DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR

ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Sylvia Luke, Chair;
The Honorable Kyle T. Yamashita, Vice Chair;
and Members of the House Committee on Finance

From: Isaac W. Choy, Director
Department of Taxation

Date: Thursday, March 31, 2022
Time: 2:30 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 514, S.D. 1, Relating to the General Fund

The Department of Taxation (Department) supports S.B. 514, S.D. 1, and offers the following comments. S.B. 514, S.D. 1, implements Article VII, Section 6, of the Hawaii Constitution by providing for an income tax credit for resident taxpayers, depositing monies into the emergency and budget reserve fund, or by depositing funds into the post-employment benefits trust fund. The measure is effective on July 1, 2021, with the tax credit applicable to taxable years beginning after December 31, 2020.

The Department notes that this measure is carried over from the 2021 Regular Session and was therefore drafted so that the proposed income tax credit would apply to tax year 2021. The tax forms required for tax year 2021 have been finalized and return filing for the 2021 tax year has already begun with approximately 310,000 individual tax returns filed to date. In order to receive the proposed credit, each of these returns would need to be amended and refiled with the Department. Furthermore, if a taxpayer needs to pay a tax practitioner to prepare the amended return, the cost of preparation may exceed the credit amount.

For the foregoing reason, the Department respectfully requests that the proposed tax credit be made applicable to taxable years beginning after December 31, 2021. This will allow the Department to administer the new credit for the 2022 tax year and avoid the need for taxpayers to amend their 2021 tax returns.

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

DAVID Y. IGE
GOVERNOR

CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAI'I EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAIʻI
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAIʻI 96810-0150

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

TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 514, S.D. 1

March 31, 2022
2:30 p.m.
Room 308 and Videoconference

RELATING TO THE GENERAL FUND

The Department of Budget and Finance (B&F) strongly supports the intent of Senate Bill (S.B.) No. 514, S.D. 1.

S.B. No. 514, S.D. 1, makes: a) an undetermined tax credit to resident individual taxpayers of Hawaiʻi; b) an undetermined deposit into the Other Post-Employment Benefits (OPEB) Trust Fund; and c) an undetermined transfer into the Emergency and Budget Reserve Fund (EBRF). This measure is being proposed as a means to comply with the constitutional mandate to provide a tax refund or credit, make a transfer into a reserve fund, or make a prepayment of either or both of 1) debt service or 2) pension or OPEB liabilities when certain conditions are met.

B&F supports any or a combination of the three options in this bill to comply with the constitutional mandate.

<u>Tax Credit</u>

The Administration proposed a one-time tax refund of $100 per qualified resident taxpayer that would not be offset by any State tax liability. The tax credit proposed in this bill is conceptually similar except that it would be offset by any State income tax liability.

B&F notes that, with respect to the tax credit, the federal American Rescue Plan (ARP) Act restricts states from using ARP Coronavirus State Fiscal Recovery Funds (CSFRF) to directly or indirectly offset a reduction in net tax revenue resulting from a change in law, regulation, or administrative interpretation beginning on March 3, 2021, through the last day of the fiscal year in which the CSFRF have been spent. If a state cuts taxes during this period, it must demonstrate how it paid for the tax cuts from sources other than the CSFRF, such as:

- By enacting policies to raise other sources of revenue;
- By cutting spending; or
- Through higher revenue due to economic growth.

If the CSFRF provided have been used to offset tax cuts, the amount used for this purpose must be repaid to the U.S. Treasury.

The U.S. Department of Treasury has issued rules governing how this restriction is to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawai‘i complies with this ARP restriction.

OPEB Prefunding Payment

The State has an unfunded actuarial accrued liability (UAAL) of $8.1 billion as of July 1, 2021. An additional OPEB prefunding payment in FY 22 will help to reduce the UAAL and mitigate regular OPEB prefunding payments in future fiscal years.

B&F notes that, with respect to the general fund appropriation for the OPEB prefunding payment, the federal Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act requires that states receiving Elementary and Secondary

School Emergency Relief (ESSER) II funds and Governor’s Emergency Education Relief II funds must maintain state support for:

- Elementary and secondary education in FY 22 at least at the proportional level of the state’s support for elementary and secondary education relative to the state’s overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 at least at the proportional level of the state’s support for higher education relative to the state’s overall spending, averaged over FYs 17, 18 and 19.

Further, the federal ARP Act requires that states receiving ARP ESSER funds must maintain state support for:

- Elementary and secondary education in FY 22 and FY 23 at least at the proportional level of the state’s support for elementary and secondary education relative to the state’s overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 and FY 23 at least at the proportional level of the state’s support for higher education relative to the state’s overall spending, averaged over FYs 17, 18 and 19.

The U.S. Department of Education has issued rules governing how these maintenance of effort (MOE) requirements are to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawaiʻi complies with these ESSER MOE requirements.

<u>EBRF Transfer</u>

The Administration proposed a transfer of $1.0 billion into the EBRF to significantly build up the State’s reserves. B&F strongly believes that it is critically important to increase the EBRF reserves during these uncertain economic times. The

EBRF is intended to help ensure greater stability and capacity of the State to handle economic downturns and other unforeseen events. Financial flexibility, in part provided by the EBRF, is a core part of discussions on fiscal remedies pertaining to the impact of recessions, significance of the tourism industry, and exposure to natural disasters. There are also potential credit enhancement and ratings benefits associated with appropriate reserve levels.

The Government Finance Officers Association recommends ". . . at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures." This amounts to a recommended minimum balance of about 16.7% of revenues. The department believes that working toward achieving and maintaining minimum reserve and fund levels of comparable levels to be prudent. The Administration's proposed transfer of $1.0 billion would bring that reserve fund up to 14.7% of the State's prior year's general fund revenues.

Additionally, recapitalizing the EBRF would be viewed positively by rating agencies that rate the State's general obligation bonds. Many factors can impact the State's credit ratings, and financial flexibility is a key factor that can have impact. Levels of reserves and the State's willingness to recapitalize reserves when they are used have been cited as positive factors by rating agencies. Higher ratings are associated with lower borrowing costs.

The COVID-19 pandemic significantly impacted Hawai‘i's economy and illustrates the need for the EBRF to be well capitalized. Amid dramatically reduced revenues and to support costs associated with the pandemic response, Hawai‘i and other states were provided extraordinary amounts of federal funds. However, the pandemic is still unfolding, and there are other potential troubling events, such as the war in Ukraine, rising geopolitical tensions with China and Russia, and climate change. The department believes that the State must be prepared to weather the worst on its own because the federal government may not be able to assist as generously in the future.

Recapitalizing the EBRF will enhance the State's reserves for times of economic downturns, natural disasters, and other unforeseen events and will mitigate the need for the State to implement less desirable measures during those times.

With respect to the general fund appropriation to make a transfer to the EBRF, the U.S. Department of Education has determined that such a transfer is not subject to the MOE requirements for the ESSER Fund under the Coronavirus Aid, Relief, and Economic Security Act, CRRSA Act, and ARP Act.

Thank you for your consideration of our comments.

TAX FOUNDATION OF HAWAII

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

SUBJECT: NET INCOME, Tax Credit, Disposition of Excess Revenues

BILL NUMBER: SB 514 SD1

INTRODUCED BY: Senate Committee on Ways & Means

EXECUTIVE SUMMARY: Provides a tax credit to taxpayers and makes deposits to the emergency and budget reserve fund and other post-employment benefits trust fund pursuant to article VII, section 6, of the Hawaii Constitution. Appropriates funds.

SYNOPSIS: Adds an uncodified section providing for a general income tax credit in an unspecified amount for each taxpayer filing an individual return in 2021.

Makes appropriations of unspecified amounts to the emergency and budget reserve fund, the other post-employment benefits trust fund.

EFFECTIVE DATE: 7/1/2021.

STAFF COMMENTS: Article VII, section 6 of the Hawaii Constitution requires that whenever the state general fund balance at the close of each of two successive fiscal years exceeds five percent of general fund revenues for each of the two fiscal years, the legislature shall either: (1) provide a tax credit or refund to the taxpayers of the State; (2) deposit the money into a rainy day fund ; or (3) appropriate general funds for either (A) debt service or (B) OPEB.

It’s hard to get excited about this provision, however, because the Constitution does not say anything about how much of the excess revenues are to be disposed of in these ways.

The last time we had a constitutional convention, in 1978, delegates thought that government shouldn’t be keeping the people’s money if it didn’t have to. “Your Committee believes that it is proper for the State’s taxpayers to benefit from any surplus in the State’s general fund balance,” they said in Committee of the Whole Report No. 14.

So, they put before the voters, and the voters approved, what became Article VII, section 6 of our Constitution. It says that if our general fund balance is more than 5% of general fund revenues for two fiscal years in a row, then the legislature is supposed to enact a tax credit or refund to give some of that money back to us taxpayers.

This credit came to be called the general income tax credit. In most of the years of its life, however, it provided for a credit of either $1 or nothing.

In 2010, the legislature proposed, and voters approved, a constitutional amendment that allowed lawmakers to forgo providing a tax credit if they instead shoved some money into our rainy-day fund. Thus 2009 was the last year of the general income tax credit. In 2016, voters approved a further constitutional amendment that would allow the money to go to debt service or OPEB. But still there is nothing mandating any particular amount.

Digested 3/28/2022

GRASSROOT
INSTITUTE OF HAWAII

March 31, 2022
2:30 p.m.
Conference Room 308 and Videoconference

To: House Committee on Finance
Rep. Sylvia Luke, Chair
Rep. Kyle T. Yamashita, Vice Chair

From: Grassroot Institute of Hawaii
Joe Kent, Executive Vice President

RE: SB514 SD1 — RELATING TO THE GENERAL FUND

Comments Only

Dear Chair and Committee Members:

The Grassroot Institute of Hawaii would like to offer its comments on SB514 SD1, which would create a one-time tax refund for resident taxpayers in keeping with Article VII, Section 6 of the Hawaii Constitution.

The state of Hawaii is currently enjoying a nearly $4 billion budget windfall, thanks to higher-than-expected tax revenues and an infusion of federal funds.

Hawaii's residents and businesses, on the other hand, are struggling to rebound from the two years of coronavirus lockdowns, which closed many businesses forever and continue to reverberate throughout the economy.

Under the circumstances, it seems clear that returning a portion of those excess funds is both compassionate and economically wise. Hawaii's taxpayers would benefit from the tax refund, and the economy would benefit from the spending and investment that would follow.

Earlier this year, the Grassroot Institute wrote about the budget surplus in the Hawaii Filipino Chronicle, suggesting that the Legislature return some of the windfall to taxpayers, as stipulated in the Hawaii Constitution. We also suggested that the Legislature help alleviate the state's high cost of living by cutting taxes, which the state can clearly afford.

When Gov. David Ige proposed that the state send refunds in the amount of $100 per taxpayer and dependent, the Grassroot Institute praised the suggestion, noting that it would be a good way to help working Hawaii families while boosting the state's economy.

The institute now commends the Legislature for considering this bill, but we would like to suggest that the Legislature go even farther in this effort to help Hawaii taxpayers.

Currently, the bill does not specify the refund amount. The governor hoped to add about $110 million to the economy via a refund of $100 per taxpayer and dependent.

However, we suggest that, given the amount of its budget surplus, the state return at least one-third of the windfall, or about $1 billion, to the taxpayers. That would equal approximately $1,361 for each of Hawaii's 734,673 taxpayers.

As we noted, the state can afford to do far more than a mere $100 each for Hawaii taxpayers, who have gone through so much in the past two years.

Thus, we urge your committee to significantly increase the amount of the refund contemplated in this bill. By doing so, you would help foster economic growth and greater prosperity in Hawaii.

Thank you for the opportunity to submit our comments.

Sincerely,

Joe Kent
Executive Vice President
Grassroot Institute of Hawaii