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DEPARTMENT OF BUDGET AND FINANCE
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN COMMENTS
TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 713
SENATE BILL NO. 712
SENATE BILL NO. 722
SENATE BILL NO. 724

February 3, 2017
9:30 a.m.
Room 211

SB 713 -- RELATING TO BUDGET DOCUMENTS
SB 712 -- RELATING TO VARIENCE REPORT
SB 722 -- RELATING TO EFFICIENCY MEASURES
SB 724 -- RELATING TO NON-DISCRETIONARY COSTS

The Department of Budget and Finance appreciates the intent of these measures and offers the following comments.

Senate Bill No.713 requires the state six-year program and financial plan and budget include information on tax expenditures, meaning the amount of revenue lost due to tax credits, exemptions, deductions, and abatements.

Senate Bill No.712 requires the annual variance report to include additional information comparing the means of financing for actual expenditures versus budgeted amounts and the status of budgeted positions appropriated in position ceilings.

Senate Bill No.722 requests the director of finance to work with various state departments to determine if inclusion of efficiency measure data in budget documents, may be prepared, collected, and analyzed by the department of budget and finance in a cost-effective manner.

Senate Bill No.724 requires the department of budget and finance to report certain data on non-discretionary costs, to provide alternative views of the burden of non-discretionary costs on the general fund.

All of these measures propose to amend or add new reporting requirements to Part IV, the Executive Budget Act, which was first enacted in 1970. If the legislature is asserting that this information is critical to the development and execution of the state budget, we would encourage a broader discussion. While it appears that there have been various reports by legislative research agencies about public finance and taxation, we could find no recent studies evaluating the Executive Budget Act itself, particularly whether it meets the current needs of either the legislative or the executive branches of government. We would welcome a continuing dialogue with the legislature about an evaluation of Part IV and based upon that evaluation, a collaboration between the branches that would result in a budget development and execution framework that serves the needs of both branches.

Thank you for your consideration of our testimony.

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To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: Friday, February 3, 2017
Time: 9:30 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 713, Relating to Budget Documents

The Department of Taxation (Department) appreciates the intent of S.B. 713 and provides the following comments for your consideration.

S.B. 713 requires the Department of Budget and Finance (B&F) to include information on "tax expenditures" by kinds of taxes made in the last completed fiscal year and estimated to be made in the fiscal year in progress, in each of the next six fiscal years in the State's six-year program and financial plan and budget. As defined in S.B. 713, "tax expenditures" are *the amount of revenue lost due to tax credits, exemptions, deductions, and abatements*. It excludes amounts lost due to compromises, settlements, closing agreements, or amounts in income taxes due to conformity to provisions in the Internal Revenue Code. The measure authorizes B&F to obtain tax expenditure data from the Department and is effective on July 1, 2018.

The Department notes that there are several important limitations to the data that must be considered. First, tax data is generally compiled and analyzed by tax year, not by fiscal year. Further, because it is common for taxpayers to file tax returns late, the Department does not start compiling the data until approximately 15 months after the close of the tax year. This practice allows the Department to compile the most complete data possible for the tax year.

Second, it is very important to keep in mind that the revenue loss due to tax expenditure as proposed in this measure cannot be equated with a revenue estimate of repealing any such tax expenditure. Changes in tax law and policy will usually elicit some kind of change in taxpayer behavior or tax planning to avoid the taxation under the new law or policy. We caution that the “revenue loss” as defined in this measure is subject to a great degree of uncertainty, and may not be appropriate for the purpose of State budget planning.

Currently, the Department is able to produce information on certain tax expenditures such as an annual report on tax credits claimed by Hawaii taxpayers (individuals, corporations, financial corporations, insurance underwriters, fiduciaries, and exempt organizations). The Department also produces an annual report on Hawaii individual income tax statistics that provides data on deductions and exemptions from Hawaii income taxes. However, most of the exemptions and deductions analyzed in this report would not be considered a tax expenditure as defined by this measure.

The data available for deductions from federal adjusted gross income (AGI) are: (1) pensions taxed at the federal-level, but not taxed by Hawaii; (2) Social Security benefits taxed on federal returns; (3) the first $6,198 of military reserve or Hawaii National Guard duty pay; (4) payments to an individual housing account; (5) exceptional trees deduction; and (6) other Hawaii subtractions from federal adjusted gross income.

The data available for itemized deductions are: (1) medical and dental expenses; (2) taxes paid; (3) interest expense; (4) contributions; (5) casualty and theft losses; and (6) miscellaneous deductions. The individual income tax report is generated based on tax year data.

Data available on deductions for corporate income tax are: (1) returns and allowances; (2) cost of goods sold; and (3) total deductions. In the past, the Department produced a report on Hawaii corporate income patterns every few years.

Fourth, the earliest available data on General Excise/Use and Transient Accommodations Tax exemptions and deductions will be for tax year 2016 based on annual reconciliation data. We note, however, that while some the reconciliation data will be available, not all taxpayers file a reconciliation, thus, these data sets may not be complete.

Fifth, with respect to certain other miscellaneous tax types where the tax return information is not captured, such as banks and other financial institutions, the Department does not have readily available data on exemptions and deductions claimed.

Lastly, other information such as uncollectible tax write-offs are reflected in the Department's annual report to the Governor.

Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Add Tax Expenditures to Budget

BILL NUMBER: SB 713

INTRODUCED BY: TOKUDA

EXECUTIVE SUMMARY: This bill requires information on tax expenditures to be included in the budget. Such information will promote transparency and accountability.

BRIEF SUMMARY: Amends HRS section 37-62 by adding a definition of "tax expenditures" to mean the amount of revenue lost due to tax credits, exemptions, deductions, and abatements, except for: (1) amounts lost due to compromises, settlements, or closing agreements; or (2) tax expenditures that are present in Hawaii's income taxes by reason of Hawaii's conformity to provisions in the Internal Revenue Code.

Amends HRS section 37-69 to require the State's six-year financial plan to include, by kinds of taxes, the amount of tax expenditures made in the last completed fiscal year and estimated to be made in the fiscal year in progress and in each of the next six fiscal years.

Amends HRS section 37-71 to require financial summaries displaying the State's receipts and revenues to include similar information on tax expenditures to that required in section 37-69.

EFFECTIVE DATE: July 1, 2018.

STAFF COMMENTS: As aptly stated by the Center on Budget and Policy Priorities in a 2011 report:

> Each year states spend tens, maybe hundreds, of billions of dollars through "tax expenditures." Tax expenditures are tax credits, deductions, and exemptions that reduce state revenue. They can include everything from poverty-reducing tax credits, to middle-class benefits, to corporate subsidies. Tax expenditures cost state treasuries money in much the same way as direct spending for schools, health care, or road construction. And like direct spending, tax expenditures are a tool states can use to accomplish policy goals.
>
> There is a key difference, however, between direct spending and tax expenditures. States typically require extensive documentation of how much direct spending they do each year, and their budget processes entail evaluation of each item. Tax expenditures usually receive far less scrutiny. For the most part, policymakers do not regularly examine tax expenditures, nor do states document their effectiveness the same way they do for on-budget expenditures.
>
> This is a serious problem. Most tax expenditures are written into the tax code and thus will continue indefinitely — regardless of how costly they may become over time — unless the legislature acts to discontinue them. (Appropriated expenditures, by contrast,

> typically last only as long as the one- or two-year budget cycle.) Without information on a particular tax expenditure's costs and benefits, lawmakers cannot make an informed decision on whether its continuation is in the state's interest.
>
> More broadly, if policymakers, the media, and the general public lack information about tax expenditures, they cannot fully participate in decisions about how to allocate state resources. In fact, in many states the policy debate encompasses little more than half of the state's total expenditures because expenditures made through the tax code are not part of the conversation.
>
> A state can address this lack of transparency by regularly publishing a tax expenditure report, also called a tax expenditure budget. A tax expenditure report lists the state's tax breaks and how much each one costs, along with other relevant information that helps policymakers and others evaluate them.
>
> If properly designed and produced, a tax expenditure report makes tax expenditures more transparent by telling policymakers and the public how the state is spending its money and what it is accomplishing through those expenditures. A tax expenditure report also encourages accountability by enabling policymakers and voters to evaluate individual tax expenditures and decide whether to continue them. In addition, a tax expenditure report saves money by enabling policymakers to monitor the costs of tax expenditures and rein in their cost if necessary.

M. Leachman, D. Grundman, N. Johnson, *Promoting State Budget Accountability Through Tax Expenditure Reporting* (updated May 24, 2011) (available at http://www.cbpp.org/research/state-budget-and-tax/promoting-state-budget-accountability-through-tax-expenditure#_ftnref1). The report studies the issue in great detail and provides recommendations for budget reporting.

CBPP classified Hawaii as having a tax expenditure report, but one that omitted at least one major tax imposed by the state. The report it identified was "Report on Tax Credits Claimed by Hawaii Taxpayers," available at http://tax.hawaii.gov/stats/a5_4credits/. That report was published annually for tax years 1994 and 2005, and then resumed annual publication beginning with tax year 2011. The latest available report is for tax year 2014, which was published in December 2016.

Digested 1/30/2017