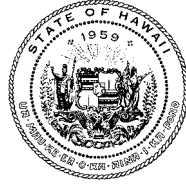


NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

LATE

To: The Honorable Clift Tsuji, Chair
and Members of the House Committee on Economic Development & Business

Date: Friday, March 22, 2013

Time: 10:30 a.m.

Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.C.R. 219 Requesting the Auditor to Conduct an Audit of the Department of Taxation to Address Any Issues Associated with the Collection of the 0.5% County Surcharge on the State General Excise Tax

The Department of Taxation (Department) **opposes** H.C.R. 219 as it is unnecessary and reflects a misunderstanding of the collection of the .5% county surcharge on the state general excise tax. The Resolution suggests that the Department has been untimely and inaccurate with respect to surcharge payments to the Honolulu Authority for Rapid Transit (HART). This is wrong, and the following information and comments are provided for the Committee's consideration.

H.C.R. 219 requests that the Office of the Auditor conduct an audit of the Department to address any issues associated with the collection of the 0.5% surcharge on the state general excise tax. The Resolution states that the HART has problems with the distribution services with respect to timeliness and accuracy of surcharge payments to HART.

The Department refutes the Resolution's assertions, especially with respect to the timeliness and accuracy of surcharge payments. For clarification, the Department reports the aggregate surcharge collection data on a monthly basis to the Department of Budget and Finance. The Department does not allocate or disperse any funds. Regardless, the Department is unaware, and has not been notified, that any quarterly payment has not been timely made.

In the Resolution, HART incorrectly asserts that the fee to administer the county surcharge is tied to costs incurred by the Department. In fact, section 238-2.6, Hawaii Revised Statutes, clearly states that the administrative fee is a reimbursement to the *State* (emphasis added), "...shall include any and all costs, direct or indirect...", and that the fee is retained in the State general fund.

As for HART's claim regarding the accuracy of the payments, the Department is aware that HART has expressed concerns about the reduced level of allocations made to the surcharge special account for the first and second quarter of Fiscal Year 2013 (FY2013). In particular,

HART has expressed a concern that while the overall general excise tax collections are rising, the county surcharge allocations have not risen proportionately.

After being notified, the Department devoted many staff hours to investigate and address these concerns. An extensive review of the county surcharge collection data by the Department has confirmed that, aside from a previously identified posting error in December 2011, which had been corrected in July 2012, the variances identified by HART are the result of processing and timing issues and a staffing shortage, not inaccurate figures.

Review of the tax data also substantiates that payments to HART are consistent with the total surcharge tax liability reported by taxpayers on their general excise tax (GET) returns. Specifically, for the period from January 2010 to January 2013, the total surcharge tax liability reported by taxpayers is \$595.7 million. Total surcharge tax payments to HART for the same period totaled \$596.2 million.

At HART's request, the Department conducted further reviews and found that the overall surcharge liabilities and the GET liabilities for activities taxed at 4% were consistent. The Department notes that the surcharge tax does not apply to the GET activities taxed at 0.5%, such as wholesale transactions and use tax on imports for resale, or the insurance commissions taxed at 0.15%.

As noted above, the Department has identified the fluctuations in the surcharge collection special account as processing and timing issues. Essentially, this means that the processing of payments and the processing of the corresponding tax returns do not occur simultaneously. In basic terms, when a tax return and payment is received, processing of the payment is first priority. The entire amount is first deposited into the State's general fund. After the tax return is processed, the surcharge amount reflected on the tax return is then allocated from the general fund to the surcharge special account. The processing and timing differences can also be substantially impacted by staffing levels in the Department's Document Processing (DP) Branch, which is what happened during the July to December 2012 period.

The following events had a direct impact on the collection amount reported in the surcharge special account:

- In July 2012, the Department identified a posting error of approximately \$10 million dollars. In December 2011, this amount should have been posted in the State's general fund account but instead was inadvertently posted to the surcharge special account. To correct this error, in July 2012, the respective amount of approximately \$10 million dollars was transferred from the surcharge special account to the general fund account.

- Starting in June 2012, eleven employees (roughly 20%) of the DP Branch staff were promoted into other positions within the Department. In addition to losing experienced staff, the DP Branch has had difficulty in filling these newly vacant positions. The obstacles to filling these positions include the temporary nature of the positions and the lengthy and involved hiring process. Regardless, the Department continues to work on filling these positions, with assistance from the Department of Human Resources Development.
- Starting in July 2012, the Department lost its additional temporary tax season employees, which normally provide extra manpower during the months of January through June. These additional employees help the Department run two additional shifts to assist with the processing of tax returns, one which occurs after normal business hours, and the second during weekends.
- The loss of experienced DP Branch staff and temporary tax season employees during the summer of 2012 resulted in a lag in the processing of tax returns during the July to December 2012 period. For the same time period in 2011, the processing of tax returns took approximately one month. In 2012, however, the processing of tax returns took two to four months. Delays in processing tax returns resulted in delays in the posting of the surcharge collection amounts.

The addition of temporary tax season employees in January 2013 has significantly reduced the backlog of tax returns waiting to be processed. Addressing the backlog of tax returns essentially means that the allocations to the surcharge special account can now be accomplished, and we fully expect to see an increase in the surcharge special account.

An additional impact on the reporting and allocating of surcharge collections to the surcharge special account is the mandatory electronic payment required of all taxpayers with annual tax liability of \$100,000 or more. As a result, a majority of these payments are collected before the Department receives and processes the corresponding tax return.

Preliminary reviews of the tax return liabilities reported and collections for the beginning part of the third quarter (January and February) in FY2013 reflect this occurrence:

1st quarter (July – Sept) FY2013:

Total surcharge liability reported by taxpayers - \$52.4 million
Total surcharge collections - \$39.5 million

2nd quarter (Oct – Dec) FY2013:

Total surcharge liability reported by taxpayers - \$50.3 million
Total surcharge collections - \$46.2 million

January and February 2013 (Preliminary):

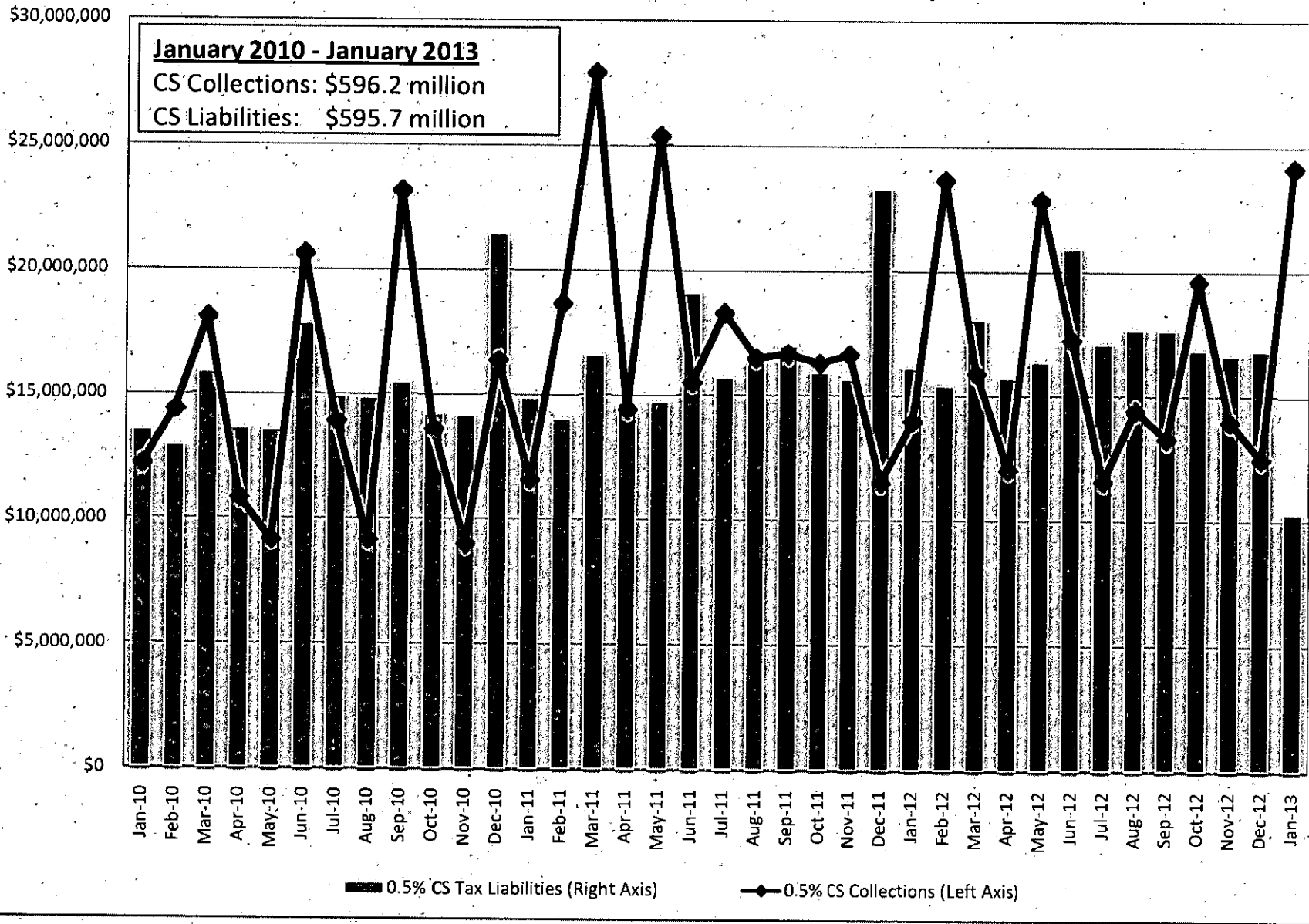
Total surcharge collections: \$43.59 million



As demonstrated above, what appears to be deviations from HART's projected collections is a misunderstanding of the processing and timing issues related to the processing of general excise tax returns. Additionally, this analysis reflects the actual impact of having insufficient staffing in critical functions within the Department. Overall, the data also clearly reflects the need to review the surcharge data over longer periods of time to better identify possible issues.

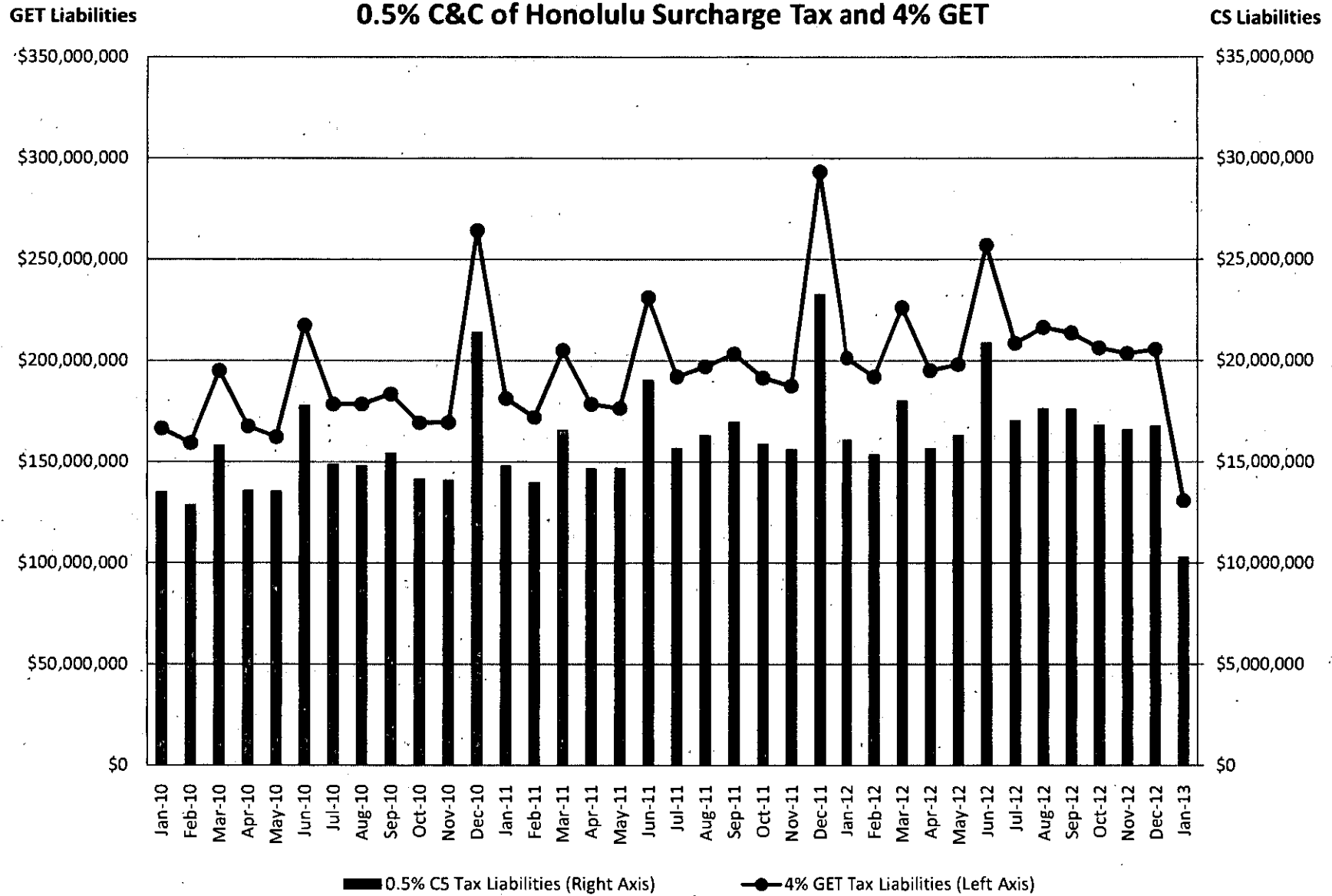
Thank you for the opportunity to provide comments.

Chart 1. County Surcharge Collections vs. Liabilities as Reported on GET Returns



LATE

**Chart 2. Tax Liabilities as Reported on GET Returns for
0.5% C&C of Honolulu Surcharge Tax and 4% GET**



LATE**Table 1. County Surcharge Tax Collections and Liabilities (January 2010 - January 2013)**

	2010				2011				2012				2013	Cumulative Total
	Jan- Mar	Apr- June	July- Sep	Oct- Dec	Jan- Mar	Apr- June	July- Sep	Oct- Dec	Jan- Mar	Apr- June	July- Sep	Oct- Dec	Jan	
	In Millions													
County Surcharge Collections	\$44.8	\$40.7	\$46.3	\$39.1	\$58.2	\$55.4	\$51.6	\$44.6	\$53.6	\$52.2	\$39.5	\$46.2	\$24.2	\$596.2
County Surcharge Liabilities	\$42.3	\$45.0	\$45.2	\$49.7	\$45.5	\$48.5	\$49.1	\$54.9	\$49.6	\$53.0	\$52.4	\$50.3	\$10.3	\$595.7
Difference	\$2.5	(\$4.3)	\$1.1	(\$10.7)	\$12.8	\$6.9	\$2.5	(\$10.3)	\$4.0	(\$0.8)	(\$12.9)	(\$4.1)	\$13.9	\$0.6

Source: GET returns processed as of March 8, 2013.