in 1990, there was evidence that the state's general fund finances were also in trouble following the burst of the Japanese "bubble."

Rather than beginning the process to adjust the growth of state government to available revenues, lawmakers and the administration felt it expedient to "take back" the general excise tax collected on the sale of gasoline by allowing the transfer enacted by Act 239, SLH 1985, to lapse. Given the deleterious impact the lapsing of this transfer of general excise tax revenues may have had on the highway fund and the politically difficult challenge of raising the fuel tax on gasoline, lawmakers devised the rental motor vehicle/tour vehicle surcharge tax which was enacted with Act 263, SLH 1991. Aimed primarily at visitors, the attempt was intended to make this segment of the de facto population pay a larger share of the cost of maintaining the highways. It also allowed lawmakers to avoid raising the tax on gasoline even higher than the additional five cents they adopted with the 1991 legislation.

Since the early 1980's a number of citizens' task forces have been convened to evaluate the fiscal viability of the state highway fund. In all cases, these task forces came to the conclusion that the state motor vehicle tax, fuel and weight taxes would periodically have to be increased because the per unit taxes used to fund the state highway program were based on consumption and are not inflation sensitive like the costs of repairing and maintaining the highway system.

The failing fiscal health of the state became very apparent by 1999 after the legislature began raiding the fund to pay for general fund programs. Over the years since this began, more than \$155 million was taken from the highway fund to keep general fund programs running. The then administration revealed the projected failure of the state highway fund when it submitted its budget in 1999 which forecast that the state highway fund would be in the red to the tune of more than \$70 million by the end of fiscal year 2003. But opportunity also struck that session when the rental car industry sought approval to show out the multitude of fees and user charges imposed by the state on the industry and for concessions at the airports. In return, the industry agreed to a temporary seven-year increase in the per day rental car fee going from \$2 per day to \$3 per day. This deal is embodied in Act 223, SLH 1999, which increased the amount of the surcharge to \$3 between 11/1/99 to 8/31/07. Act 258, SLH 2007, extended the 8/31/07 sunset date to 8/31/08. The legislature by Act 226, SLH 2008, extended the sunset date to August 31, 2011. This measure proposes that the rental motor vehicle and tour vehicle surcharge shall be permanently set at \$3 per day.

Obviously keeping the burden on non-voting visitors is politically driven especially in the wake of public complaints about the high cost of motor fuel in Hawaii. But is it necessarily the most accountable approach or for that matter transparent? Is this bill doing nothing more than hiding, if not forestalling, the problems facing the state highway fund? Does it perpetuate the inefficiencies that are inherent in a program that is entirely special-fund financed where the majority of the beneficiaries are not being asked to shoulder their fair share of the cost of operating this program?

What would highway users say if, indeed, the fuel tax rates were increased to cover the forecasted shortfalls? Would they demand more accountability from highway officials for the repair and maintenance of the state roads? Would they ask more often why highway users are being asked to pay for so much when so little seems to be done to keep the roadways in good repair? Administration officials and lawmakers may think that visitors will not notice because it is a continuance of the rate that was adopted in 1999, but what will happen when the surcharge doesn't keep up with costs and a substantial hike will be needed in the fuel tax rate regardless of these strategies?

If, indeed, the highway fund is in dire straits, then the money that was taken to supplement the general fund in the 1990's should be returned. Further, small incremental increases in the fuel tax should be undertaken to ease the burden of taxes that will be needed over time to keep the fund solvent. Consideration might be given to reestablishing the transfer of general excise taxes collected on the sale of fuel for highway use to the highway fund as those taxes are paid by highway users. While the \$3 per day rental surcharge may still be needed to balance the fund, it by no means should be the only source to be tapped as it merely postpones the day of reckoning. It should be remembered that unlike the other resources of the state highway fund, the fortunes of the motor vehicle surcharge are highly dependent on the utilization of rental cars which in turn is dependent on the fortunes of the visitor industry and the number of those visitors electing to rent those vehicles. Thus, the motor vehicle rental surcharge is the least reliable of those revenue resources available to the state highway fund.

Digested 3/29/11