APPENDIX C:

"Summary of Recommendations Made by Past Tax Review Commissions, Subsequent Legislation, and Background Information"

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SUMMARY OF RECOMMENDATIONS MADE BY PAST TAX REVIEW COMMISSIONS, SUBSEQUENT LEGISLATION, AND BACKGROUND INFORMATION

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INTRODUCTION

The 2020-2022 Hawaiʻi Tax Review Commission (TRC) has identified the following tax policy issues for investigation and possible recommendation:

1. Carbon Tax/Greenhouse Gas Impact Fees
2. Visitor Impact Fees
3. Hawaiʻi's standard deduction and personal exemptions
4. Tax system compliance and enforcement
5. Tax policy on real property and wealth
6. Tax credits and exemptions
7. Taxes on pensions and other retirement income
8. Simpson-Bowles-like commission on spending

In the next section, I summarize the recommendations made by past tax review commissions regarding each of the issues identified above. I also present the most recent and relevant policy changes regarding these recommendations along with pertinent background information.

SUMMARY OF RECOMMENDATIONS, SUBSEQUENT LEGISLATION, AND BACKGROUND INFORMATION

1. CARBON TAX/GREENHOUSE GAS IMPACT FEES

Summary of Recommendations by Tax Review Commissions	**1983-1985**	**1988-1990**	**1995-1997**	**2001-2003**	**2005-2007**	**2010-2013**	**2015-2017**
1. Study whether Hawai‘i should institute a carbon tax.							X

Recommendation 1: Study whether Hawai‘i should institute a carbon tax.

Background Information:

2015-2017 Tax Review Commission (TRC) recommended the issue of whether Hawai‘i should institute a carbon tax to be studied. They further recommended the study to consider the effect on other State goals, on what to do with the revenue, and on the best way to apply the tax.

The carbon tax would likely affect the cost of energy, transportation, and goods produced in Hawai‘i. Because the tax would affect a very significant portion of consumer expenditures, the tax burden impacts are expected to be quite significant. Existing studies have shown that the carbon tax would be regressive since lower income households spend a greater percentage of their incomes on energy. Those making $25,000 spend 5.3 percent of their income on electricity, natural gas, and heating fuels, a percentage that declines to only 2.5 percent at an income level of $150,000. Given the scale of spending on energy goods by lower income households, a carbon tax would make Hawai‘i’s tax system significantly more regressive. However, the revenue gains from such a broad-based tax could be substantial. The caveats include the fact that there are no existing “lessons learned” from other states and it is potentially a hard sell politically.

Relevant Legislation:

The Hawai‘i Carbon Pricing Study was prepared for the Hawai‘i State Energy Office by the University of Hawai‘i Economic Research Organization (UHERO) as part of **Act 122, Session Laws of Hawai‘i (SLH) 2019** and the final report was published in April 2021.[1] The study

[1] https://energy.hawaii.gov/wp-content/uploads/2021/04/HawaiiCarbonPricingStudy_Final_Apr2021.pdf

includes an illustrative range of tax amounts to explore options for achieving Hawai‘i's policy goals.

There were proposals in the 2019, 2020, and 2021 legislatures regarding the carbon tax but they have not been advanced. For instance, Senate Bill 3150 from 2020 proposed to revamp the environmental response, energy, and food security (barrel) tax to address carbon emissions. The measure proposed to increase the rates in 2021, 2024, 2027, and 2030, so that the tax rate would effectively set a price of $40 per metric ton of carbon dioxide emissions in 2021 and increase to be equivalent to a carbon price of $80 per metric ton in 2030.

Further Information

The current 2020-2022 TRC contracted with the same UHERO team for a follow-up study to analyze a wider range of scenarios regarding the social cost of carbon tax and provide a descriptive analysis of multiple considerations important for practical implementation of a carbon tax. The study will appear in the appendix of the 2020-2022 TRC Report.

2. VISITOR IMPACT FEES

Background Information:

There were no recommendations made by past tax review commissions regarding this issue. A presentation titled "Hawai‘i Green Fee" was given by Dr. Jack Kittinger and his team in the August 18, 2021 meeting of the TRC followed by a report presented on September 22, 2021.

Relevant Legislation:

There were measures under consideration in the 2021 legislature to establish a "visitor green fee" program but they have not made it through. Senate Bill 666 proposed to create a surcharge of $40 (then adjusted to be $20) per guest of a transient accommodation for the purposes of funding workforce and services that promote certain environmental goals.

3. HAWAI‘I’S STANDARD DEDUCTION AND PERSONAL EXEMPTIONS

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
1. Provide double the standard deduction to taxpayers over age 65.	X						
2. Increase the standard deduction.	X	X	X	X	X	X	X
3. Increase personal exemptions.			X	X	X	X	X
4. Index the individual income tax standard deduction and personal exemptions to inflation.					X		X

Recommendation 1: Provide double the standard deduction to taxpayers over age 65.

Background Information:

Taxpayers may reduce their adjusted gross income by a standard deduction amount or by their allowable itemized deductions. The standard deduction amounts are based on the taxpayer’s filing status and not on age.

Relevant Legislation:

This recommendation has not been adopted.

Recommendation 2: Increase the standard deduction.

Background Information:

Unlike the federal standard deduction amounts, which are adjusted annually for inflation, the Hawai‘i standard deduction amounts are fixed by statute and are changed infrequently. Each year the standard deduction rate is unchanged, the tax burden of the taxpayers utilizing standard deduction increases since the value of the deduction is eroded by inflation. Therefore, increasing standard deduction amounts was recommended by all past tax review commissions.

Relevant Legislation:

Act 321, SLH 1989; **Act 110, SLH 2006**; and **Act 60, SLH 2009** all increased the standard deduction amounts. Table 1 lists the changes in standard deduction amounts over time accordingly.

Table 1. Changes in Hawai‘i's Standard Deduction Amounts Over Time

Filing Status	1982	1987	1989	2007	2013
Married Filing Jointly	$1,000	$1,700	$1,900	$4,000	$4,400
Single	$800	$1,000	$1,500	$2,000	$2,200
Married Filing Separately	$500	$850	$950	$2,000	$2,200
Head of Household	$800	$1,500	$1,650	$2,920	$3,212

Recommendation 3: Increase personal exemptions.

Background Information:

All individuals filing a Hawai‘i state income tax return may claim one personal exemption for themselves, for their spouses if applicable, and an additional exemption for each qualified dependent if they themselves are not claimed as a dependent on another person's return. Individuals who are 65 or older may claim an additional personal exemption (the age exemption) for themselves and/or their spouses. The personal exemption amount was $1,144 per exemption as of tax year 2020. Individuals who are certified as blind, deaf or totally disabled could claim a special personal exemption of $7,000 for themselves in lieu of the regular personal exemptions. If the spouse also had a certified disability, the total allowable exemption amount would be $14,000.

Relevant Legislation:

In Hawai‘i, personal exemption multiplier was raised last time in 2013 from $1,040 (**Act 78, SLH 1985**) to $1,144 by **Act 60, SLH 2009**. The overall average growth rate of personal exemption amounts in Hawai‘i has been lower than the average US inflation rate indicating a decline in the value of personal exemptions in real terms over the years.

Recommendation 4: Index the individual income tax standard deduction and personal exemptions to inflation.

Relevant Legislation:

This recommendation has not been adopted.

Further Information

2015-2017 TRC recommended the modernization of the individual income tax by increasing the personal exemption and standard deduction amounts to the levels in the federal income tax as of tax year 2017 and indexing them to inflation thereafter, so that inflation would not cause the new tax adjustments to become outdated. They also recommended altering the tax rates and tax brackets to make the modernization revenue neutral.

4. TAX SYSTEM COMPLIANCE AND ENFORCEMENT

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
1. Give the Department of Taxation (DOTAX) resources to: (a) monitor business incentive tax credits; (b) conduct out-of-state audits; and (c) improve its collection and enforcement efforts.				X	X	X	
2. Study whether it would be cost effective for DOTAX to increase efforts to educate the public in order to improve compliance with Hawaii's tax laws.							X

Recommendation 1: Give the Department of Taxation (DOTAX) resources to: (a) monitor business incentive tax credits; (b) conduct out-of-state audits; and (c) improve its collection and enforcement efforts.

Background Information:

Compliance initiatives are important, because they can increase voluntary compliance and create greater confidence in the system by those taxpayers who pay their taxes in full and on time (who are the vast majority of Hawai‘i taxpayers). The State has undertaken compliance initiatives in the past and continues to implement changes that are focused on increasing collections, particularly for cash-based enterprises. However, budget cuts, reductions-in-force, and furloughs have decreased DOTAX’s ability to monitor business incentive tax credits at times. Out-of-state audits are being conducted, but are also limited by staffing and funding constraints.

Relevant Legislation:

Act 134, SLH 2009, the Cash Economy Enforcement Act, committed additional resources over time to DOTAX to raise additional revenue owed to the State. The primary focus of the Act was the creation of a Special Enforcement Section, which is a specialized unit within DOTAX's Compliance Division and includes civil investigators and support staff. DOTAX is required, as part of the Act, to provide regular reports to the Legislature related to the resources committed to implementing the Act and the additional revenues raised as a result of the Act.

DOTAX has been working to expand Special Enforcement Section's operations and effectiveness and has been increasingly successful in identifying non-compliance, securing voluntarily filed tax returns, and collecting general excise (GET) and transient accommodation taxes (TAT).

Recommendation 2: Study whether it would be cost effective for DOTAX to increase efforts to educate the public in order to improve compliance with Hawai'i's tax laws.

Background Information:

2015-2017 TRC noted that efforts to educate taxpayers about their tax obligations may provide greater tax revenue and at the same time improve services to taxpayers. For example, a substantial number of nonresidents own property in Hawai'i (Department of Business, Economic Development and Tourism (DBEDT), "An Analysis of Real Property Tax in Hawai'i," March 2017) and many of them are unaware of their obligations to pay Hawai'i taxes on rental income, such as the General Excise Tax (GET) and the Transient Accommodations Tax (TAT). Often, the nonresident property owners only become aware of their Hawai'i tax obligations when they try to sell the property, or when they learn by chance of their GET and TAT liabilities and are suddenly faced with potential multi-year filing obligations, and with penalties and interest on top of the underlying tax liability.

5. TAX POLICY ON REAL PROPERTY AND WEALTH

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
1. Study whether the rate of withholding on sales of real property by nonresidents (HARPTA withholding) should be restored to its original rate of 9 percent from the current rate at the time of 5 percent.					X		X
2. Conform to the federal estate tax repeal provisions except the repeal of the state death tax credit				X			

Recommendation 1: Study whether the rate of withholding on sales of real property by nonresidents (HARPTA withholding) should be restored to its original rate of 9 percent from the current rate of 5 percent.

Background Information:

Annual income is the amount earned during the year, whereas wealth is total assets minus total debts. As noted in the 2015-2017 TRC report, wealth is a substantial part of the tax base for many other states, but in Hawai‘i the State is precluded from taxing real property, which is the most common and practical way to tax wealth. (The State is precluded from taxing real property tax by Article VIII, Section 3 of the Hawai‘i State Constitution. Alternative (but less effective) ways to tax wealth are the estate/inheritance tax and taxes on personal property.) This limits the State’s ability to shift the burden of its taxes to nonresidents, because nonresidents own a substantial amount of property in Hawai‘i but have little income subject to the State's income tax.[2]

The maximum rate of income tax is 7.25 percent on long-term capital gains and 11 percent on short-term capital gains, whereas the withholding of tax for the disposition of Hawai‘i real property by nonresident persons, commonly referred to as “HARPTA” (Hawai‘i Real Property Tax Act) withholding was 5 percent of the gross selling price at the time of 2015-2017 TRC.

[2] It is estimated that nonresidents own 12.4 percent of the total value of homes in Hawai‘i (DBEDT, “An Analysis of Real Property Tax in Hawai‘i,” March 2017, p. 44.) However, nonresidents had only 6.8 percent of the total income subject to Hawai‘i's individual income tax in tax year 2019.

The amount withheld is an estimated tax payment for the benefit of the seller and is applied when such taxpayer files an income tax return for the year in which the disposition occurred. The concern of the 2015-2017 TRC was that it could be possible for the income tax liability of nonresidents to exceed the HARPTA withholding, particularly in cases where the property has been depreciated over a long period of time and the taxpayer has little basis. Furthermore, in some cases, the nonresident seller may have been renting the property and neglected to pay TAT and GET on the rental income. In such cases, the HARPTA withholding could be insufficient to cover the tax liability. An increase in the rate of HARPTA withholding to 9 percent (which was the rate in the original legislation) would reduce such occurrences.

The 2005-2007 TRC noted that increasing the rate of HARPTA withholding would encourage greater compliance by those seeking a refund and it would reduce the State's tax loss for those who continue to fail to file an income tax return. (In some situations, particularly if the taxpayer has failed to file Hawaiʻi tax returns, the taxpayer may decide that simply forfeiting the withheld HARPTA amount is preferable to satisfying Hawaiʻi tax obligations. This creates difficulties in enforcement.)

Relevant Legislation:

Act 213, SLH 1990 required purchasers of real property to withhold 9% of the amount realized from nonresident sellers.

Act 279, SLH 1991 reduced the amount to be withheld from 9% to 5%.

Act 122, SLH 2018 increased the HARPTA rate from 5% to 7.25%. The expected revenue gain according to Office of Tax Research and Planning (TRP) was $8.1 million in fiscal year (FY) 2019 and $2.6 million per year from FY 2020 to FY 2025.

Recommendation 2: Conform to the federal estate tax repeal provisions except the repeal of the state death tax credit

Background Information:

From 1924 through 2001, the federal estate tax allowed a dollar-for-dollar credit for state death taxes paid (up to maximum limits). All states imposed estate taxes up to the amount of the federal credit (pure “pickup”); some states also imposed additional inheritance or estate taxes. The

Economic Growth and Tax Relief and Reconciliation Act (EGTRRA) of 2001 repealed the federal credit for state death taxes (effective for decedents dying after December 31, 2004). States could no longer impose estate taxes that did not increase the total tax burden on estates and heirs. EGTRRA also increased the exemption amounts and reduced tax rates under the federal estate tax.

The 2001-2003 TRC recommended that the State of Hawaiʻi conform with all of the Federal Estate Tax repeal provisions of EGTRRA for administrative simplicity except the repeal of the State of Hawaiʻi Death Tax Credit. The Commission believed that the State should continue to collect its share of the "pick up tax" based on the credit schedule in effect prior to its reduction and repeal by EGTRRA.

Relevant Legislation:

Act 89, SLH 2021, conforms the Hawaiʻi Estate and Generation-Skipping Transfer Tax Law to the Internal Revenue Code (IRC) as amended as of December 31, 2021 with the exception of the excludable amount of $5,490,000. The exclusion amount of $5,490,000 is set forth for the decedent in chapter 11 of the IRC as amended as of December 21, 2017. For the 2021 tax year, the federal excludable base amount is set at $11,700,000 (Tax Cuts and Jobs Act of 2017), causing a "Gap" between the federal and state excludable amount.

Further Information

A policy exercise that was considered by consultants in the 2015-2017 TRC report appendix was looking into eliminating the itemized deduction for property taxes paid since the State is not able to tax real property and they roughly estimated a revenue gain of $30-$40 million annually. However, this policy measure was not recommended by TRC.

Although it was not recommended by any of the TRCs to increase the estate tax, **Act 3, SLH 2019** established a new estate tax rate bracket for taxable estates exceeding $10 million with a 20% rate effective April 4, 2019 applicable to decedents dying after December 31, 2019. According to TRP office, the estimated gain to the General Fund is $1.9 million in FY 2021, $2.0 million in FY 2022, $2.1 million in FY 2023, $2.2 million in FY 2024, $2.3 million in FY 2025, and $2.4 million in FY 2026.

6. TAX CREDITS AND EXEMPTIONS

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
1. Eliminate or sunset tax exemptions and credits.	X				X		
2. Eliminate or minimize all General Excise & Use Tax (GET) exemptions.			X		X		
3. Minimize all tax exemptions and credits.		X	X	X	X		
4. Eliminate the GET exemption for nonprofit organizations or establish a maximum exemption amount.				X	X		
5. Extend tax-exemption to skilled nursing facilities and for-profit hospitals, infirmaries, and sanitaria.			X				
6. Overhaul the business incentive tax credit process							
a. Overhaul and update the capital goods excise tax credit.			X				
b. Conduct a cost-benefit study prior to enacting or revising a tax credit program.				X			
c. Require periodic evaluations of all tax incentive programs.				X	X		
d. Require beneficiaries of tax incentive programs to file truth and disclosure reports separately and apart from tax returns and make all aspects of the subsidies public.				X	X		
e. Embed tax incentives in strategic plans to leverage scarce State resources.				X			
f. Encourage public participation in and comment on tax incentive use to foster public accountability.				X			
g. Require sunset provisions to ensure that targeted benefits were realized before extending an incentive.				X	X		

Recommendations 1, 2, and 3: Eliminate or sunset tax exemptions and credits; eliminate or minimize all General Excise & Use Tax (GET) exemptions; minimize all tax exemptions and credits.

Background Information–Tax Credits:

Tax credits may be applied to reduce taxpayer's tax liability including Hawai'i's individual and business income taxes, the tax on insurance premiums, or the tax on public utilities. Tax credits are subtracted directly from the tax liability, so they reduce the amount of taxes dollar-for-dollar. This makes them more valuable to taxpayers than ordinary deductions, which reduce the amount of income against which tax is applied. Tax credits may be refundable or nonrefundable. If a tax credit is nonrefundable, it can provide a tax benefit only to the extent that the taxpayer has a tax liability. In contrast, the taxpayer is ensured of receiving the full amount of a refundable tax credit in the year it is claimed, because if the tax credit exceeds the tax liability, the taxpayer receives a check from the government for the difference.

Past TRCs noted that tax exemptions and credits shrink the tax base and result in higher tax rates on the remaining tax base. This makes the tax less efficient from an economic standpoint, and frequently makes it less equitable as well.

For example, the 2005-2007 TRC noted that the Legislature should include a sunset date that will trigger a review of whether the tax credit or exemption should be continued. By reviewing the tax credits and exemptions, the State can ensure that they are meeting the goals of the State.

Some tax credits have been enacted with sunset dates and have sunsetted or have been repealed. In some cases, the sunsetted or repealed credit has been replaced with an alternative. These credits have included the Individual Development Account Contribution Tax Credit (Hawai'i Revised Statutes (HRS) §235-5.6; sunset December 31, 2004), High Technology Business Investment Tax Credit (HRS §235-110.9, §241-4.8, §431:7-209; sunset December 31, 2010), Technology Infrastructure Renovation Tax Credit (HRS §235-110.51; sunset December 31, 2010), Residential Construction and Remodeling Tax Credit (HRS §235-110.45; repealed June 30, 2003), Hotel Construction and Remodeling Tax Credit (HRS §235-110.4; repealed December 31, 2005), and the Energy Conservation Tax Credit (HRS §235-12; sunset June 30, 2003), which was partially replaced by the Renewable Energy Technologies Credit (Act 70, SLH 2003). For these 6 expired tax credits, excess credits from prior years could be carried over to subsequent years indefinitely and they continue to be claimed as of Tax Year 2019 according to the latest DOTAX Tax Credits report.[3]

Although some tax credits expired, the number of tax credits, in general, have expanded over the years peaking at 22 tax credits as of Tax Year 2019.

Relevant Selected Legislation–Tax Credits:

Act 88, SLH 2006 increased and modified the motion picture, digital media, and film production income tax credit (film credit). Act 88 was to be repealed on January 1, 2016.

Act 89, SLH 2013 extended the sunset date of Act 88, SLH 2006 (film credit) to January 1, 2019. Added reporting requirements by the Film Office, Department of Business, Economic Development & Tourism (DBEDT) to the Legislature.

Act 143, SLH 2017 extended the sunset date of the film credit as amended by Act 89, SLH 2013, from January 1, 2019 to January 1, 2026. Added verification review by a qualified CPA and reporting requirements by DBEDT and DOTAX to the Legislature. Capped the total credit to $35 million per year which is a rolling cap that allows claims for a tax credit that exceeds the $35 million cap in one year to be claimed in the subsequent year, under that year's cap, except for the final, seventh year of the tax credit in the year 2026.

Act 275, SLH 2019 increased the annual aggregate cap of the film credit from $35 million to $50 million but retained the January 1, 2026 sunset date.

Act 270, SLH 2013 re-enacted tax credit for research activities (TCRA), but conformed to section 41 and section 280C of the Internal Revenue Code (IRC). Added reporting requirements by DBEDT to the Legislature and applied to tax years from 2013 to 2019.

Act 261, SLH 2019 was effective for taxable years beginning after December 31, 2019 and extended the TCRA sunset date through December 31, 2024.

Act 200, SLH 2014 established a capital infrastructure tax credit for tenants who were relocating due to the Kapalama container terminal modernization project. The credit was available for tax

[3] DOTAX Tax Credits reports are accessible at https://tax.hawaii.gov/stats/a5_1annual/a5_4credits/.

years beginning after December 31, 2013 and were to expire for tax years beginning after December 31, 2019.

Act 213, SLH 2017 expanded the capital infrastructure tax credit, among other things, doubling the amount of credit per taxable year from $1.25 million to $2.5 million.

Act 261, SLH 2019 repealed the capital infrastructure tax credit.

Act 202, SLH 2016 repealed the ethanol facility tax credit and created a new, nonrefundable income tax credit for production of renewable fuels. The credit for production of renewable fuels applied to tax years beginning 2017 and is to be repealed on December 31, 2021.

Act 142, SLH 2017 changed the certification process of the renewable fuels credit and Act 143, SLH 2018 lowered the production threshold for eligibility for the credit.

Background Information–GET Exemptions:

Hawaiʻi's General Excise Tax (GET) is a "privilege tax" imposed on business activity in the State of Hawaiʻi. The tax is imposed on the gross income (or gross receipts) received by the person engaging in the business activity. "Gross income" is the total business income before any business expenses and it includes any cost passed on to customers such as the GET as well. GET is a tax on income from almost all business activities unlike a sales tax which is only on the retail sales of tangible goods. Activities subject to GET include wholesaling, retailing, farming, services, construction contracting, rental of personal or real property, business interest income, and royalties among others. The state GET rates are 0.15% on commissions from insurance sales; 0.5% on wholesaling activities in which a business sells goods or services to another business for resale; and 4.0% on all other activities for which all counties except Maui add a surcharge of 0.5%. The Use Tax complements the GET by imposing tax on tangible personal property, services and contracting that are imported into Hawaiʻi.

Most business expenses, such as the cost of goods sold or depreciation allowed as deductions on an income tax return, are not deductible on GET returns. Some of the more common GET exemptions include: Payments made by a contractor to a subcontractor or specialty contractor; sales of tangible personal property made directly to the federal government or credit unions; out-of-state sales; food paid for by the Supplemental Nutrition Assistance Program (SNAP) or with Women, Infants, and Children (WIC) food vouchers, among others.

"General Excise/Use Tax Schedule of Exemptions and Deductions" (Schedule GE) is required to be filed along with a taxpayer's periodic (Form G-45) and annual (Form G-49) GET returns. The Schedule GE reports the amounts and types of GET exemptions claimed and it currently lists 58 different exemptions.[4]

Apart from a brief period between 2011 and 2013 when a number of GET exemptions were temporarily suspended, the GET exemptions have neither been eliminated nor minimized.

The bottom line of TRC recommendations has been that, as a general rule, the number of exemptions should be minimized to prevent erosion of the broad tax base and to avoid increased complexity in administration of the tax.

The 2005-2007 TRC further warned that proposals to exempt transactions (such as health care services, food, apparel, or shelter) from the GET should be weighed carefully. In general, exemption of transactions primarily affecting consumers is undesirable. If the Legislature finds it desirable to grant such tax relief on equity grounds, then it should pursue those goals either through low-income credits against income taxes or through the appropriation and expenditure process, which enhances transparency and accountability. For instance, in tax year 2006, it was estimated that exempting food, health care, clothes and shelter from the GET would have cost about $501 million, or about 22.3 percent of total GET receipts. To keep revenue constant with the exemptions, the statutory rate of the GET would need to be raised from the current level of 4 percent to about 5.1 percent.

Relevant Legislation–GET Exemptions:

Act 105, SLH 2011 suspended temporarily the exemptions for certain persons and certain amounts of gross income or proceeds from GET and Use Tax and required the payment of both taxes at 4%. It was effective on July 1, 2011, and sunsetted on June 30, 2013.

[4] DOTAX GET Exemptions reports are accessible at https://tax.hawaii.gov/stats/a5_1annual/a5_7ge_use/.

Recommendations 4, and 5: Eliminate the GET exemption for nonprofit organizations or establish a maximum exemption amount; extend tax-exemption to skilled nursing facilities and for-profit hospitals, infirmaries, and sanitaria.

Background Information:

The 1995-1997 TRC cited equity concerns about taxpayers having to pay GET on medical services received at for-profit institutions as compared with nonprofit institutions. However, they also expressed concern that there may be a lack of compliance with the GET law by nonprofit organizations in general and recommended clarification of nonprofit exemptions and requiring new compliance reporting.

Because the GET is a tax on consumption rather than profits, the 2005-2007 TRC urged that consideration be given to eliminating the GET exemption for not-for-profit organizations to ensure that they are treated in the same manner as for-profit entities. (This would not affect the tax exemptions for donations or gifts to nonprofit entities; the issue is the sale of goods or services by nonprofit entities.) In the absence of eliminating this exemption, the Commission recommended that the Legislature consider establishing maximum exemption amounts for not-for-profit organizations.

Relevant Legislation:

Neither of these recommendations have been adopted.

Recommendation 6: Overhaul the business incentive tax credit process

Background Information:

The 2001-2003 TRC opined that the State must make a commitment to require accountability for all business tax incentives and ensure that any targeted tax incentive goes through a legislative process where there is accountability for the tax benefit both at the Legislature and through enforcement by DOTAX or some other agency. This would insure that (a) the true costs and benefits of the tax incentive are understood by everyone, and (b) that the benefit being provided to the State is commensurate to the cost to the State. The fact that there may be less legislative, media, and public scrutiny of how tax credit dollars are spent does not make tax credit dollars any less valuable than general fund dollars.

Sunset provisions and reporting requirements have been incorporated into some business incentive tax credits, such as the motion picture, digital media, and film production income tax credit (film credit), tax credit for research activities, and renewable fuels production tax credit.

Relevant Selected Legislation:

Act 261, SLH 2016 required the State Auditor to periodically review certain tax exemptions, exclusions, and credits under the GET and use tax, (chapters 237 and 238, HRS), public service company tax (chapter 239, HRS), and insurance premium tax (chapter 431, HRS), beginning in 2018.

Specifically, Act 261 required the Auditor to: (1) Determine the amount of tax expenditure for the exemptions, exclusions, and credits for each of the previous three fiscal years; (2) Estimate the amount of tax expenditure for the exemptions, exclusions, and credits for the current fiscal year and the next two fiscal years; (3) Determine whether the exemptions, exclusions, and credits have achieved and continue to achieve the purpose for which they were enacted by the Legislature; (4) Determine whether the exemptions, exclusions, and credits are necessary to promote or preserve tax equity or efficiency; (5) Determine whether an economic benefit has resulted, and if so, quantify the estimated benefit directly attributable to the exemptions, exclusions, and credits; and (6) Estimate the annual cost of the exemptions, exclusions, and credits per low-income resident of the State. Act 261 also required the Auditor to recommend whether an exemption, exclusion, or credit should be retained without modification, amended, or repealed.

Act 177, SLH 2017 provided the State Auditor access to any tax records that are required for the Auditor to conduct its review of tax credits, exemptions, exclusions, and deductions.

Act 88, SLH 2006 created prequalification standards and oversight by DBEDT and the Hawai‘i Film Office. Each taxpayer must apply through the Hawai‘i Film Office and have the credits certified. A taxpayer claiming this credit must attach the certification with the taxpayer’s tax return.

Act 89, SLH 2013 required DBEDT to prepare a report to the legislature setting forth the non-aggregated qualified production costs that form the basis of the film tax credit claims and expenditures, itemized by taxpayer, in a redacted format to preserve the confidentiality of the taxpayers claiming the film credit.

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME

Summary of Recommendations by Tax Review Commissions	**1983-1985**	**1988-1990**	**1995-1997**	**2001-2003**	**2005-2007**	**2010-2013**	**2015-2017**
1. Phase in taxation of all pension income.			X	X			
2. Conform to the federal tax treatment of retirement income, excluding an annual base amount (e.g., $50,000)					X		
3. Tax retirement income more evenly by making social security payments and income from employer-provided pensions subject to the State's income tax. (Enact with a five-year lag)							X

Recommendation 1: Phase in taxation of all pension income.

Background Information:

Based on a consulting report, the 2001-2003 TRC recognized that the expected tax revenue lost by the pension exemption due to the aging population, is significantly offset, over the 75-year period, by the shift in the character of retirement income from traditional pension plans (which are exempt from taxation) to 401(k) or similar deferred compensation plans (which are generally taxable). However, based on concerns for equity and fairness, the 2001-2003 TRC recommended that all forms of retirement income should be taxed the same, regardless of its source from 401(k) plans, pension plans, profit sharing plans, IRA, SEP, 457 plan, or 403(b) plans. However, they noted that any changes in this area should be made with great care and only after additional analysis. For example, if the Legislature decides to repeal the current exemption for any type of retirement income, such repeal should have a delayed phase in and not apply to persons who retire before that date, in order not to penalize current and prospective retirees who have made their financial plans based on the exemption of their current and future retirement benefits. The 2001-2003 TRC also opined that the problem of low-income retirees’ reliance on tax-exempt pension income can be addressed by increasing the lowest income tax bracket, the amount of the personal exemption, and the standard deduction, to ensure that persons qualifying for public assistance and other low income taxpayers will no longer be subject to Hawaiʻi income tax.

Recommendation 2: Conform to the federal tax treatment of retirement income, excluding an annual base amount (e.g., $50,000).

Background Information:

The 2005-2007 TRC acknowledged that the current tax treatment is not even-handed, as it distinguishes unfairly between different types of retirement income. There is another equity concern, however, in that people have made employment decisions based on the current tax treatment. For example, some may have accepted smaller government pensions on the expectation that they would not be taxed. People have also made decisions on where to live based on the current tax law. As a result, they opined that excluding a base amount would ameliorate the effect of this change on those now receiving tax-free pensions and would remove the effect entirely for those with small pensions (i.e., those below the base exclusion).

Recommendation 3: Tax retirement income more evenly by making social security payments and income from employer-provided pensions subject to the State's income tax. (Enact with a five-year lag).

Background Information:

The 2015-2017 TRC recommended that the Legislature conform to the federal tax treatment of social security income and also conform to the federal treatment of employer-provided pensions, after allowing a deduction for income attributable to employee contributions that were subject to state or municipal taxes. To lessen the burden of the tax change on retirees, the TRC recommended that it be enacted with a lag, taking effect five years after its enactment in order to give people time to plan for the change. They did not consider exempting all retirement income up to a base amount per year, because they thought it would help the State meet the goal of tax adequacy by generating more tax revenue.

The consultant report for the 2015-2017 TRC noted that there has been strong political opposition to any taxation of public pensions, and they viewed the $25,000 (per retiree) exclusion as an accommodation for those with more modest public pensions. They also pointed out that this recommendation was at odds with general belief that those on fixed income are less able to deal with additional costs, including taxes. It may also violate a form of “social compact” between the public employees and government and may potentially be subject to litigation. Finally, if the policy measure is enacted on prospective pension filers, the State would not see the positive revenue impact for many years.

Relevant Legislation:

None of these recommendations have been adopted.

Further Information

The Employees' Retirement System (ERS) was established in 1926 to provide retirement allowances and other benefits to State and county government employees of Hawai'i. ERS currently provides retirement, disability, survivor, and other benefits to more than 135,000 members and retirees, as well as their beneficiaries.[5] Employee contributions to the ERS under the current hybrid and contributory plans are subject to the State income tax upfront although the payments by ERS to the retirees after retirement are exempt from State taxes. If the State exemption for ERS pension income were to be removed, the retirees would need to be refunded for their after-tax cost of pension income over their expected lifetime to avoid being double-taxed.

8. SIMPSON-BOWLES-LIKE COMMISSION ON SPENDING

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
1. Establish a "Simpson-Bowles" Commission to examine how to handle the unfunded and underfunded liabilities for health care and pension benefits for retired State workers, including measures to raise revenues and to reduce expenditures.						X	X

Background Information:

The 2015-2017 TRC recognized that it is not empowered to make recommendations related to State expenditures so it recommended the establishment of a commission similar to the National

[5] Please see https://ers.ehawaii.gov/ for more information.

Commission on Fiscal Responsibility and Reform (also known as the "Simpson-Bowles Commission") to examine how to handle the unfunded and underfunded liabilities for health care and pension benefits for retired State workers, including measures to raise revenues and to reduce expenditures. The 2010-2013 TRC also recommended that the State create a task force mandated to recommend an overall strategy for addressing Hawai'i's likely substantial upcoming budget shortfalls through an integrated broad strategy involving both revenue enhancement and spending adjustments. Such a commission, with its singular focus, would provide a "drill down" study and recommendations that should be of great value to policy makers.