

DAVID Y. IGE
GOVERNOR

DOUGLAS S. CHIN
LIEUTENANT GOVERNOR



LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

**STATE OF HAWAII
DEPARTMENT OF TAXATION**

830 PUNCHBOWL STREET, ROOM 221
HONOLULU, HAWAII 96813

<http://tax.hawaii.gov/>
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

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

Date: Friday February 23, 2018
Time: 12:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2011, H.D. 1, Relating to Transient Accommodations Tax

The Department of Taxation (Department) offers the following comments on H.B. 2011, H.D. 1, for the committee's consideration.

H.B. 2011, H.D. 1, increases the ceiling on revenues collected by the Department's Special Enforcement Section (SES) that are retained in the Tax Administration Special Fund from \$700,000 to \$1,000,000. This measure also requires that the first \$300,000 deposited into the Tax Administration Special Fund be deposited into a separate account to be used exclusively by the SES for enforcement of the transient accommodations tax (TAT). H.D. 1 has a defective effective date of July 1, 2050.

The Department notes that SES is funded solely through the share of its tax collections that are deposited into the special fund, therefore, this proposed increase is effectively a budget increase for SES. SES contributes significantly to the Department's compliance efforts, especially in TAT enforcement and in promoting voluntary compliance. Since its inception, SES has consistently generated tax revenue in excess of its budget. In FY2017, SES generated approximately \$9 for every \$1 expended. These results can be improved upon with the increase in budget proposed by this bill. For these reasons, the Department supports the intent of the bill to increase SES's budget.

However, the Department has concerns regarding the earmarking of funds specifically for TAT enforcement. The Department notes that SES is already sharply focused on TAT. Approximately 50% of SES's time and resources is currently devoted to TAT enforcement projects. Because such a share of SES resources is already being used for TAT enforcement, the Department believes the proposed separate account for TAT enforcement will only complicate the special fund without affecting the actual use of resources. Therefore, the Department believes the separate account is unnecessary.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Increase Limit on Revenues Deposited into Tax Administration Special Fund

BILL NUMBER: HB 2011, HD-1

INTRODUCED BY: House Committee on Tourism

EXECUTIVE SUMMARY: Allows the Department of Taxation to pocket more money that it collects, and to spend it without legislative or other oversight.

SYNOPSIS: Amends section 235-20.5, HRS, to provide that all revenues collected by the department of taxation's special enforcement section (described in section 231-81, HRS) in excess of \$1 million shall be deposited into the general fund. The previous ceiling was \$700,000.

Of the revenues collected by the department of taxation's special enforcement section, the first \$300,000 of revenues shall be deposited into a separate account. Monies in that account shall be used for operations of the special enforcement section that pertain exclusively the enforcement of the transient accommodations tax law.

EFFECTIVE DATE: July 1, 2050.

STAFF COMMENTS: In early November 2017, the State Auditor issued Report 17-10, which reviewed special, revolving, and trust funds administered by the Department of Taxation. One of them is the Tax Administration Special Fund, which, although not an area of concern for the auditor, is becoming an all-purpose slush fund for which corrective action is needed.

The Tax Administration Special Fund was established by Act 215 of 2004, one of the major purposes of which was to rein in the High Technology Business Investment Credit, a whopping incentive for the high technology industry and others that was rapidly spiraling out of control. The thought at the time was that because the Department of Taxation was spending a lot of time issuing rulings on the applicability of the credits, the Department would be allowed to charge user fees for the rulings and thereby pay for a few more bodies to review the cases and pump out the rulings. The special fund was enacted for that purpose. Its authorizing statute was placed in the Income Tax Law because the high technology credit was an income tax credit.

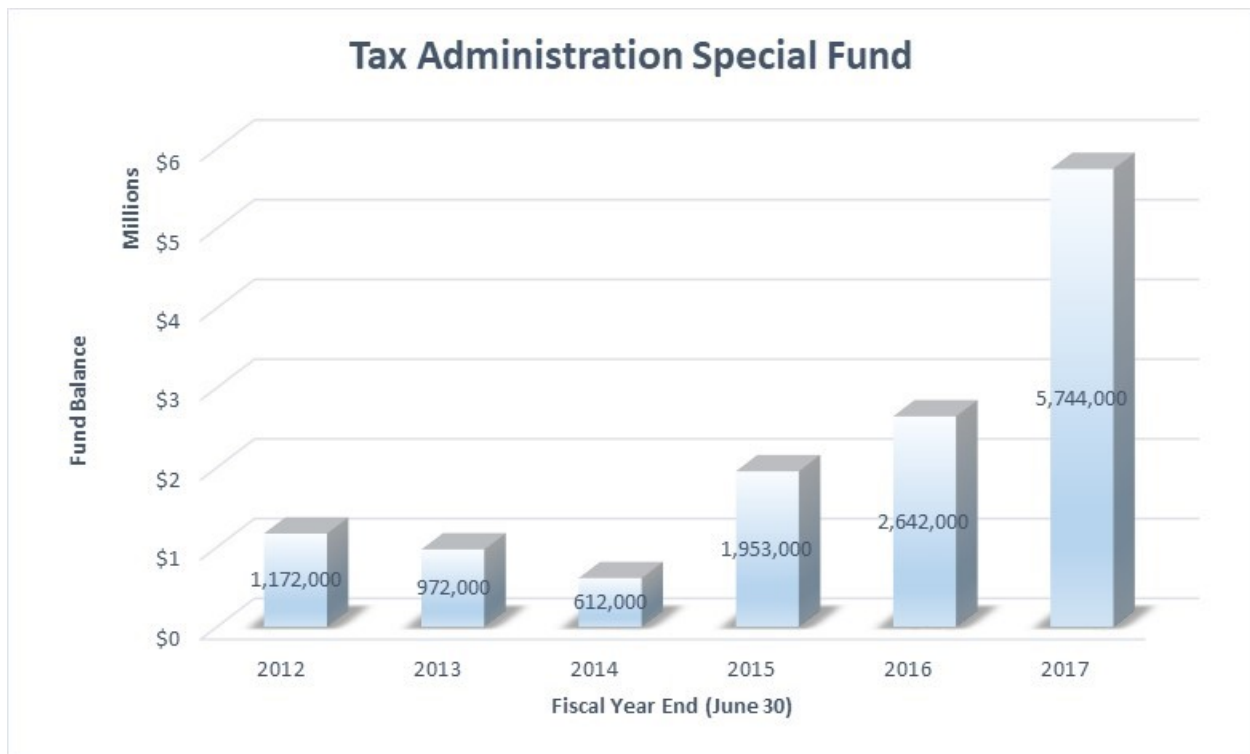
In 2009, Act 134 created a special enforcement section within the Department that was primarily targeting "cash economy" transactions, typically those where the buyer pays in cash and the seller "conveniently forgets" to pay General Excise Tax (GET). This Act amended the special fund statute so that whatever the special enforcement section brought in the door, up to \$500,000, would go to the special fund; any more would go to the general fund like most tax collections. The fund was then allowed to pay for the employees in the special enforcement section.

In 2015, Act 204 enacted new compliance requirements aimed at transient vacation rentals, such as bed and breakfast operators who “conveniently forget” to pay both GET and transient accommodations tax (TAT). The act imposed fines upon those who failed to comply, and allowed those fines to go into the special fund.

At this point, the fund was fed by activity relating to the income tax, the GET, and the TAT, but the statute authorizing the fund remained in the Income Tax Law.

On the expense side, the Department apparently found itself with too much money in the special fund, so it asked the legislature for authority to spend the fund money on taxpayer education programs and publications. That bill breezed through the legislature and became Act 89 of 2014.

Even with this extra spending authority, the fund has ballooned in recent years:



Source: Office of the Auditor, Report 17-10 (2017).

The lion’s share of the State’s tax revenue goes to the general fund. The expenses of collecting that revenue should therefore be paid by the general fund. Giving any agency a special fund allows it to spend money while bypassing legislative oversight. Moreover, when fines and penalties are channeled directly into a special fund out of which tax collectors are paid, it incentivizes those collectors to penalize people to maximize its revenue, when the Department should be administering the revenue laws equitably and fairly.

For similar reasons, the Foundation raised concerns about a bill sponsored by the Department of Public Safety in 2016 that proposed to scoop any fines raised from violations of the State drug laws. That department wanted to drop those fines into their special fund so they could hire more

enforcement personnel. We said that wasn't a good way to fund government operations. Thankfully, the Conference Committee snipped out that provision from the final version of the bill.

This year, the Department of Labor and Industrial Relations is sponsoring an Administration bill, LBR-01 (18), to pocket the penalties and civil fines it collects, and the Foundation will raise these same issues there as well.

The facts and figures in the Auditor's report highlight these concerns. The Tax Administration Special Fund, originally intended to hold a few hundred thousand dollars, has grown to \$5.7 million in just a few years. Why? Has the bloodlust to collect fines and penalties taken over at the Department? The Department is given statutory powers that can and do ruin businesses and lives, and, under HRS section 662-15(2), the Department is absolutely immune from liability for erroneous, intentional, or even fraudulent misuse of those powers. So, there are very good reasons why we need the Department to act responsibly. We need to give the Department adequate resources to do its job, but a slush fund should be out of the question.

Digested 2/21/2018