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To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Isaac W. Choy, Director
Department of Taxation

Date: Tuesday, February 15, 2022
Time: 10:30 A.M.
Place: Via Video Conference, State Capitol

Re: S.B. 3075, S.D. 1, Relating to Franchise Tax

The Department of Taxation (Department) strongly supports S.B. 3075, S.D. 1, an Administration measure, and offers the following comments for your consideration.

S.B. 3075, S.D. 1, ensures the Compliance Resolution Fund receives \$2 million per year, whether from franchise tax collections or income tax collections. Currently, the Compliance Resolution Fund is funded exclusively through franchise tax collections up to a total of \$2 million per fiscal year. S.B. 3075, S.D. 1, provides that income tax collections will be used to ensure \$2 million is deposited into the fund if franchise tax collections are insufficient. The bill is effective upon its approval.

The Department is able to administer this bill as currently drafted. Thank you for the opportunity to provide testimony in support of this measure.



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**Written Testimony Only
Testimony of the Department of Commerce and Consumer Affairs**

**Before the
Senate Committee on Ways and Means
Tuesday, February 15, 2022
10:30 a.m.
Via Videoconference**

**On the following measure:
S.B. 3075, S.D. 1 RELATING TO FRANCHISE TAX**

Chair Dela Cruz and Members of the Committee:

My name is Iris Ikeda, and I am the Commissioner of the Department of Commerce and Consumer Affairs' (Department) Division of Financial Institutions (DFI). The Department supports this administration bill.

The purpose of this bill is to clarify that the Compliance Resolution Fund is to receive \$2,000,000 of the revenues collected under chapter 241, Hawaii Revised Statutes (HRS), provided that if the revenues collected are under \$2,000,000, the difference shall be from the revenues collected under chapter 235, HRS, not to exceed \$2,000,000. The excess revenues collected under chapter 241, HRS, shall be deposited into the general fund.

The Department notes that the revenues received from the franchise tax provides a stable source of income for the DFI. Section 241-7, HRS, provides that, from the revenues collected under this chapter each fiscal year, \$2,000,000 shall be deposited to the credit of the compliance resolution fund established in section 26-9(o), HRS. Section

26-9(o), HRS was intended to provide dedicated funding to the DFI for regulation and oversight of banks and financial institutions. DFI has relied on this revenue stream for a portion of its budget since Act 028 (SLH 2001). With the recent establishment of several chapter 241, HRS, tax credits, the balance in the account that houses revenues and credits for that chapter varies significantly, sometimes resulting in a negative balance. This bill would ensure that the \$2,000,000 payment provided for in HRS section 241-7 is credited to the compliance resolution fund and if the franchise tax is insufficient to comply with HRS section 241-7, that revenues collected under chapter 235 will cover any shortfalls.

Thank you for the opportunity to testify, and we respectfully ask the Committee to pass this administration bill.

Presentation to The
Committee on Ways and Means
Tuesday, February 15, 2022, 10:30 AM
State Capitol Conference Room 211 & Videoconference

Testimony on SB 3075, SD 1 In Support With Amendment

TO: The Honorable Donovan M. Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Members of the Committee

My name is Catherine Ngo, President of the Hawaii Bankers Association (HBA). HBA represents seven Hawai'i banks and three banks from the continent with branches in Hawai'i.

The purpose of this bill is to resolve payment timing issues on the franchise tax to be paid to the Division of Financial Institutions. More than once, payment of the amount due was delayed from one fiscal year to the succeeding fiscal year.

This has the potential of delaying payments or entering into contracts, and create an aura of uncertainty in DFI. Passage of this bill does not impact the Department of Budget and Finance except the need to pay timely.

The HBA would respectfully request that there could be a more direct way for the Division of Financial Institutions to get its share from the franchise tax as suggested in Appendix A.

Thank you for the opportunity to submit testimony in support of SB 3075, SD 1. Please let us know if we can provide further information.

Catherine Ngo
(808) 544-3771

Appendix A

"§241-7 Disposition of funds. From the revenues collected under this chapter each fiscal year, [~~All taxes collected under this chapter shall be state realizations; provided that, by June 30 of each fiscal year,~~] the sum of \$2,000,000 shall be deposited with the director of finance to the credit of the compliance resolution fund as established pursuant to section 26-9(o) [~~-~~] by June 30 of the same fiscal year. The excess revenues collected under this chapter shall be deposited into the general fund.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: FRANCHISE, INCOME, Earmark Tax Collections for Compliance Resolution Fund

BILL NUMBER: SB 3075 SD 1

INTRODUCED BY: Senate Committee on Commerce & Consumer Protection

EXECUTIVE SUMMARY: Clarifies that the Compliance Resolution Fund is to receive \$2,000,000 of the revenues collected under chapter 241, Hawaii Revised Statutes, provided that, if the revenues collected are under \$2,000,000, the difference shall be from revenues collected under chapter 235, Hawaii Revised Statutes, not to exceed \$2,000,000. The excess revenues collected under chapter 241 shall be deposited into the general fund.

SYNOPSIS: Amends section 235-119, HRS, in the Income Tax Law and section 241-7, HRS, in the Franchise Tax Law to so provide.

Makes other technical and conforming amendments.

EFFECTIVE DATE: Upon Approval

STAFF COMMENTS: This is an Administration bill sponsored by the Department of Commerce and Consumer Affairs and designated CCA-01 (22).

At present, section 241-7, HRS, provides for an earmark of \$2 million annually to the Compliance Resolution Fund to defray the costs of regulating financial institutions. In its justification sheet to accompany the bill, DCCA complains that recent tax credits added to the Franchise Tax Law have dampened Franchise Tax collections, resulting in DCCA not getting their \$2 million on occasion. Because DCCA has been relying on that annual \$2 million, it wants a fallback if collections are short, and the fallback would be tapping into the income tax collections.

The bill in its present form appears to violate the Hawaii Constitution's single subject requirement because it is entitled "Relating to Franchise Tax" but also affects the Hawaii Net Income Tax.

As a policy matter, the circumstances surrounding this bill show how government finance is like pressing a balloon. The legislature enacts tax credits in furtherance of social policy. Credits reduce tax collections. The departments or agencies that previously had received such tax collections now don't get them, and they complain. What to do next?

Special funds, such as the Compliance Resolution Fund at issue here, are pots of money that exist for a specific purpose, and largely bypass the legislative appropriation process. The existence of hundreds of these special funds has often confounded those who seek answers to simple questions like "How much money does the State have?"

Our Legislature is supposed to be the steward of all state moneys, but special funds make it very easy to lose track of where the money is and how it is being spent. Departments are supposed to tell the Legislature if they have special funds and how much is in them, but they don't always. Recently, in Report No. 20-01, the State Auditor took DBEDT to task for failing to report \$6.5 million in non-general fund moneys. DBEDT's response? Just that they'll "take corrective action." Not even a "Whoops! We screwed up and promise to do better next time!" This followed closely on the heels of Report No. 19-16, where the Auditor found that \$1.04 million in non-general fund moneys administered by the Attorney General wasn't reported. That department responded that they "shall establish procedures to assure required reports are issued." Is it any wonder that it's getting harder and harder to follow the money and rein in government spending?

In its justification sheet in support of this bill, DCCA states, "This bill will provide a stable source of income for the DFI to regulate, supervise, and examine financial institutions." So why can't that money be appropriated as opposed to screwing up tax collections by earmarking them? The unstated answer to this question appears to be, "We want this money without going through the troublesome appropriation process where the legislature scrutinizes what we do."

We have news for you, DCCA. The Legislature is *supposed* to oversee and scrutinize what every executive agency, including DCCA, does. It's their job to see that taxpayer money is well spent. That is one of their key functions and the appropriations process is the way they do it.

The moral of the story is that special funds are often used to obfuscate and confuse, to put a smokescreen between those who spend the money and those who are charged with making sure the money is well spent. Let's do all of ourselves a favor and get rid of the special funds we don't really need, and make sure that the operations of the ones we do need are transparent and accountable.

Digested: 2/14/2022