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

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*The views expressed here are solely those of the author and should not be attributed to the Office of Tax Research and Planning or Hawai‘i Department of Taxation.

2020-2022 Hawai‘i Tax Review Commission (TRC): Issues for Investigation and Possible Recommendation

1. Carbon Tax/Greenhouse Gas Impact Fees
2. Visitor Impact Fees
3. Hawai‘i’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

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

2015-2017 TRC Recommendation:
- Study whether Hawai‘i should institute a carbon tax
- Study the effect on other State goals, on what to do with the revenue, and on the best way to apply the tax

Background Information:
- The carbon tax would likely affect the cost of energy, transportation, and goods produced in Hawai‘i.
- Existing studies: carbon tax would be regressive since lower income households spend a greater percentage of their incomes on energy.

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1. CARBON TAX/GREENHOUSE GAS IMPACT FEES (CONT.)

Background Information (Cont.):

- Revenue gains from such a broad-based tax could be substantial.
- Caveats include:
  - There are no existing “lessons learned” from other states
  - Potentially a hard sell politically.

Relevant Legislation:

- The Hawai‘i Carbon Pricing Study, 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**
- Final report published in April 2021

1. CARBON TAX/GREENHOUSE GAS IMPACT FEES (CONT.)

Relevant Legislation:

- Proposals in the 2019, 2020, and 2021 legislatures on carbon tax stalled.
- Example: Senate Bill 3150 from 2020 proposed to revamp the environmental response, energy, and food security (barrel) tax to address carbon emissions.
- Measure proposed: Increase rates in 2021, 2024, 2027, and 2030, so effective price of $40 per metric ton of carbon dioxide emissions in 2021 and increase to $80 per metric ton in 2030.

Further Information:

- The current 2020-2022 TRC contracted with the same UHERO team for a follow-up study.
- Study to appear in the appendix of the 2020-2022 TRC Report.

2. VISITOR IMPACT FEES

Background Information:

- No recommendations by past TRCs
- “Hawai‘i Green Fee” presentation given by Dr. Jack Kittinger and his team in the August 18, 2021 meeting of the TRC.

Relevant Legislation:

- Measures under consideration in the 2021 legislature to establish a “visitor green fee” program stalled.
- Senate Bill 666 proposal: 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.

- Adjusted gross income can be reduced by standard or itemized deductions.
- Standard deduction amounts based on filing status, not age.

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3. STANDARD DEDUCTION AND PERSONAL EXEMPTIONS (CONT.)

Recommendation 2: Increase the standard deduction.

- Federal standard deduction amounts adjusted annually for inflation
- Hawaiʻi standard deduction amounts fixed by statute and changed infrequently: Prone to erosion by inflation
- Increasing standard deduction amounts 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.

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

Hawai'i Standard Deduction	
1982-2013 Average Growth Rate	4.90%
1982-2013 Average Inflation Rate	**3.12%**
1982-2020 Average Growth Rate	3.98%
1982-2020 Average Inflation Rate	**2.63%**

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3. STANDARD DEDUCTION AND PERSONAL EXEMPTIONS (CONT.)

Recommendation 3: Increase personal exemptions.

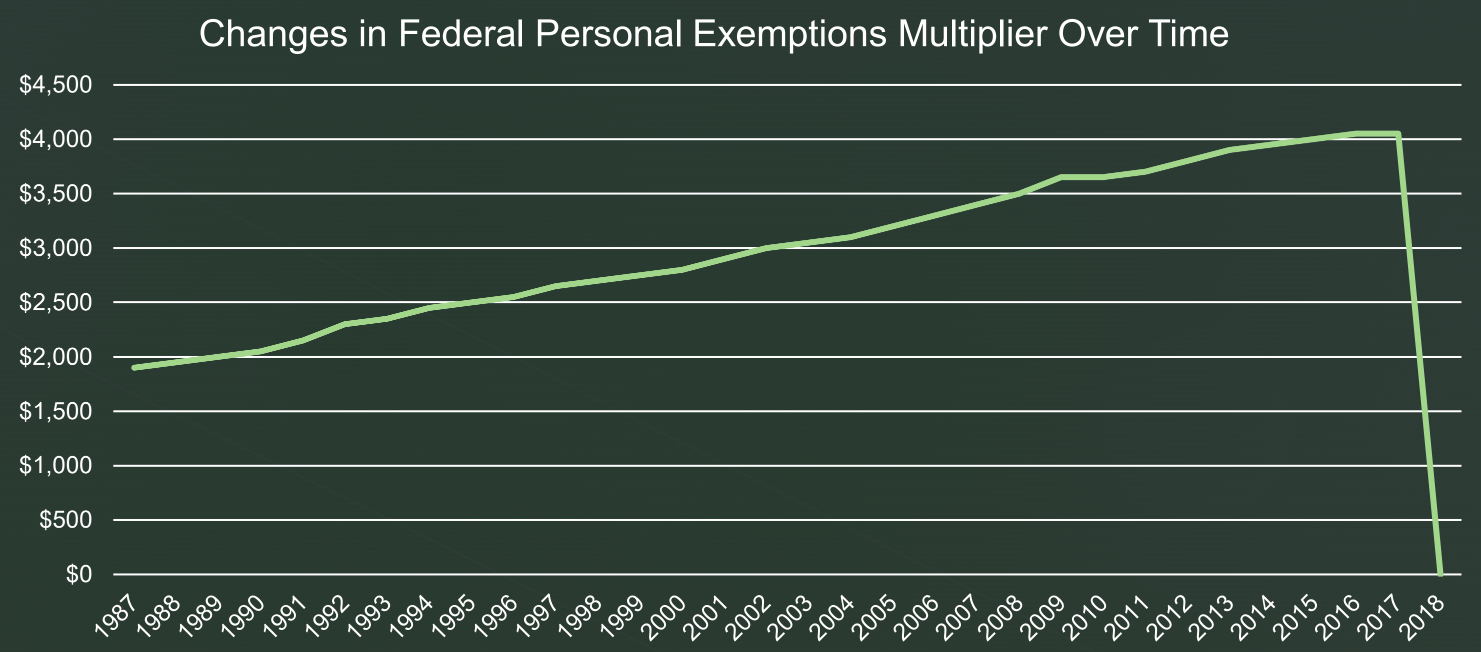
- In Hawai‘i, personal exemption multiplier raised last time in 2013 from $1,040 (**Act 78, SLH 1985**) to $1,144 by **Act 60, SLH 2009**.
- Eroded by inflation over the years.

Changes in Hawaii's Personal Exemptions Multiplier Over Time

	1985	2013
Regular personal exemption	$1,040	$1,144

Hawai'i Personal Exemptions	
1985-2013 Average Growth Rate	0.34%
1985-2013 Average Inflation Rate	**2.80%**
1985-2020 Average Growth Rate	0.27%
1985-2020 Average Inflation Rate	**2.54%**

Federal Personal Exemptions



Federal Personal Exemptions	
1987-2017 Average Growth Rate	2.55%
1987-2017 Average Inflation Rate	**2.60%**

3. STANDARD DEDUCTION AND PERSONAL EXEMPTIONS (CONT.)

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

- Not adopted

- 2015-2017 TRC recommended modernization of the individual income tax by
  - increasing the personal exemption and standard deduction amounts to federal levels in 2017
  - indexing them to inflation thereafter.
  - Altering tax rates and 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 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 the Department to increase efforts to educate the public in order to improve compliance with Hawaii's tax law.							X

Background Information–General:

- Compliance initiatives important because
  - Can increase voluntary compliance
  - Create greater confidence in the system by those taxpayers who pay their taxes in full and on time (vast majority of Hawaiʻi taxpayers).

4. TAX SYSTEM COMPLIANCE AND ENFORCEMENT (CONT.)

Relevant Legislation:

- **Act 134, SLH 2009**, the Cash Economy Enforcement Act, committed additional resources over time to the Department to raise additional revenue owed to the State.
- Primary focus of the Act: Creation of a *Special Enforcement Section*,
  - A specialized unit within the Department's Compliance Division and includes civil investigators and support staff.
- The Department required to provide regular reports to the Legislature about
  - Resources committed to implementing the Act
  - Additional revenues raised as a result of the Act.

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			

Background Information–General:

- Annual income is the amount earned during the year, whereas wealth is total assets minus total debts.
- Wealth a substantial part of the tax base for many other states, but Hawaiʻi State precluded from taxing real property (most common and practical way to tax wealth)

5. TAX POLICY ON REAL PROPERTY AND WEALTH (CONT.)

Background Information–HARPTA:

- Income tax rate 7.25% on long-term capital gains and 11% on short-term capital gains
  - BUT withholding of tax for the disposition of Hawaii real property by nonresident persons, “HARPTA” (Hawai‘i Real Property Tax Act) withholding was 5% (of the gross selling price) at the time of 2015-2017 TRC.
  - Possibility: Income tax liability of nonresidents to exceed HARPTA withholding (particularly if property depreciated over a long period of time and taxpayer has little basis)
  - Plus nonresident seller may have been renting the property and neglected to pay TAT and GET on the rental income: HARPTA withholding insufficient to cover tax liability
- 2005-2007 TRC: Increasing HARPTA withholding rate would encourage greater compliance by those seeking a refund and reduce loss from non-filers

5. TAX POLICY ON REAL PROPERTY AND WEALTH (CONT.)

Relevant Legislation–HARPTA:

- **Act 213, SLH 1990:** HARPTA withholding rate 9%
- **Act 279, SLH 1991:** Reduced HARPTA rate from 9% to 5%.
- **Act 122, SLH 2018:** Increased HARPTA rate from 5% to 7.25%.
  - Expected revenue gain (per TRP) was $8.1 million in FY 2019 and $2.6 million per year from FY 2020 to FY 2025.

5. TAX POLICY ON REAL PROPERTY AND WEALTH (CONT.)

Background Information–Estate Tax:

- 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.
- 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.

5. TAX POLICY ON REAL PROPERTY AND WEALTH (CONT.)

Background Information–Estate Tax (Cont.):

- 2001-2003 TRC recommended:
  - Conform with all of the Federal Estate Tax repeal provisions of EGTRRA for administrative simplicity except the repeal of the State of Hawai‘i Death Tax Credit.
  - 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–Estate Tax:

- Act 89, SLH 2021: conforms to federal as amended as of December 31, 2021 with the exception of the excludable amount of $5.49 million which was set on December 21, 2017.
- For TY 2021, federal excludable base $11.7 million (Tax Cuts and Jobs Act of 2017), causing a “Gap” between the federal and state excludable amount.

5. TAX POLICY ON REAL PROPERTY AND WEALTH (CONT.)

Further Information–Estate Tax:

- None of the TRCs recommended 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 applicable to decedents dying after December 31, 2019.
- According to TRP, the estimated gain to the General Fund is $1.9 million in FY 2021 and $2.0 million in FY 2022.

Further Information–Property Tax Deduction:

- Policy exercise by consultants in the 2015-2017 TRC report appendix: Eliminating the itemized deduction for property taxes paid since the State is not able to tax real property (rough revenue gain estimate of $30-$40 million annually.)
- However: Not recommended by TRC.

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		

Background Information–Tax Credits:

- Tax credits 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 subtracted directly from the tax liability, so they reduce the amount of taxes dollar-for-dollar: More valuable than ordinary deductions which only reduce taxable income.

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–Tax Credits (Cont.):

- Tax credits may be refundable or nonrefundable.
  - Nonrefundable: tax benefit up to taxpayer's liability.
  - Refundable: full amount guaranteed even with zero/negative liability (effectively a subsidy, e.g. film credit, food/excise tax credit).

Past TRCs:

- Tax exemptions and credits shrink tax base.
- Results in higher tax rates on the remaining tax base:
  - Makes the tax less efficient (from an economic standpoint)
  - Frequently makes it less equitable.

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–Tax Credits (Cont.):

- 2005-2007 TRC: 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

Status Check:

- Some tax credits enacted with sunset dates and some repealed.
- Some repealed credits replaced with alternatives.
- For the 6 expired tax credits (between 2003-2010), excess credits from prior years could be carried over to subsequent years indefinitely and they continue to be claimed as of Tax Year 2019
- Number of tax credits expanded over the years peaking at 22 tax credits as of Tax Year 2019

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–GET Exemptions:

- General Excise Tax (GET): “privilege tax” on business activity in the State of Hawai‘i.
- GET imposed on gross income/receipts, i.e. before any business expenses including any cost passed to customers (like GET)
- GET on almost all business activities unlike sales tax (on retail sales of tangible goods only).
- Activities subject to GET: Wholesaling, retailing, farming, services, construction contracting, rental of personal or real property, business interest income, and royalties,...
- GET rates: 0.15% on commissions from insurance sales; 0.5% on wholesaling activities (i.e. a business sells goods or services to another business for resale); and 4.0% on all other activities
  - All counties except Maui add a county surcharge of 0.5%.
- Use Tax imposes GET on goods, services, and contracting that are imported to Hawai‘i

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–GET Exemptions (Cont.):

- “General Excise/Use Tax Schedule of Exemptions and Deductions” (Schedule GE) 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.

Past TRCs:

- Number of exemptions should be minimized to prevent erosion of the broad tax base and to avoid increased complexity in administration of the tax.

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–GET Exemptions (Cont.):

- 2005-2007 TRC warning: 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.
  - In tax year 2006, exempting food, health care, clothes and shelter from the GET estimated cost: about $501 million (22.3% of total GET collection). Revenue neutrality would require raising GET from 4% to 5.1%

Status Check:

- 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.

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6. TAX CREDITS AND EXEMPTIONS (CONT.)

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
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				

Background Information–GET on Nonprofits:

- 1995-1997 TRC cited equity concerns for GET on medical services at for-profit institutions versus nonprofit institutions.
- Also expressed concern about potential noncompliance with the GET law by nonprofit organizations in general
- Recommended clarification of nonprofit exemptions and requiring new compliance reporting.

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–GET on Nonprofits (Cont.):

- 2005-2007 TRC: GET is a tax on consumption rather than profits, so eliminate GET exemption for nonprofits to ensure equity (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.) OR At least establish maximum exemption amounts for nonprofits.

Status Check:

- None adopted
- In tax year 2019, GET exemption for nonprofits was the second highest exemption in the whole State costing about $240 million

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Summary of Recommendations by Tax Review Commissions	1983-1985	1988-1990	1995-1997	2001-2003	2005-2007	2010-2013	2015-2017
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			

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Background Information–Business Tax Credits:

- 2001-2003 TRC: State must require accountability for all business tax incentives and ensure that the 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.

Status Check:

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

6. TAX CREDITS AND EXEMPTIONS (CONT.)

Relevant Legislation–Business Tax Credits:

- **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.
- Tasks such as:
  - Determine/estimate the amount of tax expenditure of exclusions, exemptions, credits
  - Determine if they achieved or continue to achieve Legislature's purpose in enacting them
  - Tax equity and efficiency
  - Determine any economic benefits
  - Determine any annual costs
  - Recommend whether they should be retained without modification, amended, or repealed

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

Background Information–General:

- Based on a consulting report, 2001-2003 TRC recognized: Expected tax revenue lost by the pension exemption due to the aging population significantly offset in the long run by the shift in retirement income from traditional pension plans (nontaxable) to 401(k) or similar deferred compensation plans (taxable).

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME (CONT.)

Recommendation 1: Phase in taxation of all pension income.

- 2001-2003 TRC: Based on concerns for equity and fairness, 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.
- Any changes in this area should be made with great care and only after additional analysis
- 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.

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME (CONT.)

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

- 2005-2007 TRC acknowledged current tax treatment not even-handed
- Another equity concern: 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.
- 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).

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME (CONT.)

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).

- 2015-2017 TRC: Conform to the federal tax treatment of social security income and 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, enact with a 5-year lag
- No base amount recommended, because would generate less tax revenue and not help State meet tax adequacy goals.

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME (CONT.)

Further Information:

- 2015-2017 TRC Consultant Report: Strong political opposition to any taxation of public pensions so $25,000 (per retiree) exclusion to accommodate retirees with more modest public pensions.
- TRC recommendation at odds with general belief that those on fixed income are less able to deal with additional costs, including taxes.
- It may violate a form of “social compact” between the public employees and government and may potentially be subject to litigation.
- If enacted on prospective pension filers, the State would not see the positive revenue impact for many years.

7. TAXING PENSIONS AND OTHER RETIREMENT INCOME (CONT.)

Further Information:

- Employees' Retirement System (ERS) established in 1926 and currently provides retirement, disability, survivor, and other benefits to more than 135,000 members and retirees, as well as their beneficiaries.
- Employee contributions to the ERS under the current hybrid and contributory plans subject to the State income tax upfront
- If 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:

- 2015-2017 TRC: Recognizing it is not empowered to make recommendations related to State expenditures, recommended a commission similar to the National 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

8. SIMPSON-BOWLES-LIKE COMMISSION ON SPENDING (CONT.)

Further Information:

- 2010-2013 TRC: 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.