

July 13, 2005

The Honorable Robert Bunda, President
and Members of the Senate
Twenty-Third State Legislature
State Capitol, Room 003
Honolulu, Hawaii 96813

Dear Mr. President and Members of the Senate:

Re: House Bill No. 1309 HD2 SD2 CD1

On July 12, 2005, House Bill No. 1309, entitled "Relating to Taxation" became law without my signature, pursuant to Section 16 of Article III of the State Constitution.

The purpose of House Bill No. 1309 is to authorize the counties to establish a surcharge of up to 0.5 percent on the State general excise and use taxes by the adoption of an ordinance no later than December 31, 2005. Under this measure, the funds from the county surcharge must be used:

- (1) By any county with a population greater than 500,000 for operating or capital costs of a locally preferred alternative for a mass transit project and for complying with the Americans With Disabilities Act of 1990 ("ADA"); or
- (2) By any county with a population less than 500,000 for operating or capital costs of public transportation systems, including public roadways, highways, public buses, trains, ferries, pedestrian paths, sidewalks, or bicycle paths, and expenses in complying with the ADA.

This bill currently requires the Department of Taxation, State of Hawaii ("DOTAX") to administer any surcharge taxes that are enacted by the counties. This bill also directs the State Director of the Department of Budget and Finance to retain ten (10) percent of the total surcharge tax revenues that are collected by DOTAX and deposit these revenues into the State's general fund.

The major problem with this bill is that it does not clearly and definitively authorize the counties additional taxing authority to meet public needs. I am pleased that the President of the Senate and the Speaker of the House have pledged to introduce amendments to House Bill No. 1309 in the 2006 session to clarify that a county that enacts a surcharge tax should be empowered and required to administer and collect that tax, utilizing what portions it needs to pay for the administrative costs associated with its collection and disbursement.

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The bill as written mandates that the State Department of Taxation administer and collect the counties' enacted surcharge taxes but fails to appropriate the start-up funds for the Department to institute the changes that would be necessary to implement, test, and administer the collection and rebate system. The Department of Taxation testified on more than one occasion before the Legislature on the adverse administrative and fiscal impact this bill would have on its primary duty to administer the State's complex tax structure.

Furthermore, this bill as currently written would require the Department of Taxation to give expedited processing of the county surcharge tax over and above its responsibility to collect and administer State tax revenues. Specifically, the bill would require the county surcharge tax to be processed within ten days when there is no similar time limit for the State's portion of the general excise tax.

In addition, this bill does not address whether the counties would receive a portion of collected penalties or interest or receive any portion of a tax settlement in which a fraction of the total tax liability is collected. In short, this bill does not consider or put into place practical mechanisms to deal with the very real problems created by the bifurcated tax collection and disbursement system it established. These issues should be corrected when the amendments to establish each county as the collection authority are enacted.

House Bill No. 1309, as passed by the Legislature, also contains a number of technical flaws that should be addressed in the next legislative session.

For example, a loophole exists in this measure in that any written contract signed by June 30, 2006 that does not provide for the passing of the county surcharge tax may not be subject to the 0.5 percent county surcharge tax for an indefinite period of time. Therefore, leases, rental agreements, supply contracts, service contracts, and other such documents that are executed prior to June 30, 2006, and that do not provide for the passing of the county surcharge, may likely not be subject to the 0.5 percent county surcharge tax.

House Bill No. 1309, as drafted, fails to apply the surcharges to the same types of goods and services as the underlying State general excise tax. Specifically, the current State general excise tax is assessed, levied, and collected on "the value of tangible personal property, services, and contracting." House Bill No. 1309 applies the 0.5% surcharge only to the value of "property and services," thereby leaving as ambiguous its applicability to tangible personal property and contracting services.

Finally, this bill places a harsher penalty for failure to pay the 0.5% surcharge than is imposed on those who fail to pay the 4% general excise tax. Specifically, this bill would impose a 10% penalty on the entire amount of the surcharge owed by a taxpayer rather than imposing that penalty on the amount of the underpayment only.

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I wish to reaffirm my commitment to the strength and vitality of county government and the ability of county officials to address and solve the issues that face them in the twenty-first century. I have consistently held the position for nearly twenty-five years that government closest to the people is the government that can best meet the needs of its citizens.

Each of the four counties is working on its own plan to deal with transportation issues, especially the ever-increasing traffic that is negatively affecting the quality of life of its residents. Each county has the ability to plan for and take the critical steps necessary to develop preferred local alternatives to address what are widely recognized as serious transportation issues on each island. Developing a sound, comprehensive solution to each island's traffic problems is a multi-year effort that should not be done in haste and can and should proceed with all due deliberation. Further, this work can be carried out at the same time as the Legislature rewrites House Bill No. 1309 to address the flaws identified in this statement of concern.

Since the proposed 0.5% surcharge embodied in this bill does not go into effect until January 1, 2007, there is time for the counties that want to impose such a tax to develop the mechanisms they will need to assess and collect the monies. The State, through my offices, has already pledged to provide maximum support to each county that wants to proceed.

Therefore, I allowed House Bill No. 1309 HD2 SD2 CD1 to become law as Act 247 effective July 12, 2005 without my signature.

Sincerely,

LINDA LINGLE