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

Date: Wednesday, February 19, 2014
Time: 2:00 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 1764, Relating to The Department of Taxation

The Department of Taxation (Department) appreciates the intent of the H.B. 1764, but is not able to comply with the requirements set forth in the bill.

H.B. 1764 requires the Department to: (1) conduct a study to evaluate the costs and benefits of major state income and excise tax incentives; and (2) submit to the Legislature a report of its findings and recommendations, including any proposed legislation, not later than twenty days prior to the convening of the regular session of 2015. This measure, if adopted, will take effect upon its approval.

The Department's Tax Research and Planning (TRP) Office provides the estimated revenue impact that legislation may have on state revenues utilizing tax collection data. A study of the costs and benefits of tax incentives is not a similar type of analysis and the Department does not have the expertise necessary to generate such a study. For this reason, the Department is unable to comply with the requirements of this bill.

The Department appreciates the Legislature's desire to better understand the cost of tax incentives. However, the Department's ability to provide more and better data collection information is largely impacted by the reporting limitations of our current computer system and our current staffing levels. Extensive resources would need to be expended to increase the reporting capabilities of the computer system; instead, the Department believes it would be more efficient and cost effective to focus on the development of the data reporting functionality for the Tax System Modernization project.

Thank you for the opportunity to provide comments.



TAXBILLSERVICE

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SUBJECT: ADMINISTRATION, Evaluation of state income and excise tax incentives

BILL NUMBER: HB 1764

INTRODUCED BY: Evans and 1 Democrat

BRIEF SUMMARY: Requires the department of taxation to conduct a study to develop a systematic approach to evaluate the costs and benefits of major state income and excise tax incentives. The study shall include the following: (1) an inventory of the major state income and excise tax incentives; (2) the current methodologies used to evaluate the costs and benefits of those major state income and excise tax incentives; (3) the results of evaluations employing current methodologies; (4) recommendations for effective methodologies for future evaluations; and (5) any other issue that the department may deem informative for an understanding of the matter.

Requires the department shall submit a report of its findings and recommendations to the 2015 legislature.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The proposed measure would require the department of taxation to evaluate the major income and general excise tax incentives with the focus on their cost and benefits. While the measure directs the department to conduct a study to develop a systematic approach for the evaluation and requires the department to submit a report of its findings to the 2015 legislature, it is questionable whether the department would be able to complete its evaluation within the allotted time period.

When judging targeted tax incentives, we recommend that the department consider the criteria proposed by the 2001-2003 Tax Review Commission:

(i) *Cost-benefit studies.* Cost-benefit studies should be required prior to inaugurating new or revised tax credit programs. Policy makers should use only those programs with quantifiable and demonstrable benefits over costs. Such costs and benefits should not only look at fiscal and economic effects, but should examine social ones as well.

(ii) *Periodic evaluations* of all tax incentive programs should be required.

(iii) *Truth and disclosure reporting* separate and apart from a taxpayer's tax returns should generally be required of all taxpayers benefitting from tax incentive programs, making public all aspects of these subsidies for private investment.

(iv) *Strategic planning.* Embed tax incentives in strategic plans, leveraging as much of the State's scarce resources as possible. Rather than promoting diverse incentives in search of a cohesive strategy, the State should employ only incentives that make strategic sense.



HB 1764 - Continued

(v) *Public participation.* Encourage public participation in and comment on tax incentive use to foster public accountability. There should at least be as much public discussion over generous multi-million dollar business incentive tax credits as there is over \$50,000 renovations to school libraries.

(vi) *Sunset provisions* should be required to ensure that the above processes will be implemented before an incentive can be extended. It should be demonstrated to the Legislature that the targeted benefit to the State was in fact received, what the tax cost of that benefit was, and whether the continuation of the tax incentive is appropriate and necessary.

(vii) *Enforcement.* Given the magnitude and the complexity of these business incentive tax credits, the small chance of audit, ambiguous statutory requirements as to what can be claimed as a credit, there must be legislative oversight of these credits. In addition, the Department of Taxation must be given sufficient resources to police these credits.

Given that these tax incentives are a back door expenditure of public dollars, the granting of these tax preferences should be subjected to the same scrutiny to which appropriation and expenditure of tax dollars are subjected. How can policymakers justify the establishment of such tax incentives when there is no means by which to measure the costs (revenue loss) and the benefits (such as jobs, economic stimulation, or growth in the industry)? Although it will take resources, at the very least, the tax department should begin examining such incentives as they have a substantial impact on the revenue base and tax collections.

Digested 2/18/14