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

WRITTEN ONLY
TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON PUBLIC SAFETY,
INTERGOVERNMENTAL, AND MILITARY AFFAIRS
ON
SENATE BILL NO. 938

January 31, 2017
1:15 p.m.
Room 229

RELATING TO REIMBURSEMENTS TO THE STATE FOR THE COSTS OF
ASSESSMENT, COLLECTION, AND DISPOSITION OF THE COUNTY
SURCHARGE ON STATE TAX

Senate Bill No. 938 repeals the requirement that the Director of Finance deduct 10% of the gross proceeds of a respective county's surcharge on state tax to reimburse the State for the cost of assessment, collection, and disposition of the county surcharge on State tax incurred by the State.

The Department of Budget and Finance supports the general intent of the bill. This will help the City and County of Honolulu to address the rail project's funding needs.

**HONOLULU CITY COUNCIL
CITY AND COUNTY OF HONOLULU**

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Ron Menor
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IKAIKA ANDERSON
VICE CHAIR

Kymerly Marcos Pine
FLOOR LEADER

**CITY AND COUNTY OF HONOLULU
BEFORE THE SENATE COMMITTEE ON PUBLIC SAFETY,
INTERGOVERNMENTAL, AND MILITARY AFFAIRS**

TUESDAY, JANUARY 31, 2017, 1:15 PM

**TO: THE HONORABLE CLARENCE K. NISHIHARA, CHAIR
THE HONORABLE GLENN WAKAI, VICE CHAIR
AND MEMBERS OF THE SENATE COMMITTEE ON PUBLIC SAFETY**

**FROM: COUNCIL CHAIR RON MENOR
COUNCILMEMBER JOEY MANAHAN, CHAIR OF COMMITTEE ON
BUDGET
COUNCILMEMBER IKAIKA ANDERSON, CHAIR OF COMMITTEE ON
TRANSPORTATION AND PLANNING
COUNCILMEMBER KYMBERLY MARCOS PINE, CHAIR OF COMMITTEE
ON ZONING AND HOUSING**

**SUBJECT: COMMENTS ON S.B.938, RELATING TO REIMBURSEMENTS TO THE
STATE FOR THE COSTS OF ASSESSMENT, COLLECTION, AND
DISPOSITION OF THE COUNTY SURCHARGE ON STATE TAX.**

My name is Ron Menor, and I am here to testify as the Chair of the Honolulu City Council.

Along with Councilmembers Joey Manahan, Ikaika Anderson, and Kymerly Marcos Pine, we are members of a Permitted Interaction Group (P.I.G.) which was established by the Council to address the rail issue. We are offering testimony in support of the INTENT of this measure which is to generate additional revenue to cover future anticipated costs of the Honolulu Rail Transit Project.

S.B. 938 would repeal the requirement that the Director of Finance deduct ten percent of the gross proceeds of a respective County's surcharge on state excise tax to reimburse the State for various costs. Under this bill, the City is estimated to receive approximately \$300,000,000

over the next ten years.

However, this amount would not be adequate to fully fund the construction and financing costs to complete rail according to the original alignment and design under the Full Funding Grant Agreement (FFGA) with the Federal Transit Administration (FTA). According to HART estimates, the total construction costs of completing rail to Ala Moana are \$8.2 billion not including the debt service costs.

The City Council respectfully requests that the Legislature pass legislation to extend the County surcharge in perpetuity. The Council's position in this regard is reflected in Council Resolution 16-248, CD1, FD1 which was unanimously adopted by the Council on December 1, 2016. The permanent extension of the county surcharge would provide a stable and broad-based source of funding to ensure that the rail project effectively addresses the transportation needs of residents while contributing to positive economic growth and development on our island.

Thank you for the opportunity to offer testimony on this measure.



IN REPLY REFER TO:
CMS-AP00-01965

HONOLULU AUTHORITY for RAPID TRANSPORTATION

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**SENATE COMMITTEE ON PUBLIC SAFETY,
INTERGOVERNMENTAL,
AND MILITARY AFFAIRS**

Tuesday, January 31, 2017
1:15 p.m.
State Capitol, Conference Room 229

The Honolulu Authority for Rapid Transportation (HART) **supports the intent** of **Senate Bill 938**, which proposes to repeal the requirement that the Director of Finance deduct 10 percent of the gross proceeds of a respective county's surcharge on State tax to reimburse the State for the costs of assessment, collection and disposition of the county surcharge on State tax incurred by the State.

While HART favors and supports legislative measures which seek to explore revenues sources resulting in an increase of funding levels for the construction of the Honolulu Rail Transit Project (Project), HART believes extending the surcharge on State general excise and use tax (GET) beyond the sunset date of December 31, 2027, is the best option to achieve our immediate goal of meeting the City's obligations under the Full Funding Grant Agreement to complete this Project.

HART estimates that the cost to complete construction of the Project will be \$8.2 billion, not including finance charges. Consequently, financing the Project through the issuance of bonds will be in addition to the \$8.2 billion in capital project cost. HART further supports an extension of the surcharge in perpetuity to complete construction and to pay the additional financing costs into the future. The surcharge provides a consistent, broad-based source of funding, as well as providing our Federal partners the confidence in Honolulu's ability and financial commitment to complete the Project.

Thank you for this opportunity to provide written testimony.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Repeal 10% Skim Off County Surcharge

BILL NUMBER: SB 938

INTRODUCED BY: Kouchi by request

EXECUTIVE SUMMARY: A contributing factor to the financial woes of the City and County of Honolulu is the fact that the state is siphoning 10% of all rail surcharge collections into the general fund. This diversion was supposed to represent payment to the state for the costs incurred in administering the surcharge, but the amount diverted turns is a massive amount of money, roughly \$25 million a year which is almost as much as the entire operating budget of the department of taxation. The amount is obviously far in excess of the costs involved. The Foundation has contended that a diversion of the City and County's revenue of that magnitude is unconstitutional and its lawsuit is still pending in the court system. This bill eliminates the 10% diversion.

BRIEF SUMMARY: Amends HRS section 248-2.6 to repeal the provisions requiring the State to collect and keep 10% of the gross amount of county surcharge collected under HRS sections 237-8.6 and 238-2.6.

EFFECTIVE DATE: Upon approval, takes effect on January 1, 2018.

STAFF COMMENTS: This bill is submitted by the department of budget and finance as BUF-29 (17).

It concerns the surcharge on Hawaii General Excise Tax (GET) and Use Tax now imposed by HRS sections 237-8.6 and 238-2.6. Most of us are aware that an extra 0.5% is added to the price of most things that we in Honolulu buy or import. What not all of us are aware of, however, is that 10% of the gross collections go straight to the State's general fund, as is apparently required by HRS section 248-2.6(a).

Section 248-2.6 is part of Act 247, SLH 2005, which allowed the counties to enact a surcharge upon the GET and Use Tax by ordinance. The City & County of Honolulu ("Honolulu") was the only county to do so, enacting Ordinance No. 05-027, codified at Rev. Ord. of Honolulu ("ROH") §§ 6-60.1 to 6-60.3.

The Legislature specified that the purpose of Act 247 was "to authorize counties to levy a county surcharge on state tax by ordinance to fund public transportation systems." No mention whatsoever is made of raising State general fund revenue. From the outset, however, it was apparent that there would be a large disparity between the 10% provided for and the real costs of collection. In testimony for HB 1309 (2005), the bill that became Act 247, the Department of Taxation stated that it would require a one-time appropriation of \$3.6 million for hardware, software, and equipment and \$2.5 million annually thereafter for recurring staffing and

operational costs. At the same time, the Department estimated that a 1% surcharge in Honolulu would generate \$296 million in additional revenues. Thus, a 10% “administrative fee” on a 0.5% surcharge would be expected to yield close to \$15 million a year, many times the costs projected at the time.

When HB 1309 passed the Legislature, then-Governor Lingle had serious home rule concerns about the bill. News media at the time reported that she, House Speaker Calvin Say, Senate President Robert Bunda, and Mayor Mufi Hannemann agreed that the bill would become law but that in 2006 legislation would be introduced to turn collection responsibility over to the counties enacting the surcharge. In the ensuing legislative session, the Department of Taxation sponsored a bill to do just that (HB 2420 and SB 2383 of 2006, also known as TAX-12 (2006)). The justification sheet appended to the bill, which was prepared by the Department of Taxation as the sponsoring agency, recited and described the agreement. When the 2006 session started, however, the agreement apparently fell apart; two committees in the Senate jointly heard the bill and voted to kill it. The House did not hear the bill at all.

At the time, David Shapiro, writing in the *Honolulu Advertiser* on March 15, 2006, described what went on in colorful language:

Lost in the political tiff over who will collect the new excise tax for O’ahu rail transit is the more important matter of rectifying a \$15 million-a-year gouging O’ahuans will suffer if this law isn’t fixed.

Gov. Linda Lingle, Mayor Mufi Hannemann and the Legislature are arguing about whether it should be the city’s responsibility to collect its own tax, as Lingle wants, or the state’s role, as Hannemann and the Legislature prefer.

There’s little talk about a 10 percent state kickback lawmakers extracted when they approved a half-cent excise tax for O’ahu transit on top of the 4 cents the state already assesses.

The superfluous surcharge was supposed to disappear as part of the deal Lingle reached with legislators and Hannemann last year to allow the transit tax to become law in exchange for promises that her concerns about how the tax is collected would be addressed this year.

But lawmakers discarded bills to enact the agreement before the legislative session was half over.

The dispute about whether the city or the state will collect the tax is mostly politics.

The greedy and ill-timed state surcharge, however, is of real consequence.

Legislators claimed the state needed to take 10 percent off the top of the transit tax to cover its “administrative costs” for collecting the city’s excise tax revenues.

None of the money, however, was earmarked for the Department of Taxation, which would bear any administrative costs.

The surcharge all goes to the general fund with no defined purpose, making it a backdoor general tax increase that lawmakers can spend on pet projects unrelated to transit.

The transit tax, which takes effect next year, is expected to raise the city \$150 million a year over its life of 15 years, which means the state's 10 percent vigorish would be \$225 million over that period.

Some analysts predict that the city excise tax will ultimately have to double or even triple to yield enough cash to finish the rail project — potentially increasing the state's take to more than a half-billion dollars.

It's unconscionable for lawmakers to stick taxpayers with a gratuitous tax surcharge of such magnitude when the state is running a budget surplus likely to exceed \$600 million next year and residents are already being battered by rising costs on all fronts.

And it's grossly irresponsible to increase the immense cost of building a rail line to Leeward O'ahu by 10 percent off the bat for no good public purpose.

Lawmakers are trying to cover their tracks by saying they'll now direct some of the surcharge money to the Tax Department, but it won't likely be anywhere near the total amount the state is collecting.

Tax Director Kurt Kawafuchi's preliminary estimate was that it would cost his department \$13.6 million over four years to collect the excise tax for the city — a fraction of the \$60 million the state would reap from its surcharge during that time.

And Kawafuchi's cost estimate will probably prove to be high; how much could it cost to calculate the city's fixed share of gross O'ahu excise tax receipts and deliver a check across the street?

Public confidence in rail transit has been shaken by political bickering and allegations of cronyism in the award of the first transit contract.

Lingle, Hannemann and the Legislature need to sit down now to hammer out an agreement that eliminates the odious surcharge and satisfies all parties that faith has been kept with the deal struck last year.

We need assurances that the costliest public works project in O'ahu's history won't be used as cover for a massive siphoning of public money for other purposes.

Shapiro, "Collection Surcharge Looms as Another Tax," Honolulu Advertiser (Mar. 15, 2006) (available at <http://the.honoluluadvertiser.com/-article/2006/Mar/15/op/FP603150315.html>).

Collection of the county surcharge began on January 1, 2007. At that point, events began unfolding that shed light on how much (or how little) it actually costs to administer the tax.

In the General Appropriations Act of 2007, Act 213, SLH 2007, the Legislature was asked to give the Department of Taxation additional resources to administer and collect the surcharge. As

explained in the Senate Ways and Means Committee report, however, those resources amounted to less than \$1 million per year:

On January 1, 2007, the Department of Taxation began collection of the county surcharge tax for the city and county of Honolulu. As a result, the Department required additional funds for its operations. Under Act 247, Session Laws of Hawaii 2005, the Department collects the surcharge on behalf of the county and in return the State retains ten per cent of the collections, to be deposited in the general fund. Because Act 247 did not provide positions or funds for the collection activity, an appropriation from the general fund for the Department of Taxation is necessary. Your committee provided nineteen positions and general funds of \$944,312 for fiscal year 2007-2008 and \$717,944 for fiscal year 2008-2009. Your Committee has included a provision requiring the Department to study and report to the Legislature during the Regular sessions of 2008 and 2009 on the totality of the additional work represented by the county surcharge collection activity.

Senate Stand. Comm. Rep. 1586 (2007). Accordingly, a proviso, section 121 of the appropriations act, was inserted to require the Department to generate such reports.

In response to the budget proviso, the Department issued two reports. Department of Taxation, Annual Report as Required by Act 213, SLH 2007, Section 121 (2007), and Department of Taxation, Annual Report as Required by Act 213, SLH 2007, Section 121 (2008). In the latter report, the Department stated that the budgeted salary for positions dedicated to surcharge collection was approximately \$750,000 in FY 2008 and \$700,000 in FY 2009, to which should be added a portion of the salaries of existing Compliance Division staff (audit and collection functions) amounting to about \$440,000 per year. The Department also noted that its request to the 2008 Legislature for an additional \$233,000 for computer support needed to administer the county surcharge tax was denied. So the costs to administer the surcharge in FY 2008 and FY 2009 were approximately \$1.2 million and \$1.15 million respectively. Even if the \$233,000 that the Department wanted but didn't get were added, the total costs would be considerably less than the earlier projected amounts.

Over the ensuing several years, the 10% amount diverted grossly exceeded the \$1.2 million per year that the Department reported, and in FY 2014 exceeded the entire budget of the Department of Taxation.

On October 21, 2015, the Foundation sued the State of Hawaii over the 10% skim, contending that the diverted money amounted to a hidden State tax unwittingly paid by Oahu residents and businesses—and only them, even though the tax goes straight to the general fund to be used for projects benefiting the entire State. The Foundation's suit is now pending in the appellate courts.

The bill repeals the 10% skim.