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To: The Honorable Sean Quinlan, Chair;
The Honorable Daniel Holt, Vice Chair;
and Members of the House Committee on Economic Development

From: Isaac W. Choy, Director
Department of Taxation

Date: Wednesday, February 9, 2022
Time: 10:00 A.M.
Place: Via Video Conference, State Capitol

Re: H.B. 1493, Relating to the Tax Administration Special Fund

The Department of Taxation (Department) strongly supports H.B. 1493 and offers the following comments for the committee's consideration.

H.B. 1493 increases the maximum amount of total revenues collected by the Department's Special Enforcement Section that may be retained in the Tax Administration Special Fund from \$2 million to \$5 million. The measure also allows the special fund revenue to be spent on tax compliance programs. The measure is effective upon approval.

H.B. 1493 will provide the Department with necessary means and flexibility to implement tax compliance programs. Tax compliance programs generate revenue and bolster voluntary taxpayer compliance.

Thank you for the opportunity to provide testimony in support of this measure.

TAX FOUNDATION OF HAWAII

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SUBJECT: ADMINISTRATION, Beef Up Tax Administration Special Fund

BILL NUMBER: SB 2380, HB 1493

INTRODUCED BY: SB by MORIWAKI, Ihara, San Buenaventura; HB by YAMASHITA

EXECUTIVE SUMMARY: Increases to \$5,000,000 the maximum amount of total revenues collected by the Special Enforcement Section of the Department of Taxation that may be deposited into the Tax Administration Special Fund. We have concerns that allowing the Tax Administration Special Fund to swell further amounts to a diversion of lawful government revenue outside of the appropriation and budgeting processes, and thus would be bad policy.

SYNOPSIS: Amends section 235-20.5, HRS, to provide that of the total revenues collected by the Department of Taxation's special enforcement section, all revenues in excess of \$5 million shall be deposited into the general fund. The previous threshold was \$2 million.

Also explicitly allows the money in the special fund to be expended by DOTAX on compliance programs (*i.e.*, programs to ferret out and then bring to justice those who have not paid that which is legally due).

EFFECTIVE DATE: Upon Approval

STAFF COMMENTS: Appropriation is not supposed to be difficult. Lawmakers, with the help of our Council on Revenues, figure out how much money we're expected to collect. They listen as the various executive agencies and departments show them what their respective programs have achieved for the people of Hawaii. Lawmakers then decide which programs and services are worthy of how much of our hard-earned taxpayer dollars, and off we go for another fiscal year.

This, however, isn't enough for some people (or departments), who are absolutely fixated on securing a "dedicated funding source" for their favorite program or department. A dedicated funding source usually means setting up a special fund, which is tougher to police using the appropriation process, and a grab on tax revenues before they can be counted with the rest of state realizations during the budgeting processes. Dedicated funding sources can and do protect inefficient or questionable programs and expenditures, and they make it tougher for all of us to figure out where our state's money is being spent.

Legislators argue that the Legislature exercises more than adequate oversight over these special funds even though they aren't covered in the normal appropriation process. But how does that explain findings like the State Auditor's Report No. 20-06, which found more than \$75 million in accounts associated with inactive special or revolving funds? Or Report No. 20-07, which found tens of millions of dollars in special funds that swelled in size over the years, indicating an imbalance between the so-called dedicated funding source and the programs and services it was

supposed to fund? Or Report No. 20-08, which built on Report No. 20-06 and made the bold statement, “More than \$483 million in excess moneys may be available to be transferred from 57 special and revolving fund accounts to the General Fund without adversely affecting programs”?

The continued existence of a program or service is supposed to be earned. If a program or service efficiently delivers value to the people of Hawaii, then it is worthy of our continued support. It’s not supposed to be forced by tax grabs, special funds, and other gimmicks. We need to start recognizing that this “dedicated funding source” rhetoric is taking us down the wrong path.

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 should 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 bill 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, SLH 2014. In the meantime, different acts through the years allowed DOTAX to hoard more money and fund more positions, increasing the special enforcement section collection threshold from \$500,000 to \$700,000 (Act 204, SLH 2015) to \$2 million (Act 123, SLH 2018).

In the Office of the Auditor Report No. 17-10, the Auditor reviewed the Tax Administration Special Fund and found that its ending balance had started rising significantly, from just under \$1 million in FY2013 to \$5.7 million in FY2017. In Act 87, SLH 2021, the Legislature found

that this fund had accumulated significant monies in excess of its requirements and authorized raiding the fund to the tune of \$15 million.

Allowing this fund to swell further is not good policy. Tax collections, from whatever source, are government realizations under the law imposing the tax. Penalties and fines are treated as additional taxes (see, for example, section 231-39(b), HRS, providing that penalties “shall be added to and become a part of the tax imposed by such tax or revenue law, and collected as such”). These tax collections rightfully belong to the general fund. Allowing them to get swept into special funds, no matter which department, program, or service “owns” the special fund, is a subversion of the budgeting and appropriation processes. Special funds should not be allowed to spiral out of control. The fact that this fund was deemed worthy of a \$15 million raid just last year indicates that it was out of control and should be reined in, not allowed to spiral further and faster.

Digested: 1/27/2022