Agenda item II

COUNTY COUNCIL
COUNTY OF MAUI
200 S. HIGH STREET
WAILUKU, MAUI, HAWAII 96793
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October 6, 2015

TO: Honorable Simeon R. Acoba, Chair
and Members of the State-County
Functions Working Group (TAT)

FROM: Mike White
Council Chair

SUBJECT: **MEETING OF OCTOBER 7, 2015; TESTIMONY ON ALLOCATION OF TRANSIENT ACCOMODATIONS TAX REVENUES**

Thank you for the opportunity to testify on this important matter. The Maui County Council has not taken a formal position on the allocation of transient accommodations tax (TAT) revenues. Therefore, I am providing this testimony in my capacity as an individual member of the council.

At this critical juncture, I would like to reiterate that the counties' share of the total TAT revenue, at a minimum, should be fixed at 50 percent.

As stated in my previous testimony, I hope you will take time to review the *2014 HVS Lodging Tax Report* that lists 150 cities, special districts, and counties throughout the nation incorporating all taxes imposed on lodging, including state taxes. This report includes, in my opinion, enough data to set a fair benchmark.

In reviewing the data, the 150 *local* governments in the report receive an average of a 9.08 percent accommodations tax rate. In contrast, counties in Hawaii on average receive a 2.26 percent accommodations tax rate, ***which is less than a quarter of the 9.08 percent average among our national peers.***

The State of Hawaii receives revenues equivalent to a 10.99 percent tax rate, which is more than double the 4.33 percent that the states of the 150 local governments' average. In other words, ***the State of Hawaii takes more than 2.5 times more of the accommodations taxes collected in local jurisdictions than other states do.***

The State provides a mere 28 percent of the overall lodging taxes to counties, but only eight cities in the study receive anything below 40 percent in accommodation taxes. In addition, 21 percent of the municipalities in the study receive 100 percent of taxes on lodging, and ***67 percent in the study receive 60 percent or more***.

We also must keep in mind that Hawaii utilizes a general excise tax and most other states employ a sales tax. Therefore, the State has a greater ability to raise revenue.

	Local Gov't	*State*	*Total*
Average accommodations tax rate of 150 municipalities	9.08%	4.33%	**13.41%**
Current average accommodations tax rate for Hawaii counties	2.26%	10.99%	**13.25%**
Proposed 60-40 split accommodations tax rate for Hawaii counties	3.70%	9.55%	**13.25%**

Despite the new proposal of 60 percent of accommodations revenue going to the State and 40 percent to the counties, ***this still does not bring us close to our peers nationally.***

COUNTIES HAVE KEY RESPONSIBILITES
I would like to reiterate that local governments bear a significant responsibility for providing a wide array of services and infrastructure necessary to support a vibrant visitor industry. While the State has taken a greater share of the TAT, the cost of core services provided by the counties to our residents and visitors have continued to increase.

On average, the cost for core services in Maui County from 2007 to 2014 ***increased 33 percent***, or around $27 million, yet Maui County has only received an increase in TAT revenue of $508,623 or 2.2 percent, over the same period.

	Cost increases		*Change*	
	2007	*2014*	*$*	*%*
Fire	$21.9M	$29.9M	**$7.9M**	**36.1%**
Parks	$23.7M	$29.9M	**$6.2M**	**26.5%**
Police	$37.9M	$50.5M	**$13.1M**	**35.3%**

It is often said that counties should increase their property tax rates. *We have done exactly that* in response to declining property values. Since the start of the recession, Maui County has *reduced* exemptions and *increased* tax rates. The result is an ***increase of 23 percent*** in the effective tax rate per $1,000 of property value. Along with our property taxes, the TAT distribution provides critical support for visitor-related infrastructure and operating expenses.

Some State officials erroneously view giving TAT to the counties a potential loss. But the State and the counties serve the same constituents of Hawaii, which is why I continue to urge legislators to view these proposals as shared investments.

CONCLUSION

As the visitor industry begins to rebound, it is only fair that the counties receive a larger share of the TAT. National data clearly suggest counties in Hawaii are lagging behind their Mainland counterparts in the amount of revenue generated from lodging taxes.

With the current distribution, we rank 149 out of 150 in lodging taxes distributed to counties. With the proposed 40 percent distribution to counties, our ranking would improve to only 142.

It is critical to note the TAT distribution is particularly important to Neighbor Islands because our economic regrowth continues to lag behind that of Oahu. In addition, visitors in the Neighbor Islands make up a much larger portion of the de facto population.

The increase in the cap last year was much appreciated, but ***fairness dictates that more should be done***. It is simply not right for the State to have helped itself to a tax meant to benefit the counties. With the State receiving ***23 times more*** than in 2007 and the counties getting an increase of just 2.2 percent, it is only fair and appropriate for more parity and balance in the TAT distribution.

The counties are currently receiving $103 million in TAT revenue or approximately 25 percent of the total TAT revenue. If the counties received the same portion as an average municipality in the HVS study, the counties would be receiving over $270 million.

At a minimum, I firmly believe that the counties' share of the total transient accommodations tax revenue should be 50 percent. This would move us up to the rank of 130 out of 150. Thank you for your consideration.

Agenda item IV.

BELT COLLINS

MEMORANDUM

TO:	FROM:
State-County Functions Working Group and Jan Yamane, Acting State Auditor	John Kirkpatrick for the Belt Collins Hawaii Consulting Team
COMPANY: Office of the Auditor	DATE: September 29, 2015
SUBJECT: Submittal for October 7, 2015 meeting	JOB NUMBER/REFERENCE NUMBER: 2015.70.0300

As directed at the last Working Group (WG) meeting, we have (a) compiled a list of models considered to date for Transient Accommodation Tax (TAT) revenues and (b) calculated the impacts of several models over a ten year period, using both a slow-growth forecast and a "Recession Forecast" modeled on the changes in the TAT tax base over the years 2004-2014. These materials are attached. The slow-growth forecast draws on the Hospitality Advisors LLC forecast presented at the last meeting.

Since that meeting, we have submitted a request to the State Department of Taxation (DoTAX) for information about the break-out of Transient Accommodations Tax (TAT) vs. Transient Occupancy Tax (TOT) revenues over time. That information will help us refine the forecast as we head towards the draft and final report. We will report on information received by October 7 at the next meeting.

Our schedule had called for the Consultant to submit preliminary findings and recommendations for the October 7 meeting. We enclose a preliminary list of findings for consideration by the Working Group. The findings may help to provide the context for the WG's choice of a model and recommendations.

Models Considered

The WG has considered at least nine models so far:

- **Simple Shares Model**. Revenues divided into three shares:

  20% Tourism Special Fund (TSF)
  32% Counties
  48% State of Hawai‘i

  All shares would grow or contract along with revenues. Any existing set-asides (including the Convention Center Special Fund) would come from the State share.

  This allocation incorporates the 60/40 ratio that members of the Working Group found reasonable as a basic division between the State and counties.

- **Simple Shares, Alternative shares**

  20% Tourism Special Fund
  35% Counties
  45% State of Hawai‘i

  This allocation was developed by consultant as a simple alternative.

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- **Shares Model, with Tourism Special Fund Protected against Downturns**
  A. Tourism Special Fund, amount set by Legislature ($82 million for FY 2015) but changing with inflation from year to year
  B. Remainder split by State and counties on a 60/40 basis

- **Shares Model, with Existing Special Funds Increasing with Inflation**
  A. Special Funds protected:

$82.0	TSF, starting at $82 million and changing with inflation
$26.5	Convention Center Enterprise Special Fund
$1.5	Turtle Bay Special Fund
$3.0	Special Land Development Fund (DLNR)
$113.0	million in FY 2015.

  The protected TSF would presumably need to grow with inflation to insure consistent levels of services. Other special funds might not be subject to inflationary pressure – but for modeling purposes, all the Special Funds are treated as increasing along with the Consumer Price Index-Urban Consumers for Honolulu (CPI), unless corrected figures are provided by State members of the WG.

  B. Shares of remainder of TAT funds:

40%	Counties
60%	State of Hawai‘i

- **Current Distribution**
  A. Set-asides:
  $1.5 million for Turtle Bay SF
  $26.5 million for Convention Center SF
  $82.0 million for TSF (with some $1.4 million directed to specific ends)
  B. Counties: $103 million for FY2015, FY 2016; $93 million for later years
  C. Remainder to State, with $3 million allocated to Special Land Development Fund

- **“Historic Intent” Model Devised by Allocation Models Investigative Group**
  This model was developed to follow the allocations made at various times by the Legislature.
  A. Assuming the TAT rate is 9.25%, allot the first 5% (i.e., 54.054% of total revenues:
  95% to the counties
  5% to the State (administration)
  B. Take the next 2.25% (24.324% of revenues) and allocate it to amortization of Convention Center and to HTA[1]
  C Allocate remaining 2% [(21.622% of revenues) to the State

[1] Allocation Model Investigative Group memo dated May 29, 2015 identified shares of 5%, 2.5% and 2% -- totaling 9.5%, not the 9.25% rate of the TAT. The second share has been revised here to match the sequence of increases in the TAT over time.

- **Three-stage Model "Recommended" by Allocation Models Investigative Group**

  A. Guaranteed to TSF: $83 million plus growth with inflation

  B. 90% of remainder divided 60/40 for State and counties, of which $100 million each, guaranteed to allow the State and counties (guaranteed amounts to increase over time with inflation)

  C. 10% of remainder reserved for Legislative discretion, with recommendation that funds spent on visitor-related expenditures.

  Existing set-asides for the Convention Center, the Turtle Bay SF and the Special Land Development Fund would be allocated from the State's Stage B share.

  Should TAT revenues available to be divided 60/40 in Stage B amount to less than amount needed to cover anticipated needs of the State and counties, the difference would be made up from (a) the Legislative discretionary Stage and, if necessary, the State's Stage B amount. This model differs from the one originally proposed by the Investigative Group by including an inflation factor for the TSF and the State and county minimum figures.

- **"Recommended" Model Variant**

  A. Guaranteed to TSF: $83 million plus growth with inflation

  B. 90% of remainder divided 60/40 for State and counties, of which $100 million each, guaranteed to allow the State and counties (guaranteed amounts to increase over time with inflation)

  C. 10% of remainder for Legislative appropriations, to include set-asides for Turtle Bay, Convention Center, Special Land Development Fund, and the remainder for legislative appropriations as of 2015 or later.

  If the 10% is not enough to cover the set-asides, the State would cover these from its share of Stage B moneys.

- **"Lessons Learned" Model**

  A. Baseline distributions (set amounts for FY 2015, changing over time with inflation)

  $82 million for TSF
  $103 million for counties
  $103 million for State

  B. If TAT revenues exceed 120% of baseline, distribute next 20% in much the same proportions:

  28.50% for TSF
  35.75% for the counties
  35.75% for the State

  IF TAT revenues do not exceed 120% of baseline, all of this increment goes to State.

  C. Remaining revenues go to State.

This model was developed by the consultant in an attempt to (a) insure predictability, even in recessionary economic circumstances and (b) to use baseline figures derived from the Current Allocation.

At the September 30 meeting, members of the WG expressed interest in seeing the impacts over time of:

A. The Simple Shares Model
B. The Simple Shares Model, with TSF Protected against a Downturn
C. The Simple Shares Model, with Existing Special Funds Increasing with Inflation
D. The “Recommended” Model
E. The “Recommended” Model with Existing Special Funds treated as part of the Legislative Allocation

These impacts are shown in the next pages, after a brief account of the forecasts used for the analysis.

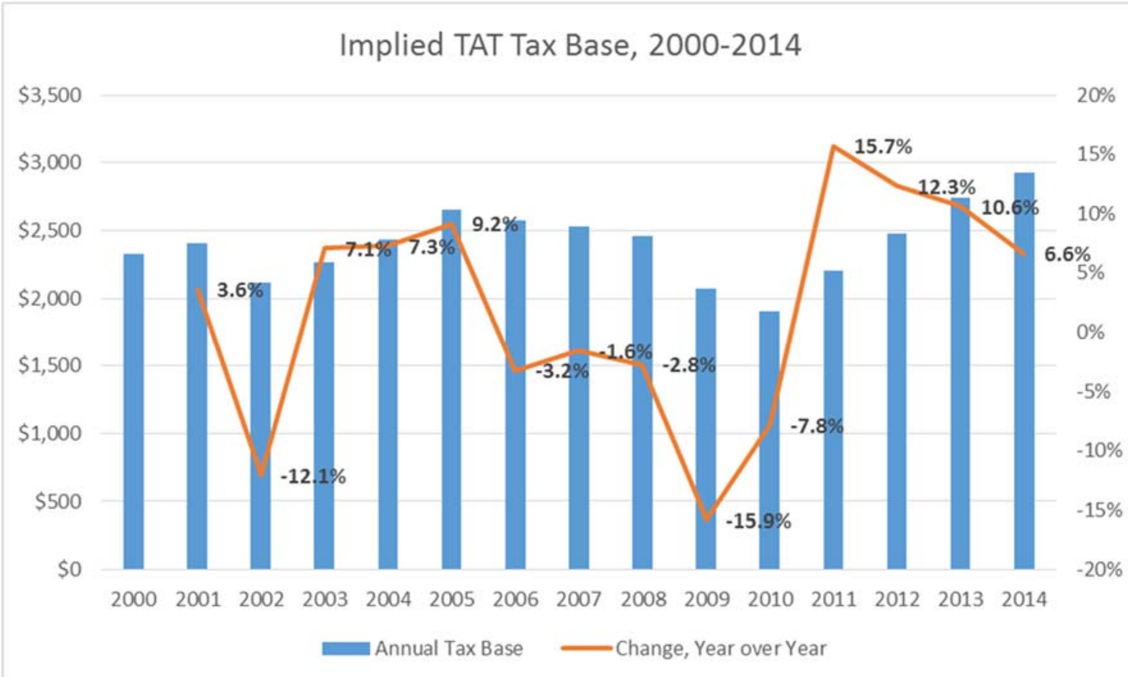
Forecasts

The crucial item to be forecast is that amount of revenues gathered annually in TAT and TOT collections. (We understand the Legislature and Working Group to be seeking a single allocation formula for both.)

Hospitality Advisors LLC (HA) developed a forecast based on the information it collects on visitor accommodations throughout Hawai‘i. That information includes the occupancy and rate data that HA tracks and reports regularly, and financial information from both public and proprietary sources. The version of the forecast reported at the September 30 meeting covers TAT revenues only; we plan to incorporate TOT revenues by drawing on DoTAX information as this becomes available. We expect to learn that TOT revenues account for a small percentage of the total, so our current estimate will turn out to be low but close to the total.

The forecast estimates that TAT revenues will grow from about $413 million in FY 2015 to $676 million in FY 2025. It takes into account anticipated changes in the visitor plant and in visitor demand.

The second forecast used for the ten-year models is a “what if” forecast, developed to learn how allocations would change if the visitor industry experienced an economic slowdown similar to the one that affected Hawai‘i as of 2008. It starts from the same FY 2015 figure used in the HA forecast. Subsequently, annual TAT revenues are projected as changing following the same pattern as the TAT tax base from 2004 to 2014. Those changes were calculated by Dr. Mak as shown below:



NOTE: Annual tax base is in millions of current dollars. Years are Fiscal Years. Adapted from J. Mak, *Sharing TAT Revenues in Hawai'i: A Background Paper (2015).*

The HA and Recession Forecast (RF) yield the following estimated TAT revenues (in millions) for the coming years, assuming no change in the tax rates:

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
HA	$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
RF	$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496

Two other forecasts have been discussed:

- The DBEDT near-term forecast of visitor expenditures was used until the HA forecast became available. It is both too general for current purposes, since it estimates total expenditures, not just spending on lodging, and too short-term, since it specifies less than half of the forecast period. It will not be used further.

- Both the range of visitor accommodations and compliance with the TAT law could change significantly in the coming years. Those changes would depend on political and economic trends that do not yield precise estimates. Consequently, while TAT collections could well grow faster than forecast by the HA model, no further revenue or allocation estimates are presented using an increased-compliance forecast.

Ten-Year Forecasts

In the Appendix to this memo, both HA slow-growth and RF what-if forecasts are used to show the impacts of different allocation models. Points of note include:

- The A. Simple Shares and B. TSF-Protected Shares Models have similar results.

- In the C. Shares Model with all Existing Special Funds Increasing with Inflation, State and county revenues would decline appreciably during the downturn. The counties' revenues could reach a low of $77 million in one year, and be below the level desired for predictable budgeting for three years in a row.

- The D. "Recommended" Model and E. Variant "Recommended" Model provide predictable cash flows for the TSF, State and counties. The fact that the Legislature will look to TAT funds to address other needs that arise was recognized. However, recessionary conditions leave no funds for the Legislature to use in this way. In the E. Variant "Recommended" Model, the State's share of revenues is also affected, because the Existing Allocations (i.e., the Convention Center, Turtle Bay, etc.) demand more funds than remain for the Legislature to allocate.

We look forward to reviewing these allocation forecasts with the WG during the next meeting.

Consultant's Provisional Findings (for review by the WG)

Expenditures by State and Counties

The Legislature instructed the working group to propose a division of TAT revenues between the State and counties, taking into consideration expenditures for public services. The Working Group (WG) has considered several ratios. The ratios considered by the WG and the Consultant team include:

Relation of State Expenditures to Counties' Expenditures	State Share	Counties' Share
1.Total expenditures, FY 2014	77%	23%
2. Direct expenditures on tourism. FY 2014 (State IG)	52%	48%
3. Weighted direct and indirect expenditures on tourism, FY 2014 (County IG)	57%	43%
4. Average of total expenditures, 2002-2012	78%	22%
5. Net Expenditures, all government functions, FY 2014	85%	15%
6. Net Expenditures, direct expenditures on tourism, FY 2014	55%	45%
7. Gross Expenditures, "Government Activities" only, FY 2014	54%	46%
8. Net Expenditures, "Government Activities" only, FY 2014	52%	48%
9. Net Expenditures, "Government Activities" only, direct expenditures on tourism, FY 2014	55%	45%

NOTES: Net expenditure analysis drawn from FY 2014 Consolidated Annual Financial Reports (CAFR) tables dealing with Net (Expense) Revenues and Changes in Net Position. The distinction between "Government Activities" and "Business Activities" is drawn from the CAFR reports. The sort of direct expenditure follows the State IG analysis of gross expenditures. Items 6 and 9 were developed by the Consultant team, using the State Investigative Group's sort of government functions. The detailed sort of "indirect" tourism-related expenditures involved detailed judgments as to the share of expenditures in a category for each county; the consultants did not have a comparable expert basis for allocating State expenditures, so this analysis was not carried over in the table.

Recognizing the complexity of the analysis of expenditures, the Allocations Models Investigative Group of the WG found it reasonable to use a 60% to 40% distribution of State to counties' expenditures for modeling purposes. The net expenditures analyses in the table above suggest that a 55% to 45% ratio could also be considered.

Principles

The WG recognizes that any allocation strategy must strive to achieve the goals established by the Legislature for the TAT and comply with an enabling statute. However, the Legislature has identified a complex range of goals over the years, and the Legislature has charged the WG with developing a new allocation strategy, which could be accepted in a new enabling statute. Additional principles for assessing allocation strategies include:

- Fairness: Allocations should equitably reflect expenditures of the State and counties, and be perceived to be fair;

- Predictability: Allocations should provide a predictable stream of revenues to facilitate budgeting;

- Simplicity: Allocations should be simple to administer; and

- Flexibility in Changing Circumstances: Allocations should be acceptable to multiple agencies and constituencies. To be acceptable, an allocation strategy must be able to accommodate Legislative and agency responses to pressing issues that arise from time to time.

These principles can be in tension, both in the abstract and in specific situations (notably during a recession, when revenues decline but demand for expenditures increases). The allocation strategy proposed by the WG is chosen to combine these principles judiciously.

Components of Allocations

- TAT revenues are the predominant source of funds for tourism marketing, and a major source of funds for the counties. Predictable revenue streams are crucial for the TSF and the counties.

- Use of a set amount for an allocation (e.g., $103 million annually for the counties) fails to anticipate changes in the cost of goods and value of money, so set amounts should be adjusted in line with inflation over time.

- The problem with set amounts can be addressed by annual adjustments for inflation. Inflation adjustments can be made by changing annual allocations at the published rate that the Consumer Price Index for Urban Consumers, Honolulu, has changed in the most recent 12-month period.

  This rate is published by the Bureau of Labor Statistics (posted at http://www.bls.gov/regions/west/news-release/consumerpriceindex_honolulu.htm). The Honolulu data are typically available semi-annually by February and August; the most recent annual rate posted by August can be incorporated into budgets for consideration by the next year's Legislature.

- Over time, the cost of services provided by the counties and State, along with the cost of tourism marketing, are likely to change with the price of other goods. Unless allocations are specifically tied to fixed-amount obligations such as fixed loan repayment schedules, all allocations can be modeled as varying with inflation.

- Allocation of the TAT revenues on a share basis is simple and appropriate for government bodies responsible for many public services, i.e., the State and counties. A share basis is not appropriate for single-purpose entities such as the TSF, since shares reflect revenues from the visitor industry, not the specific expenditures for which appropriations have been targeted.

- The WG has considered several models that had "floors" – minimum allocations – for various recipients of TAT revenues. It is also possible to include "ceilings" or "escalators" – upper limits on the amount of allocations or the rate of growth of allocations. The WG did not choose to pursue these concepts beyond setting increases in some funds in line with inflation.

External Factors that Could Affect the Allocations

- Act 174, SLH 2014, stipulates that the counties' share of TAT revenues could be reduced to cover unmet annual minimal obligations to the Employer-Union Trust Fund (EUTF) as of FY 2019. The counties have enough time to plan for this provision, and to avoid reductions in TAT funds due to underpayment of EUTF obligations. They are already taking steps to do so. Consequently, this provision is recognized as an integral part of the TAT statute, but has not been incorporated in the models considered by the WG.

- The forecasts used to anticipate allocations to 2025 include anticipated changes in the visitor plant inventory. They do not assess the impacts of a major switch in consumer preferences towards lodgings such as Airbnb and Vacation Rental by Owner (VRBO) units. Nor do they assess the impact of increased compliance with TAT registration and tax payment regulations.

- However, if Airbnb and other innovative lodging systems increase their share of Hawai‘i visitors' spending on accommodations, the established visitor industry could find it difficult to maintain rates and occupancy. If Hawai‘i's hotels and vacation condos become less competitive with other destinations, lower income streams and strong pressure to reduce the TAT rate could result.

APPENDIX: MODELS FOR REVIEW AT OCTOBER 7, 2015 MEETING

STATE-COUNTY FUNCTIONS WORKING GROUP

FORECASTS

Ten year forecasts:

A. Forecast of TAT revenues based on HA data

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
millions of current dollars	$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676

B. Recession Forecast

Use 2015 starting point

Run annual rate of change based on changes in the TAT tax base, to 2014

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Annual Change (historic)	7.3%	9.2%	-3.2%	-1.6%	-2.8%	-15.9%	-7.8%	15.7%	12.3%	10.6%	6.6%

TAT revenues under	RF 2015	RF 2016	RF 2017	RF 2018	RF 2019	RF 2020	RF 2021	RF 2022	RF 2023	RF 2024	RF 2025
Recession Forecast:	$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496

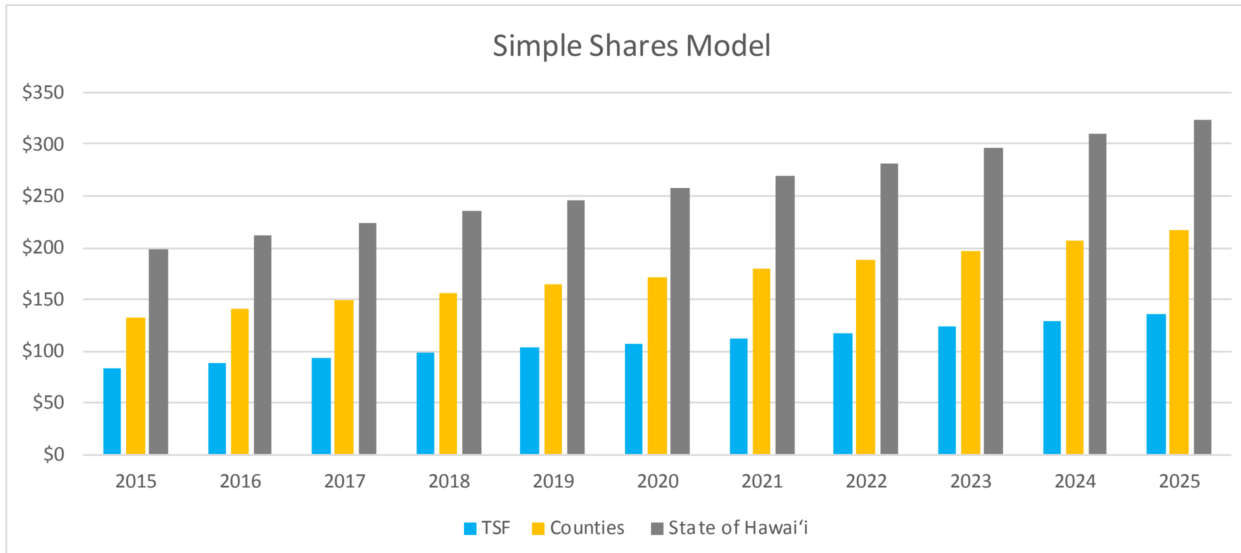
C CPI (extrapolating from DBEDT)

2015 = 100	100.00	102.30	104.86	107.69	110.60	113.58	116.65	119.80	123.03	126.36	129.77
Protected amounts, with CPI											
TSF	$82	$84	$86	$88	$91	$93	$96	$98	$101	$104	$106
State, Counties	$100	$102	$105	$108	$111	$114	$117	$120	$123	$126	$130
Existing Appropriations	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40

MODELS

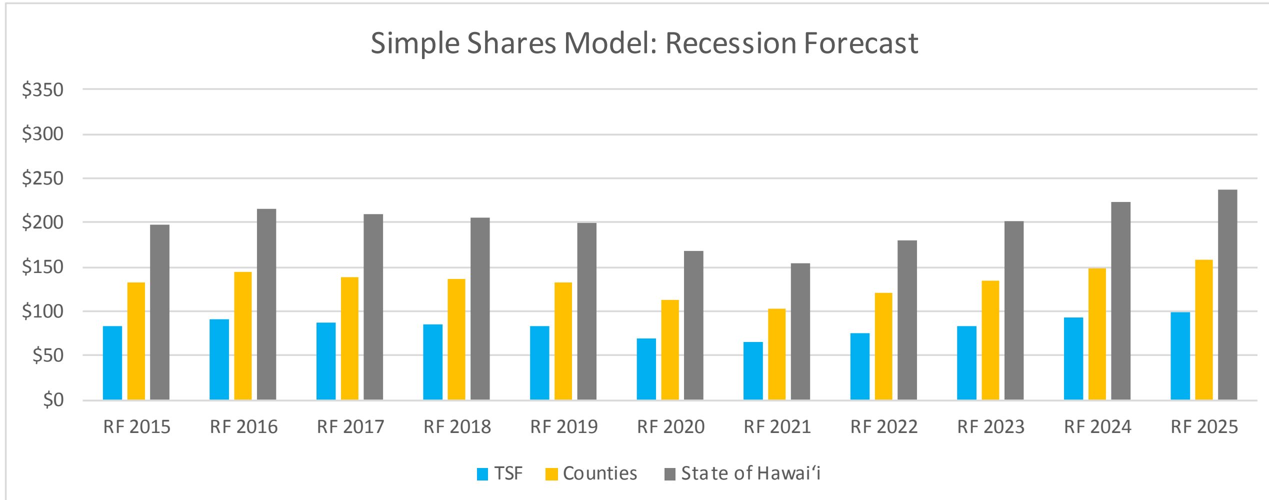
A. Simple Shares Model. Revenues divided into three shares:

FORECAST	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total (million)	$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
20% TSF	$83	$88	$93	$98	$103	$108	$112	$117	$123	$129	$135
32% Counties	$132	$141	$149	$157	$164	$172	$180	$188	$197	$207	$216
48% State of Hawaiʻi	$198	$212	$224	$235	$246	$258	$269	$282	$296	$310	$324



A. Simple Shares Model. Revenues divided into three shares:

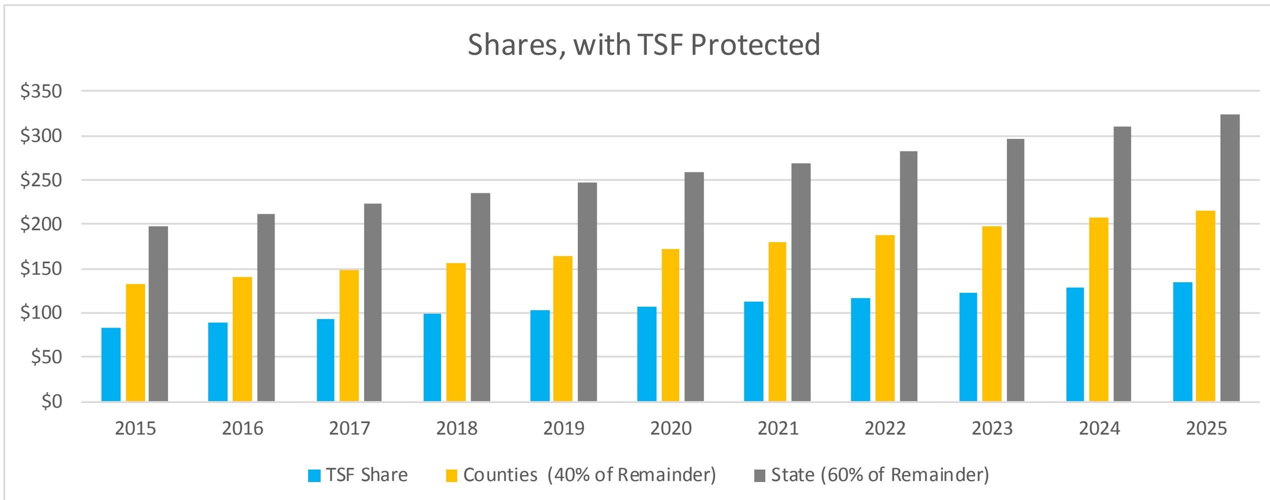
RECESSION FORECAST	**RF 2015**	**RF 2016**	**RF 2017**	**RF 2018**	**RF 2019**	**RF 2020**	**RF 2021**	**RF 2022**	**RF 2023**	**RF 2024**	**RF 2025**
Total (million)	$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496
20% TSF	$83	$90	$87	$86	$83	$70	$65	$75	$84	$93	$99
32% Counties	$132	$144	$139	$137	$133	$112	$103	$120	$134	$149	$159
48% State of Hawai'i	$198	$216	$209	$206	$200	$168	$155	$180	$202	$223	$238



NOTE: Model includes no "floor" provisions; TSF can fall below current level.

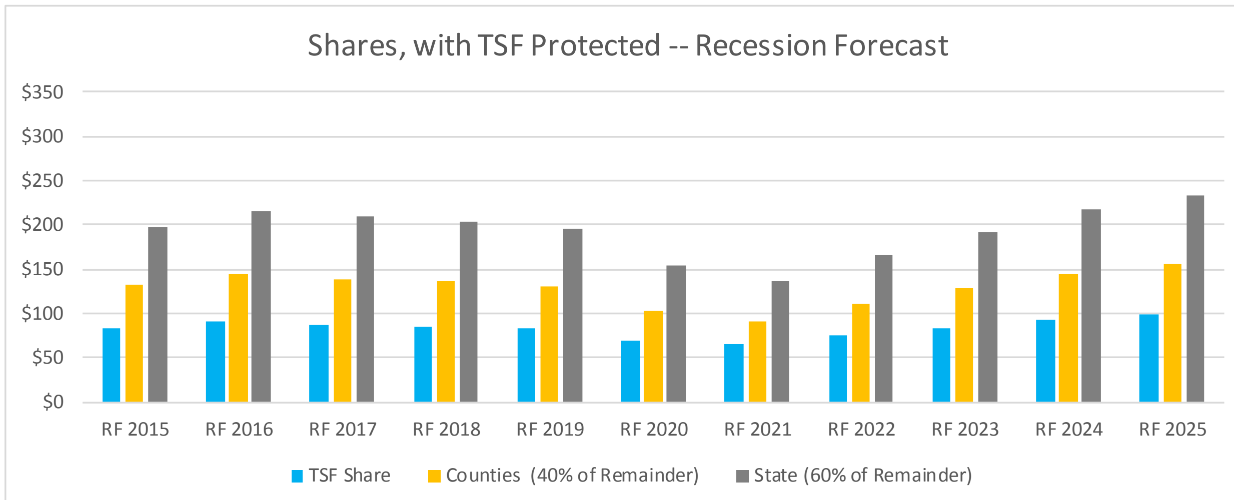
B Shares Model, with Tourism Special Fund Protected against Downturns

FORECAST		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Total (million)	$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
20%	TSF Share	$83	$88	$93	$98	$103	$108	$112	$117	$123	$129	$135
	TSF Floor ($82 + CPI)	$82	$84	$86	$88	$91	$93	$96	$98	$101	$104	$106
	TSF Allocation	$83	$88	$93	$98	$103	$108	$112	$117	$123	$129	$135
	Remainder (Total - TSF)	$330	$353	$373	$392	$411	$430	$449	$470	$494	$517	$541
32%	Counties (40% of Remainder)	$132	$141	$149	$157	$164	$172	$180	$188	$197	$207	$216
48%	State (60% of Remainder)	$198	$212	$224	$235	$246	$258	$269	$282	$296	$310	$324



B Shares Model, with Tourism Special Fund Protected against Downturns

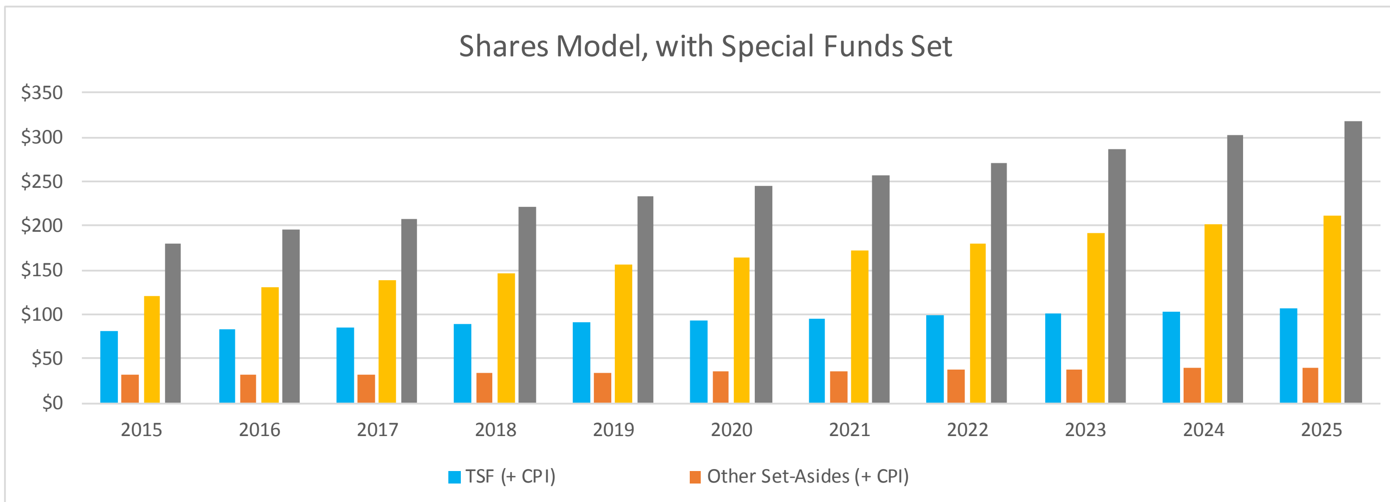
RECESSION FORECAST	RF 2015	RF 2016	RF 2017	RF 2018	RF 2019	RF 2020	RF 2021	RF 2022	RF 2023	RF 2024	RF 2025
Total (million)	$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496
20% TSF Share	$83	$90	$87	$86	$83	$70	$65	$75	$84	$93	$99
TSF Floor ($82 + CPI)	$82	$84	$86	$88	$91	$93	$96	$98	$101	$104	$106
TSF Allocation	$83	$90	$87	$88	$91	$93	$96	$98	$101	$104	$106
Remainder (Total - TSF)	$330	$360	$349	$340	$326	$258	$228	$276	$319	$361	$389
32% Counties (40% of Remainder)	$132	$144	$139	$136	$130	$103	$91	$110	$128	$145	$156
48% State (60% of Remainder)	$198	$216	$209	$204	$196	$155	$137	$166	$192	$217	$234



NOTE: Model includes "floor" for TSF, not for counties or State. Counties' revenue can fall below current level.

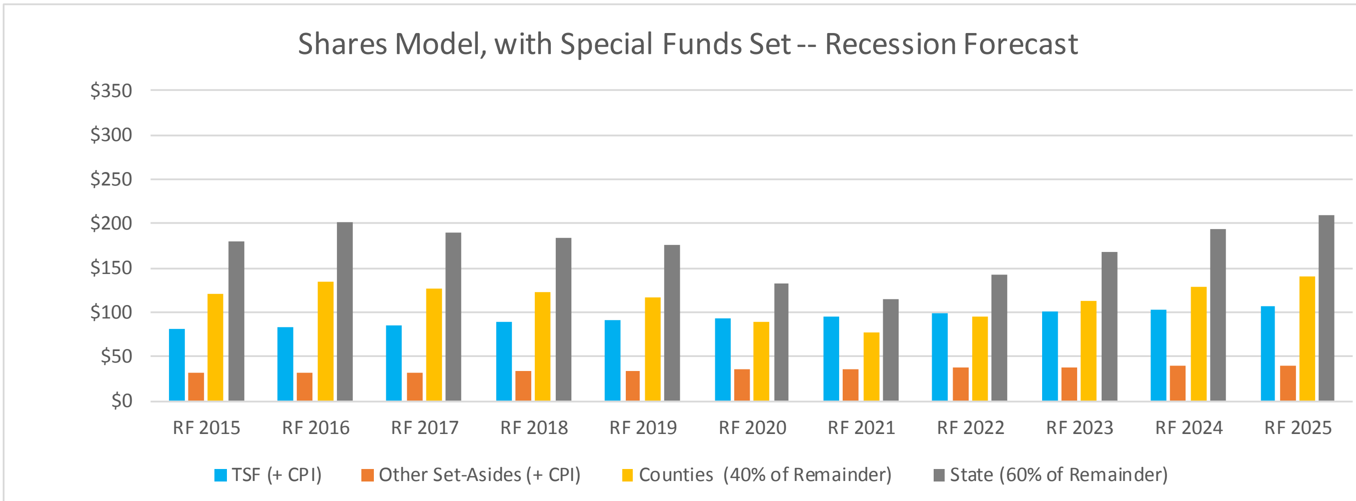
C. Shares Model, with Existing Special Funds Increasing with Inflation

FORECAST	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Total (million)	$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
TSF (+ CPI)	$82	$84	$86	$88	$91	$93	$96	$98	$101	$104	$106
Other Set-Asides (+ CPI)	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
Remainder (Total - Set-Asides)	$300	$325	$347	$368	$388	$409	$429	$452	$478	$503	$529
Counties (40% of Remainder)	$120	$130	$139	$147	$155	$164	$172	$181	$191	$201	$212
State (60% of Remainder)	$180	$195	$208	$221	$233	$246	$258	$271	$287	$302	$317



C. Shares Model, with Existing Special Funds Increasing with Inflation

RECESSION FORECAST	RF 2015	RF 2016	RF 2017	RF 2018	RF 2019	RF 2020	RF 2021	RF 2022	RF 2023	RF 2024	RF 2025
Total (million)	$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496
TSF (+ CPI)	$82	$84	$86	$88	$91	$93	$96	$98	$101	$104	$106
Other Set-Asides (+ CPI)	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
Remainder (Total - Set-Asides)	$300	$335	$317	$307	$292	$222	$192	$239	$281	$322	$349
Counties (40% of Remainder)	$120	$134	$127	$123	$117	$89	$77	$96	$113	$129	$140
State (60% of Remainder)	$180	$201	$190	$184	$175	$133	$115	$143	$169	$193	$210

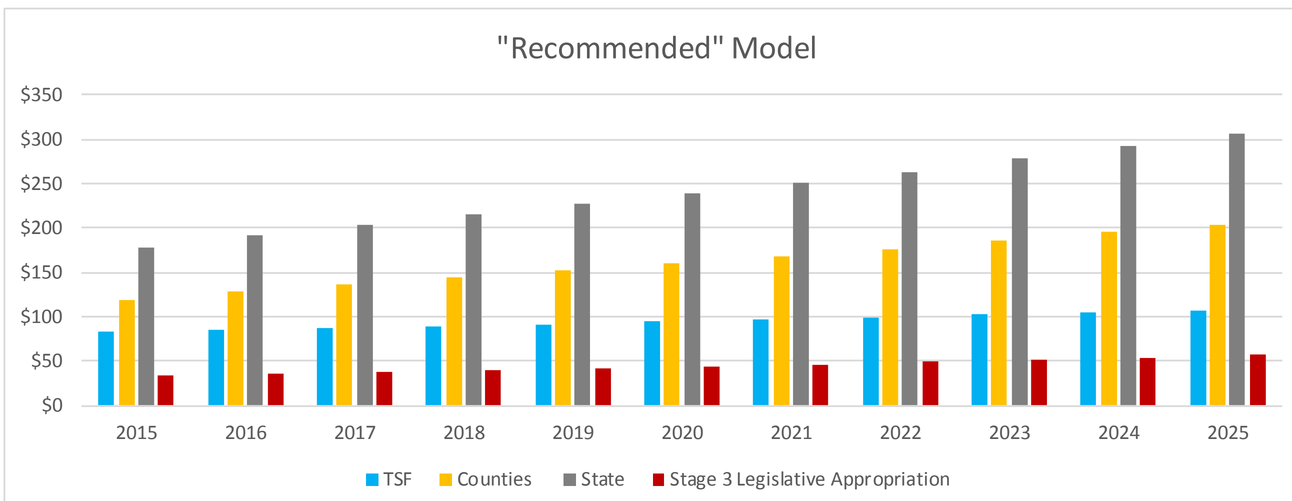


NOTE: Model includes "floor" for TSF and other exisitng State appropriations, not for counties or State. Counties' revenue can fall below current level.

D. Three-stage Model "Recommended" by Allocation Models Investigative Group

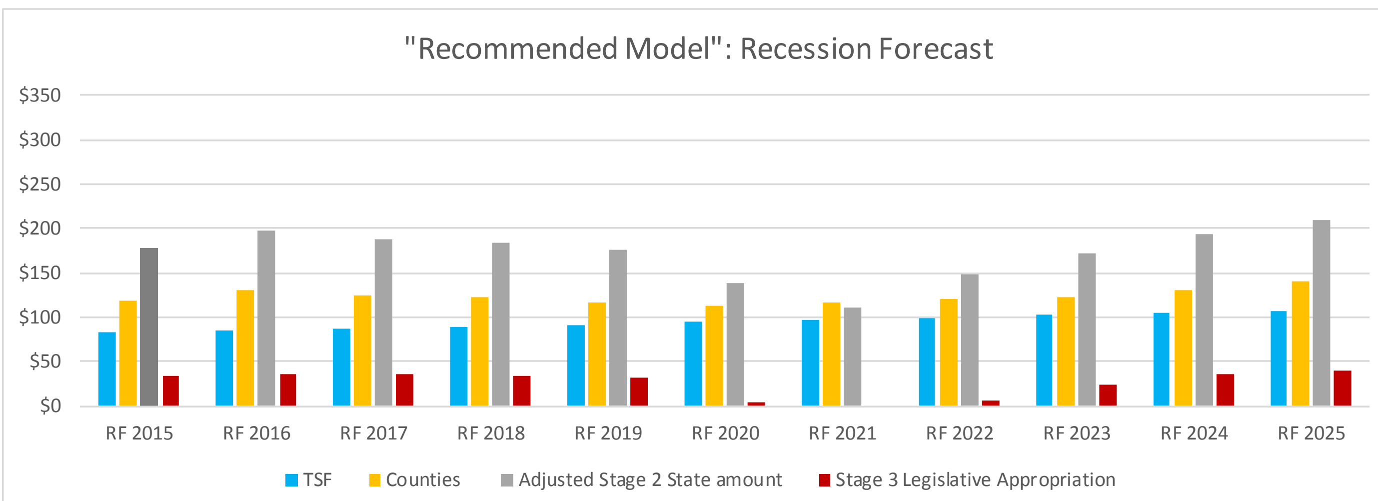
(with CPI increase for TSF)

FORECAST		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total		$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
Stage 1												
TSF		$83	$85	$87	$89	$92	$94	$97	$99	$102	$105	$108
Stage 2												
90% of remainder		$297	$321	$341	$360	$379	$399	$418	$439	$463	$487	$511
Counties	40%	$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
State	60%	$178	$192	$204	$216	$228	$239	$251	$263	$278	$292	$307
"Floor" for counties or State		$100	$102	$105	$108	$111	$114	$117	$120	$123	$126	$130
Appropriation (larger of share or floor)												
Counties		$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
State		$178	$192	$204	$216	$228	$239	$251	$263	$278	$292	$307
Stage 3 Legislative Appropriation												
Remaining after Stages 1, 2		$33	$36	$38	$40	$42	$44	$46	$49	$51	$54	$57
Appropriation		$33	$36	$38	$40	$42	$44	$46	$49	$51	$54	$57
Reduction, Stage 2 State amt.		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Adjusted Stage 2 State amount		$178	$192	$204	$216	$228	$239	$251	$263	$278	$292	$307



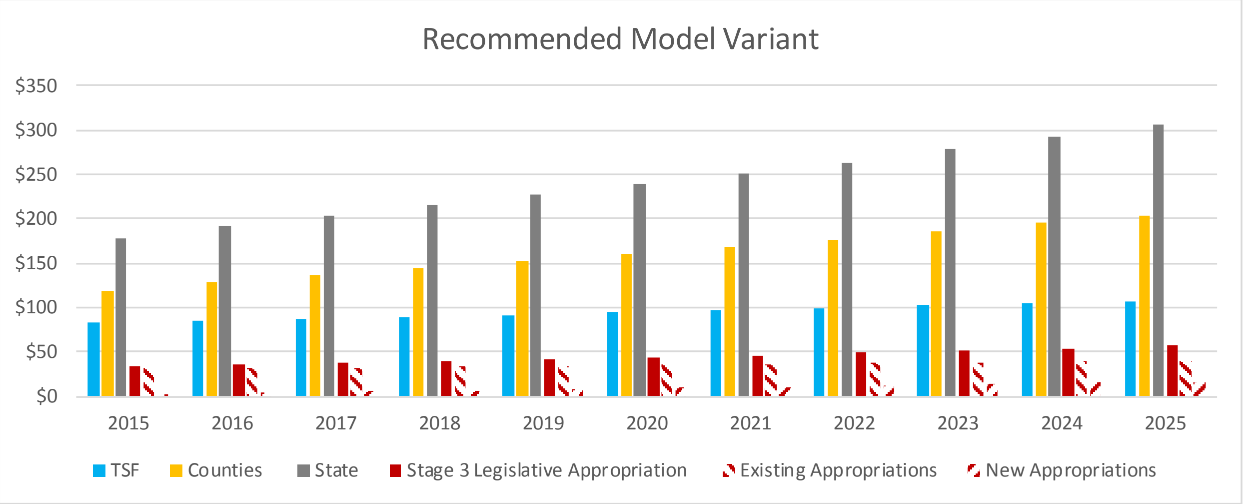
D. Three-stage Model "Recommended" by Allocation Models Investigative Group

RECESSION FORECAST		RF 2015	RF 2016	RF 2017	RF 2018	RF 2019	RF 2020	RF 2021	RF 2022	RF 2023	RF 2024	RF 2025
Total		$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496
Stage 1												
TSF		$83	$85	$87	$89	$92	$94	$97	$99	$102	$105	$108
Stage 2												
90% of remainder		$297	$329	$314	$305	$293	$231	$204	$247	$286	$324	$349
Counties	40%	$119	$132	$126	$122	$117	$92	$82	$99	$115	$130	$140
State	60%	$178	$197	$188	$183	$176	$139	$122	$148	$172	$194	$210
"Floor" for counties or State		$100	$102	$105	$108	$111	$114	$117	$120	$123	$126	$130
Appropriation (larger of share or floor)												
Counties		$119	$132	$126	$122	$117	$114	$117	$120	$123	$130	$140
State		$178	$197	$188	$183	$176	$139	$122	$148	$172	$194	$210
Stage 3 Legislative Appropriation												
Remaining after Stages 1, 2		$33	$37	$35	$34	$33	$4	-$12	$7	$23	$36	$39
Appropriation		$33	$37	$35	$34	$33	$4	$0	$7	$23	$36	$39
Reduction, Stage 2 State amt.		$0	$0	$0	$0	$0	$0	-$12	$0	$0	$0	$0
Adjusted Stage 2 State amount		$178	$197	$188	$183	$176	$139	$110	$148	$172	$194	$210



E. Variant of "Recommended Model"

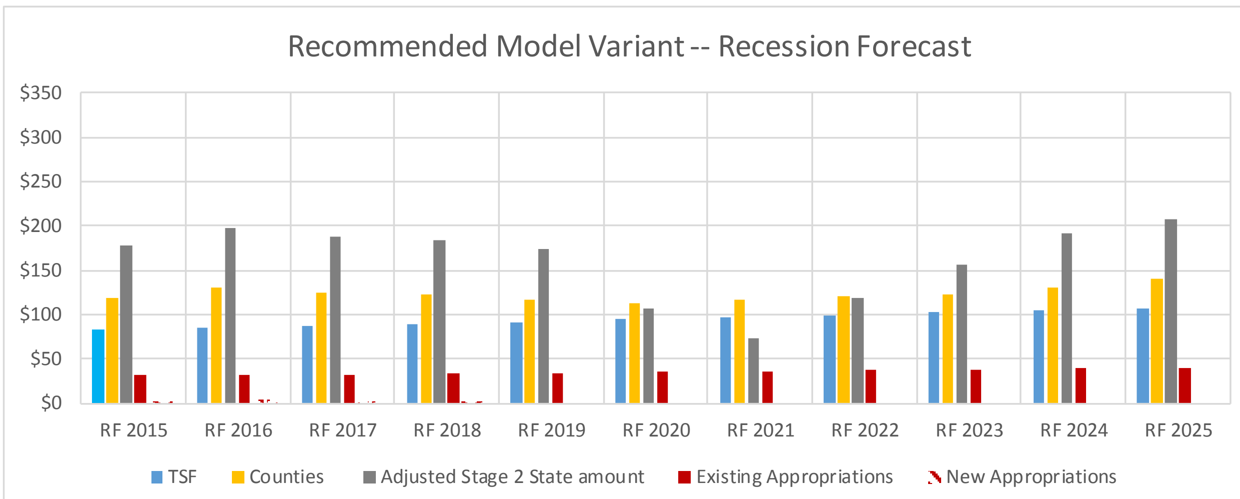
FORECAST		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total		$413	$441	$466	$490	$513	$538	$561	$587	$617	$646	$676
Stage 1												
TSF		$83	$85	$87	$89	$92	$94	$97	$99	$102	$105	$108
Stage 2												
90% of remainder		*$297*	*$321*	*$341*	*$360*	*$379*	*$399*	*$418*	*$439*	*$463*	*$487*	*$511*
Counties	40%	$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
State	60%	$178	$192	$204	$216	$228	$239	$251	$263	$278	$292	$307
"Floor" for counties or State		$100	*$102*	*$105*	*$108*	*$111*	*$114*	*$117*	*$120*	*$123*	*$126*	*$130*
Appropriation (larger of share or floor)												
Counties		$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
State		$178	$192	$204	$216	$228	$239	$251	$263	$278	$292	$307
Stage 3 Legislative Appropriation												
Remaining after Stages 1, 2		$33	$36	$38	$40	$42	$44	$46	$49	$51	$54	$57
Total DLA		$33	$36	$38	$40	$42	$44	$46	$49	$51	$54	$57
Existing Appropriations		$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
New Appropriations		$2	$4	$5	$7	$8	$9	$10	$12	$13	$15	$17



NOTE: "Existing appropriations" = Convention Center SF, Turtle Bay SF, and Special Land Development Fund.

E. Variant of "Recommended Model"

RECESSION FORECAST		RF 2015	RF 2016	RF 2017	RF 2018	RF 2019	RF 2020	RF 2021	RF 2022	RF 2023	RF 2024	RF 2025
Total		$413	$450	$436	$429	$417	$351	$323	$374	$420	$465	$496
Stage 1												
TSF		$83	$85	$87	$89	$92	$94	$97	$99	$102	$105	$108
Stage 2												
90% of remainder		$297	*$329*	*$314*	*$305*	*$293*	*$231*	*$204*	*$247*	*$286*	*$324*	*$349*
Counties	40%	$119	$132	$126	$122	$117	$114	$117	$120	$123	$130	$140
State	60%	$178	$197	$188	$183	$176	$139	$122	$148	$172	$194	$210
"Floor" for counties or State		$100	$102	$105	$108	$111	$114	$117	$120	$123	$126	$130
Appropriation (larger of share or floor)												
Counties		$119	$132	$126	$122	$117	$114	$117	$120	$123	$130	$140
State		$178	$197	$188	$183	$176	$139	$122	$148	$172	$194	$210
Stage 3 Legislative Appropriation												
Remaining after Stages 1, 2		$33	$37	$35	$34	$33	$4	-$12	$7	$23	$36	$39
Existing Appropriations		$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
Amount Remaining		$2	$5	$2	$1	-$2	-$31	-$49	-$31	-$15	-$3	-$1
New Appropriations		$2	$5	$2	$1	$0	$0	$0	$0	$0	$0	$0
Reduction, Stage 2 State amt.		$0	$0	$0	$0	-$2	-$31	-$49	-$31	-$15	-$3	-$1
Adjusted Stage 2 State amount		$178	$197	$188	$183	$174	$108	$74	$118	$157	$191	$208



NOTE: "Existing appropriations" = Convention Center SF, Turtle Bay SF, and Special Land Development Fund.

Comparison of Counties' Shares

		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
A.	**Simple Shares Model**											
	Amount, HA Forecast	$132	$141	$149	$157	$164	$172	$180	$188	$197	$207	$216
	Share, HA	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%
	Amount, RF	$132	$144	$139	$137	$133	$112	$103	$120	$134	$149	$159
	Share, RF	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%
B	**Shares Model, with Tourism Special Fund Protected against Downturns**											
	Amount, HA Forecast	$132	$141	$149	$157	$164	$172	$180	$188	$197	$207	$216
	Share, HA	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%	32%
	Amount, RF	$132	$144	$139	$136	$130	$103	$91	$110	$128	$145	$156
	Share, RF	32%	32%	32%	32%	31%	29%	28%	29%	30%	31%	31%
C.	**Shares Model, with Existing Special Funds Increasing with Inflation**											
	Amount, HA Forecast	$120	$130	$139	$147	$155	$164	$172	$181	$191	$201	$212
	Share, HA	29%	30%	30%	30%	30%	30%	31%	31%	31%	31%	31%
	Amount, RF	$120	$134	$127	$123	$117	$89	$77	$96	$113	$129	$140
	Share, RF	29%	30%	27%	25%	23%	17%	14%	16%	18%	20%	21%
D.	**Three-stage Model "Recommended" by Allocation Models Investigative Group**											
	Amount, HA Forecast	$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
	Share, HA	29%	29%	29%	29%	30%	30%	30%	30%	30%	30%	30%
	Amount, RF	$119	$132	$126	$122	$117	$114	$117	$120	$123	$130	$140
	Share, RF	29%	29%	29%	28%	28%	32%	36%	32%	29%	28%	28%
E.	**Variant of "Recommended Model"**											
	Amount, HA Forecast	$119	$128	$136	$144	$152	$160	$167	$176	$185	$195	$204
	Share, HA	29%	29%	29%	29%	30%	30%	30%	30%	30%	30%	30%
	Amount, RF	$119	$132	$126	$122	$117	$114	$117	$120	$123	$130	$140
	Share, RF	29%	29%	29%	28%	28%	32%	36%	32%	29%	28%	28%

Comparison of Legislative Appropriations

		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
A.	**Simple Shares Model**											
B.	**Shares Model, with Tourism Special Fund Protected against Downturns**											
	Amount, HA Forecast	No Post-Share Appropriation										
	Share, HA	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Amount, RF	No Post-Share Appropriation										
	Share, RF	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
C.	**Shares Model, with Existing Special Funds Increasing with Inflation**											
	Amount, HA Forecast	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
	Share, HA	8%	7%	7%	7%	7%	7%	6%	6%	6%	6%	6%
	Amount, RF	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
	Share, RF	8%	7%	7%	8%	8%	10%	11%	10%	9%	8%	8%
D.	**Three-stage Model "Recommended" by Allocation Models Investigative Group**											
	Amount, HA Forecast	$33	$36	$38	$40	$42	$44	$46	$49	$51	$54	$57
	Share, HA	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%
	Amount, RF	$33	$37	$35	$34	$33	$4	$0	$7	$23	$36	$39
	Share, RF	8%	8%	8%	8%	8%	1%	0%	2%	6%	8%	8%
E.	**Variant of "Recommended Model"**											
	<u>Existing Appropriations</u>											
	Amount, HA Forecast	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
	Share, HA	8%	7%	7%	7%	7%	7%	6%	6%	6%	6%	6%
	Amount, RF	$31	$32	$33	$33	$34	$35	$36	$37	$38	$39	$40
	Share, RF	8%	7%	7%	8%	8%	10%	11%	10%	9%	8%	8%
	<u>New Appropriations</u>											
	Amount, HA Forecast	$2	$4	$5	$7	$8	$9	$10	$12	$13	$15	$17
	Share, HA	0%	1%	1%	1%	2%	2%	2%	2%	2%	2%	2%
	Amount, RF	$2	$5	$2	$1	$0	$0	$0	$0	$0	$0	$0
	Share, RF	0%	1%	1%	0%	0%	0%	0%	0%	0%	0%	0%

Chapter 1

Introduction

Hawai‘i’s transient accommodations tax (TAT) was enacted in 1986 as a tax upon room revenues derived from transient accommodations and imposed upon every operator of such accommodations.[1] Since that time, the Legislature has adjusted the TAT by both raising the TAT rate and changing the distribution of TAT revenues. In 2014, the Legislature indicated it would consider permanently establishing the TAT revenue allocations between the State and the counties. In light of this, it established the State-County Functions Working Group and directed it to:

1. Conduct a study to evaluate the division of duties and responsibilities between the State and counties relating to the provision of public services and

2. Submit a recommendation to the Legislature on the appropriate allocation of the TAT revenues between the State and counties that properly reflects the division of duties and responsibilities relating to the provision of public services.

This final report of the Working Group addresses these objectives[2] and includes draft legislation in a form suitable for introduction during the 2016 Regular Session.

[1] Act 340 (Session Laws of Hawai‘i 1986).
[2] Act 174 (SLH 2014).

State-County Functions Working Group composition, responsibilities, and meetings

The Working Group is comprised of 13 members and is administratively placed within the Office of the Auditor. As directed by Act 174, Session Laws of Hawai‘i (SLH) 2014, the members of the Working Group were appointed by the governor, chief justice of the State of Hawai‘i, the president of the Senate, the speaker of the House of Representatives, and each of the county mayors. Members appointed by the chief justice, president, and speaker could not be state or county employees. Working Group members are listed below, along with their affiliation and appointing authorities:

Working Group Member	**Appointing Authority**
Simeon Acoba, Chair Associate Justice (retired)	Chief Justice
Sananda Baz Budget Director	Mayor, County of Maui
Edward E. Case Senior Vice President and Chief Legal Officer Outrigger Enterprises Group	House Speaker
Mary Alice Evans Deputy Director Department of Business, Economic	Governor

Development & Tourism

Steven Hunt Tax Manager	Mayor, County of Kaua‘i
George Kam Quiksilver	Senate President
Neal Miyahira Administrator Budget Program Planning and Management Division Department of Budget and Finance	Governor
Deanna Sako Finance Director	Mayor, County of Hawai‘i
Ray Soon Chief of Staff	Mayor, City and County of Honolulu
Jesse Souki Deputy to the Chair Board of Land and Natural Resources (until December 2014)	Governor

Of Counsel

Imanaka Asato

(from January 2015)	
George D. Szigeti President and CEO Hawaiʻi Lodging & Tourism Association	House Speaker (Resigned from Working Group in June 2015)
Ronald K. Williams President and CEO Atlantis Adventures, LLC	Senate President
Tina Yamaki Executive Director Surfrider Spirit Sessions	House Speaker (Appointed to Working Group in June 2015)
Kerry Yoneshige Business Management Officer Department of Accounting and General Services	Governor

Working Group meetings were held once or twice monthly from October 2014 through December 2015 and were subject to the State's sunshine law, Chapter 92, Hawaiʻi Revised Statutes. Agendas and minutes, as well as meeting materials, information, and resources, are posted to the Office of the Auditor's website at http://auditor.hawaii.gov/task-forceworking-group/. The Office of the Auditor provided staff support for the Working Group.

Background on Hawai‘i’s Transient Accommodations Tax

The TAT took effect on January 1, 1987, and levied a 5 percent tax on the *gross income* or *gross proceeds* derived from furnishing transient accommodations. The Legislature sought to tax the tourism industry for the benefit of the state, while at the same time limiting the impact of the tax on the industry by excluding general excise taxes collected from calculation of gross income or gross proceeds.

Transient accommodations tax rate

The TAT rate has increased over time. In 1993, the Legislature changed the TAT rate from 5 percent to 6 percent beginning July 1, 1994. Five years later, in 1998, the rate was increased to 7.25 percent beginning January 1, 1999. The act also assessed occupants of resort time share vacation units a 7.25 percent tax on the fair market rental value of those units.[3]

Finally, Act 61 (SLH 2009) increased the rate from 7.25 percent to 8.25 percent for the period July 1, 2009 to June 30, 2010; and to 9.25 percent for the period July 1, 2010 to June 30, 2015. The rate had been scheduled to revert to 7.25 percent on July 1, 2015,[4] but Act 161 (SLH 2013) made permanent the 9.25 percent rate which had been in effect since July 1, 2010. The effective dates and changes in TAT rates are shown in Exhibit 1.

Exhibit 1

TAT Rate Changes and Effective Dates, Inception – Current

Effective Date	Rate

[3] Act 93 (SLH 2015) amends the definition of fair market rental value and increases the transient accommodations tax imposed on resort time share vacation units by 1 percent each year to gradually achieve a rate of 9.25 percent of the fair market rental value.

[4] Act 161 (SLH 2013).

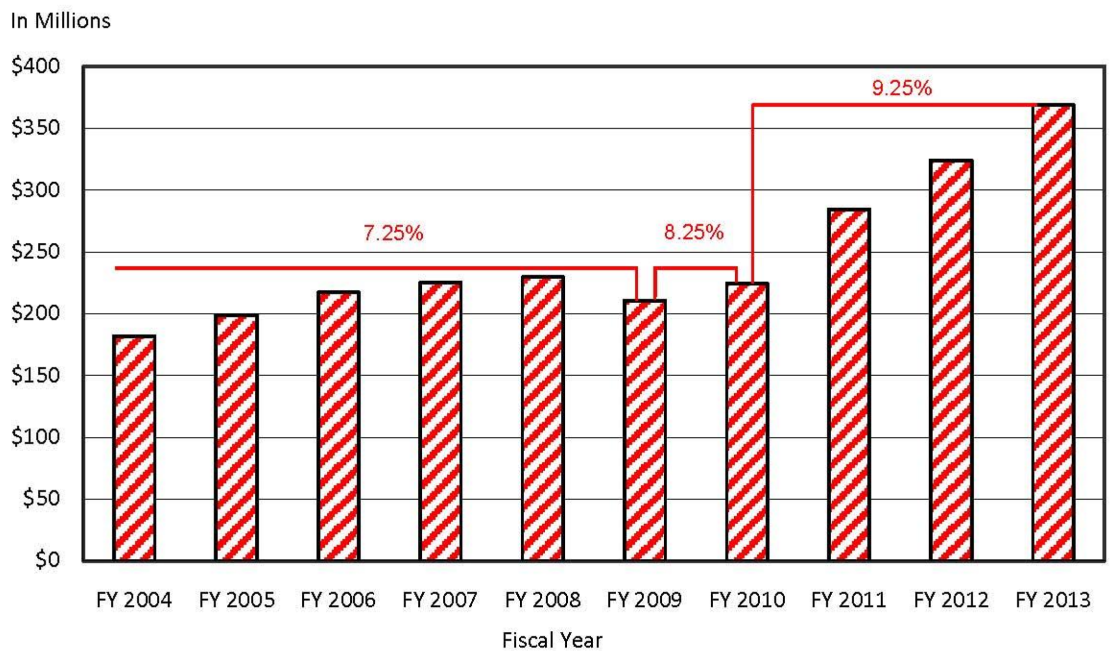
January 1987	5 %
July 1994	6 %
January 1999	7.25 %
July 2009	8.25 %
July 2010	9.25 %

Source: Office of the Auditor

Exhibit 2 shows TAT collections and rates for FY2004–FY2013.

Exhibit 2

TAT Collections and Rates, FY2004–FY2013



Source: Hawaiʻi Department of Taxation, Annual Report 2012-2013 and Office of the Auditor

Transient accommodations tax distribution

Although the TAT took effect in 1987, it was not until 1990 that a portion of the TAT collected was distributed to the counties. Thereafter, the distribution rate changed more than a dozen times over the next two decades.

Act 185 (SLH 1990) began distributing TAT funds to the State and various counties as follows:

- 5 percent of the revenues collected were retained by the State for TAT-related administrative purposes;

- Of the remaining 95 percent of TAT collected:

    - 14.5 percent was to be distributed to Kauaʻi County;
    - 18.6 percent was to be distributed to Hawaiʻi County;
    - 22.8 percent was to be distributed to Maui County; and
    - 44.1 percent was to be distributed to the City and County of Honolulu.

In 1993,[5] the distribution was changed beginning July 1994, by increasing the State's portion for deposits to the Convention Center Capital and Operations Special Fund.[6] Distribution to the counties remained the same as in 1990; thus:

[5] Act 7 (Special Session Laws of Hawaiʻi 1993).
[6] The Legislature later changed the Convention Center Capital and Operations Special Fund to the Convention Center Capital Special Fund through Act 124 (SLH 1997).

- 5 percent of the revenues collected was retained by the State for TAT-related administrative purposes;

- One-sixth (1/6) of the revenues collected was deposited into the Convention Center Capital and Operations Special Fund; and

- The remaining TAT collected was distributed to the counties in the same proportional share as in prior years.

The 1998 Legislature amended the TAT by assessing and collecting taxes on resort time share vacation units.[7] Additionally, the measure increased the distribution to the Convention Center Capital Special Fund, included a distribution to the Tourism Special Fund, and divided the remaining TAT collected among the counties so that:

- 17.3 percent of the revenues collected was deposited into the Convention Center Capital Special Fund;

- 37.9 percent was deposited into the Tourism Special Fund; and

- 44.8 percent was distributed to the counties in the same proportional share as in prior years.

In 2002,[8] the Legislature for the first time limited TAT distributions to the Tourism Special Fund (capped at almost $62.3 million, and lowered the percentage deposited to the fund from 37.9 percent to 32.6 percent, effective July 2002) it also limited TAT distributions to the Convention Center Enterprise Special

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[7] Act 156 (SLH 1998).
[8] Act 250 (SLH 2002).

Fund by capping it at $31 million, with any excess revenues deposited into the general fund, effective January 2002.[9] If the deposit to the tourism fund exceeded its cap, then of the remaining overage, $1 million would be deposited in

the following proportional shares—90 percent to the State Parks Special Fund and 10 percent to the Statewide Trail and Access Program—but not more than $1 million in any fiscal year. Finally, the Legislature deposited 5.3 percent into the newly established Transient Accommodations Tax Trust Fund.[10]

Over the next few years—2005 to 2008—the Legislature continued adjusting TAT revenue distribution by removing caps,[11] increasing and changing distribution,[12] and establishing and funding new funds.[13]

In 2009, the Legislature began exploring different avenues for increasing revenues to replace record shortfalls in the State budget, due to what was later called the Great Recession. Initially vetoed by the governor, the TAT bill[14] veto was overridden by the Legislature and later enacted as Act 61 (SLH 2009); it increased the TAT rate and required that the additional revenues collected be deposited to the general fund. Thus, the 2009 TAT rate of 7.25 percent was increased to 8.25 percent from July 2009 to June 2010; and to 9.25 percent from July 2010 to June 2015.

In 2011, the Legislature continued to address budget shortfalls by increasing revenues from the TAT to the State. To accomplish this, the Legislature passed a measure that limited TAT revenues deposited into

[9] Act 253 (SLH 2002).
[10] The Legislature later repealed the Transient Accommodations Tax Trust Fund through Act 235 (SLH 2005).
[11] Act 235 (SLH 2005) removed the cap and increased the allocation of TAT revenues to the Tourism Special Fund; repealed the Transient Accommodations Tax Trust Fund; revised the allocation of TAT revenue for the State Parks Special Fund and the Special Land Development Fund; and directed excess revenues to be deposited into the general fund.
[12] Act 209 (SLH 2006) increased the ceiling of TAT revenues deposited into the Convention Center Enterprise Special Fund and directed excess revenues to be deposited into the general fund.
[13] Act 201 (SLH 2007) established and funded the Tourism Emergency Trust Fund.
[14] Senate Bill No. 1111, Senate Draft 1, House Draft 1, Conference Draft 1, 2009 Regular Session.

the Tourism Special Fund to no more than $69 million, and capped TAT revenues to the counties at $93 million.[15] In its Conference Committee Report,[16] the Legislature stated that the measure was intended to temporarily increase and preserve the amount of state revenues derived from the TAT, calling it a necessary component of the package of legislation aimed at addressing the State's extended economic crisis.

By 2012, the State's focus returned to growing travel and tourism. Leveraging an executive order by President Obama in January 2012 that announced new initiatives to significantly increase travel and tourism in the United States, the Legislature sought to grow TAT deposits in the Tourism Special Fund to $71 million (from $69 million) to take advantage of the easing of access to Hawai‘i for international visitors.[17]

In 2013, the Legislature made permanent the 9.25 percent TAT rate and the caps on TAT distribution to the Tourism Special Fund and the counties.[18] Versions of the measure—for example, Senate Bill 1194, Senate Draft 2, proposed House Draft 1—were hotly debated among stakeholders in legislative committees.

The State director of finance testified that reducing the 9.25 percent TAT charge to 7.25 percent would repeal an important revenue source for fiscal years 2014 and 2015. Hawai‘i Lodging and Tourism Association and Hawai‘i Tourism Authority representatives advocated a reduction of the TAT to 7.25 percent as a means of keeping Hawai‘i's visitor industry competitive and maintaining the positive momentum of the industry and long-term positioning of the Hawaiian Islands in the world-wide market. The counties—the City and County of Honolulu and the counties of Hawai‘i, Maui, and Kaua‘i—

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[15] Act 103 (SLH 2011).
[16] Conference Committee Report No. 139 on Senate Bill 1186, Senate Draft 2, House Draft 1, Conference Draft 1, dated April 29, 2011.
[17] Act 171 (SLH 2012).
[18] Act 161 (SLH 2013).

espoused the need for the TAT to support services for residents and visitors alike, including ocean safety, park maintenance, police protection, fire protection, bus services, and infrastructure repair and maintenance. For some counties, TAT distributions are the second largest source of county revenue, making it important that the distributions increase as visitor counts increase.

The Legislature ultimately decided that allowing the TAT rate to revert to 7.25 percent would deprive the general fund of needed tax revenues. Retention of the 9.25 percent tax rate was seen as key to ensuring that the State's general fund remains balanced beyond the fiscal biennium 2013–2015.[19] The 9.25 percent cap was made permanent, and the distribution of revenue was set as follows:

- $33 million is allocated to the Convention Center Enterprise Special Fund (rather than 17.3 percent);

- $82 million is allocated to the Tourism Special Fund (rather than 34.2 percent), $1 million of which is allocated to operate a Hawaiian center and the Museum of Hawaiian Music and Dance at the Hawai‘i Convention Center;

- The $1 million allocation to the State Parks Special Fund and Special Land Development Fund is repealed;

- $93 million is allocated to the counties (rather than 44.8 percent) and the $93 million cap for the period beginning on July 1, 2011, and ending on June 30, 2015, is repealed; and

[19] Conference Committee Report No. 146 on Senate Bill 1194, Senate Draft 2, House Draft 1, Conference Draft 1, dated April 26, 2013.

- $3 million of the excess TAT revenues is deposited into the general fund for natural resources important to the visitor industry, facilities, and public lands connected with enhancing the visitor experience, to be expended by mutual agreement of the Board of Land and Natural Resources and the Board of Directors of the Hawai‘i Tourism Authority.[20]

The Legislature also added in 2013 the required use of a portion of the TAT revenues to supplement deficient county public employer contribution amounts commencing with FY2019.[21] Recognizing the need to reduce the unfunded liability of the State's Employer-Union Health Benefits Trust Fund, the Legislature directed the use of general excise tax and TAT revenues to supplement deficit payments by state and county public employers, respectively.

In 2014, the Legislature again changed TAT allocations to the counties and established the State-County Functions Working Group to evaluate the division of duties and responsibilities between the State and counties and to recommend the appropriate TAT allocations to the counties.[22] One legislative committee noted that TAT had been the subject of considerable discussion and debate among policymakers regarding its effect as a significant revenue generator and funding source in the State.[23]

Stakeholder testimonies alluded to myriad impacts if the cap was lifted or retained, citing general fund tax losses if the cap was removed;[24] that county annual tourism-related expenditures far exceed the county's

[20] According to Department of Land and Natural Resources, the $3 million is not accessible by the department because there is no appropriation.
[21] Act 268 (SLH 2013).
[22] Act 174 (SLH 2014).
[23] House Committee on Finance, Standing Committee Report No. 764-14 on House Bill 1671, House Draft 1, dated February 28, 2014.
[24] Testimony by Kalbert Young, State Director of Finance, dated March 28, 2014, to the Senate Committee on Ways and Means on House Bill No. 1671, House Draft 1, Senate Draft 1.

capped portion of the TAT;[25] and that the imposed cap was always understood to be a temporary measure;[26] among others. In conference, the Legislature raised the TAT revenues allocated to the counties to $103 million for fiscal years 2015 and 2016, but reduced the allocation to $93 million thereafter. Before the Legislature considered permanently establishing the TAT revenue allocations between the State and counties, it directed this State-County Functions Working Group to conduct a study to evaluate the division of duties and responsibilities between the State and counties relating to the provision of public services; and submit a recommendation to the Legislature on the appropriate allocation of the transient accommodations tax revenues between the State and counties that properly reflects the division of duties and responsibilities relating to the provision of public services.

In 2015, the Legislature again introduced numerous measures to amend distribution of the TAT even as the Working Group continued to meet. The Working Group offered comments on all such measures, suggesting that the Legislature resist amending the distribution rate until after the group completed its work and issued its final report to the 2016 Legislature. Nevertheless, the Legislature passed two measures that changed the distribution priority and rate, which were signed by the governor as Acts 117 and 121, SLH 2015. As amended, the law now distributes TAT revenues in the following priority and rate:[27]

(1) $1.5 million to the Turtle Bay conservation easement;

(2) $26.5 million to the Convention Center Enterprise Special Fund;

(3) $82 million to the Tourism Special Fund;

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[25] Testimony of Kirk Caldwell, Mayor of the City and County of Honolulu, dated March 28, 2014, to the Senate Committee on Ways and Means on House Bill No. 1671, House Draft 1, Senate Draft 1.
[26] Testimony of William P. Kenoi, Mayor of the County of Hawaiʻi, dated March 28, 2014, to the Senate Committee on Ways and Means on House Bill No. 1671, House Draft 1, Senate Draft 1.
[27] Act 121 (SLH 2015).

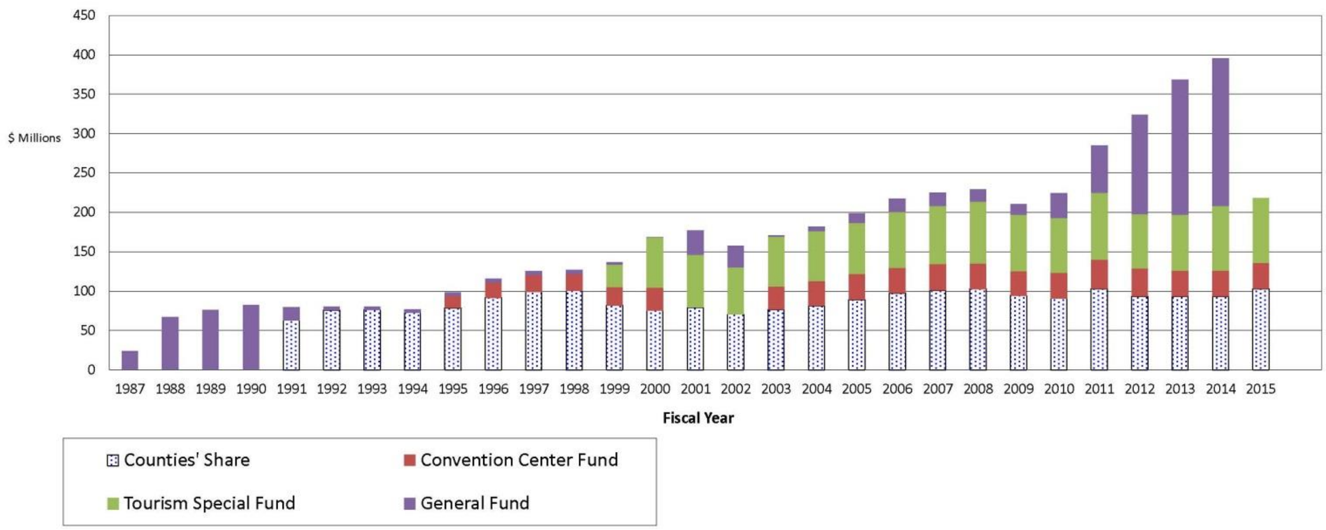
(4) $103 million for each of fiscal years 2015 and 2016;[28] and $93 million for each fiscal year thereafter to the counties; and

(5) $3 million to the Special Land and Development Fund to be expended according to the Hawai‘i Tourism Authority Strategic Plan for protection, preservation, maintenance, and enhancement of natural resources, including beaches, among other purposes.

Exhibit 3 shows TAT distributions to the various funds—counties’ share, Convention Center Enterprise Special Fund, Tourism Special Fund, and the general fund—from FY1987 to March 2015.

Exhibit 3

TAT Distributions, FY1987–FY2014 and FY2015 (partial)



Source: Hawai‘i Department of Taxation

[28] Act 134 (SLH 2015) specifies that funds appropriated to the State-County Functions Working Group—$165,000—shall come from the TAT revenues allocated to the counties for FY2015-2016.

State-County Functions Working Group Study Approach, Timetable, and Reporting

The Working Group undertook an ambitious monthly meeting schedule from November 2014 through August 2015; additionally, it met twice montly from September through December 2015. Delays in engaging consultant services affected the Working Group's initially planned timetable and deliverables, but it sought to make up the lost time rather than eliminate work needed to address both Act 174 objectives. This report represents the Working Group's final report to the 2016 Legislature, governor, and each county mayor and council as required in Act 174, SLH 2014.

Funding and consultant services

As directed by Act 174, the Office of the Auditor paid all expenses incurred by Working Group members during the performance of their duties, and sought reimbursement by requesting that such amounts be included in the legislative budget act of 2015. Although the Auditor's budget request included Working Group funding, such funding was not included in the legislative budget bill; instead, the Legislature introduced two bills—one each in the House[29] and Senate[30]—requesting $165,000 for the State-County Functions Working Group ($150,000 for consultant services and $15,000 for actual expenses). The 2015 Legislature passed the House bill,[31] with funding of $165,000 to be appropriated out of the $103 million of TAT revenues allocated to the counties pursuant to Section 237D-6.5(b)(3), Hawai‘i Revised Statutes. The bill was signed by the governor as Act 134, SLH 2015, on June 19, 2015.

The Working Group determined at its November 5, 2014 meeting that it would request $150,000 to engage a consultant to assist the group with carrying out its roles and responsibilities and in preparing the final report. Although Working Group members possess specialized knowledge about county and state

[29] House Bill 1214, 2015 Regular Session.
[30] Senate Bill 1359, 2015 Regular Session.
[31] House Bill 1214, House Draft 1, Senate Draft 1, Conference Draft 1, 2015 Regular Session.

government and the tourism industry, collectively they lack background in tax policy and the skillset needed to develop methodologies, formulas, and calculations to determine an appropriate allocation of the TAT. The Working Group envisioned that the consultant would conduct research, attend meetings, and present reports, analyses, and information to the Working Group at its monthly meetings, in addition to assisting the Working Group with presentations and briefings to the 2016 Legislature on the Working Group's TAT recommendations.

On August 19, 2015, the Working Group engaged the services of a consultant, Belt Collins Hawaii LLC, for $150,000, to assist with compilation of references and resources, data analysis, development of allocation models integrating data on resident and tourist populations, use of major public facilities and infrastructure, and the cost of operations and expansion of infrastructure, especially facilities on which visitor satisfaction depends. Belt Collins would also assist with final report development, among other tasks.[32]

Belt Collins Hawaii LLC key personnel

Belt Collins has been a Hawai'i planning and engineering firm since 1953. Key personnel on the Belt Collins team managed the work flow, conducted fiscal analyses of net costs of infrastructure, and produced documents and slides with assistance of Belt Collins graphics staff. These key personnel brought years of experience in tax policy development, economic analysis of tourism, project management, long-range planning, infrastructure development and growth, among other specialties, and included:

[32] The consultant was procured via a request for proposals (RFP) with moneys appropriated by Act 134, SLH 2015.

James Mak, Ph.D. – Dr. Mak has been active in Hawai‘i state policy development and the economic analysis of tourism since the 1970s. He wrote the definitive account of tourism policy in Hawai‘i and has made pioneering studies of the transient accommodations tax.

Joseph Toy, CPA – Mr. Toy’s experience combines research and hands-on experience. He has advised private clients, the Hawai‘i Tourism Authority, and state and county agencies on visitor industry issues and trends. With over 30 years in management consulting and public accounting on an international basis, he is the President and CEO of Hospitality Advisors LLC based in Honolulu, Hawai‘i.

Ms. Cheryl Palesh, P.E. – Ms. Palesh served as the Principal in Charge and has extensive project management experience. With a varied background working on engineering, master planning and environmental studies as well as design and construction projects, Ms. Palesh has an understanding of community infrastructure requirements, long-range planning, and the counties capital improvements programming.

John Kirkpatrick, Ph.D. – Dr. Kirkpatrick served as the Project Manager. Dr. Kirkpatrick has contributed to analyses of the contributions of existing and new development to transportation impact fees, working with county agencies and developers to project growth of infrastructure and demand from resident and visitor use. He has also addressed policy implications of transient visitor units on Maui, drawing on real property data and a resident survey.

Consultant’s Scope and Methodology

The Belt Collins team provided a series of memos to help the Working Group in its deliberations. Dr. Mak brought principles for taxation to the Working Group’s attention, and provided current examples of State/county allocations in other jurisdictions. The team conducted a working session on the impacts of different models over time, and provided forecasts of allocations in both a growth period and a recessionary one. Additional research conducted with help from the Hawai‘i Departmentof Taxation helped refine the forecasts sa s to incorporate both TAT and transient occupancy tax (time share) revenues in the analysis. The Belt Collins team went on to contribute to the drafting of this report.

Working group interim and final reports

The Working Group’s interim report was delivered in December 2014 to the 2015 Legislature, governor, and each county mayor and council. This final report of the Working Group is being submitted to the 2016 Legislature, governor, and each county mayor and council, in December 2015 by the required deadline of 20 days prior to the convening of the 2016 Regular Session. It includes a summary of Working Group discussions, analyses, and work undertaken by Belt Collins, as well as the Working Group’s conclusions, and recommendations. The Legislative Reference Bureau assisted with drafting legislation, which is attached to this report in a form suitable for introduction during the 2016 legislative session.

The Working Group intends to meet during the 2016 legislative session in order to monitor and respond to legislative inquiries on the Working Group’s proposed legislation. The Working Group’s Chair, Associate Justice Simeon Acoba (retired), and the Office of the Auditor will testify in support of the proposed legislation on behalf of the Working Group. Other Working Group members may testify on the proposal either in each member’s capacity as a Working Group member or, alternatively, in each member’s capacity as a county or state official, or as a representative of the tourism industry. Belt Collins personnel will testify and be available for technical expertise.

The Working Group looks forward to opportunities to explain its proposal to the Legislature's committees in informational briefings, upon the Legislature's request. The Working Group will cease to exist upon adjournment of the 2016 Regular Session, as directed by Act 174, SLH 2014.

Chapter 2

Introduction

Over the years, the transient accommodations tax (TAT) has been the subject of considerable discussion and debate among policymakers regarding its effect as a significant revenue generator and funding source in the State. The economic downturn and slow periods of economic growth in recent years greatly lowered the amount of TAT and other tax revenues generated by the State, thus affecting the provision of government services to the community. Hard-pressed to make tough decisions to balance the State Budget while ensuring that health, education, pension, and other state services are met,[1] the Legislature in 2009[2] increased the TAT and required that the additional revenues collected be deposited into the general fund. In 2011,[3] the Legislature placed a temporary cap on the counties' share of TAT revenues.

In 2014, the Legislature introduced House Bill 1671 (later signed into law as Act 174, Session Laws of Hawai'i 2014), which would remove the $93 million cap on transient accommodations tax revenues allocated to the counties and establish the distribution of these revenues as a percentage of TAT collected.[4] The purpose of the measure was to assist the counties financially so they can better support and enhance tourism and tourism-related services by ensuring that tax revenues derived from guest visits to the different islands of Hawai'i will help offset the costs of providing services that guests use while visiting the islands.[5]

[1] Standing Committee Report No. 764-14, House Committee on Finance, on House Bill No. 1671, House Draft 1, dated February 28, 2014, pp. 1-2.
[2] Act 61, Session Laws of Hawai'i 2009.
[3] Act 103, Session Laws of Hawai'i 2011.
[4] House Bill 1671, 2014 Regular Session.
[5] Committees on Tourism and Public Safety, Intergovernmental and Military Affairs, Standing Committee Report No. 3063 on House Bill No. 1671, House Draft 1, Senate Draft 1, dated March 21, 2014, Regular Session of 2014, pp. 1-2.

The Legislature recognized that much of the cost associated with tourism is carried by the counties, including the ever-increasing costs of providing county services to these visitors. Counties maintain roads and parks and provide the law enforcement officers and first responders who serve residents and visitors.[6] Further, counties have faced financial challenges in providing these county services since the cap on TAT revenues distributed to the counties was put in place in 2011.[7] While county testimony characterized the cap as having been "imposed" on the counties, the Legislature noted that in placing the $93 million cap into effect in 2011, the State effectively guaranteed the counties a historically high share of revenues.[8]

After deliberation, the Legislature agreed that increasing the maximum amount of TAT revenues allocated to the counties will allow the counties to better provide for public safety, parks, road maintenance, and visitor-related services. However, it also believed that a study to determine the appropriate division of duties and responsibilities to provide public services should be conducted before permanently establishing the TAT revenue allocations between the State and counties. In light of this belief, the measure was amended to change the amount of TAT revenues to be allocated to the counties to $103 million for fiscal years 2015 and 2016, and $93 million for each fiscal year thereafter; and establish a working group to evaluate the division of duties and responsibilities between the State and counties relating to the provision of public services and recommend the appropriate amount of TAT revenues to be allocated to the counties.[9]

[6] Committees on Tourism and Public Safety, Intergovernmental and Military Affairs, Standing Committee Report No. 3063 on House Bill No. 1671, House Draft 1, Senate Draft 1, dated March 21, 2014, Regular Session of 2014, pp. 1-2.
[7] Standing Committee Report No. 160-14, House Committee on Tourism, on House Bill No. 1671, House Draft 1, dated February 5, 2014, pp. 1-2.
[8] Committees on Tourism and Public Safety, Intergovernmental and Military Affairs, Standing Committee Report No. 3063 on House Bill No. 1671, House Draft 1, Senate Draft 1, dated March 21, 2014, Regular Session of 2014, pp. 1-2.
[9] Conference Committee Report No. 145-14 on House Bill No. 1671, House Draft 1, Senate Draft 1, Conference Draft 1, dated April 25, 2015, pp. 1-2.

Signed into law as Act 174, Session Laws of Hawai‘i 2014, the measure established and directed the work of the State-County Functions Working Group. This Working Group final report addresses both objectives of the act:

1. Evaluate the division of duties and responsibilities between the state and counties relating to the provision of public services; and

2. Submit a recommendation to the Legislature on the appropriate allocation of the transient accommodations tax revenues between the State and counties that properly reflects the division of duties and responsibilities relating to the provision of public services.

Evaluate the Division of Duties and Responsibilities Between the State and Counties Relating to the Provision of Public Services

During the Working Group's initial meetings in 2014, a broad array of foundational topics and issues related to its work on the division of duties and responsibilities between the State and counties were discussed. The Working Group researched and gained an in-depth understanding of the relevant legislative history and acts relating to the transient accommodations tax, including the TAT rate and distribution of TAT revenues. It also sought to determine and understand what are *public services*, as referred to in Act 174, and the possible ways of measuring what these are.

Looking at various resources and guides to county and state government, the Working Group reviewed the division of public services as articulated in the Constitution of the State of Hawai‘i and the Revised Charter of Honolulu and Maui County, Kaua‘i County, and Hawai‘i County Charters. Related to this, the group sought to understand both the division of public services between the State and the counties, and such division with respect to tourism. It gathered county and state data and sought to apply different formulas, standards, and guidelines to the topics and issues. It assessed the desirability, rationality, and objectivity of formulas, standards, and guidelines.

Ultimately, the Working Group determined to use the State and county comprehensive annual financial reports (CAFRs) as a starting point for discussion and analysis as CAFR categories reflect public services provided by government. The Working Group noted that there are some differences between State and county CAFR categories, but that such differences could be clarified and their corresponding expenditures normalized for comparison.[10]

Establishment and assignment of investigative groups pursuant to sunshine law

The Working Group established three investigative groups permitted under the sunshine law to identify the duties and responsibilities between the State and counties relating to public services and to identify visitor-related needs for State and county services:

1. County Duties and Responsibilities Investigative Group;
2. State Duties and Responsibilities Investigative Group; and
3. Visitor Industry Investigative Group.

Five to six Working Group members were assigned to each investigative group. The County Duties and Responsibilities Investigative Group's and State Duties and Responsibilities Investigative Group's scope of investigation was to develop (1) a common template for the counties and State to evaluate the duties and responsibilities, considering CAFR data; and (2) allocation(s) based on tourism factors, including population. The Visitor Industry Investigative Group's scope of investigation was to review and summarize visitor industry and other views on visitor-related needs for State and county services.

[10] For example, Maui includes *public works* in its *highways & streets* category. Kaua'i reports *transportation* and *bus service* in *public welfare*.

Investigative group final reports were accepted by the Working Group. All investigate group final reports are summarized below and can be found in the appendices.

State and Counties Comprehensive Annual Financial Report expenditure categories reflect public services provided

The State and counties' investigative groups determined that the State and county CAFR categories related to public services and have some nexus to tourism, except the State categories of *interest expense, unemployment compensation*, and *nonmajor proprietary fund*. Exhibit 1 lists the state and county CAFR expenditure categories.

Exhibit 1 County and State CAFR Expenditure Categories, FY2013-14

County CAFR Expenditure Categories	State CAFR Expenditure Categories
General government	General government
Public safety	Public safety
Public works	Highways
Highways & streets	Conservation of natural resources
Sanitation	Health
Human services	Welfare
Culture & recreation	Lower education
Public welfare	Higher education
Utilities/Transportation	Other education
Debt service	Culture and recreation
Miscellaneous	Urban redevelopment and housing
Net transfer	Economic development and assistance
Capital outlay	Interest expense*
Proprietary funds	Airports
	Harbors
	Unemployment compensation*
	Nonmajor proprietary fund*

* The State Duties and Responsibilities Investigate Group determined that there was no nexus to tourism for these categories.
Source: Office of the Auditor based on County Duties and Responsibilities Investigative Group and State Duties and Responsibilities Investigative Group final reports

Some Working Group members noted limitations to reviewing expenditures alone and encouraged the group to review revenues. For example, county members noted that county revenues are related to tourism when they come from real property taxes, specifically those paid by hotels and resorts. However, the Department of Taxation Tax Research and Planning Officer, who had been invited to speak at the April 1, 2015, Working Group meeting, said that it would be difficult to earmark TAT revenues for public services that benefit tourists, even though there may be nexus between tax revenue and tourism. He also noted that the *1988 Tax Review Commission Report* stated that 53 percent of costs for tourism are paid by the counties.[11] That report also addressed how tax responsibility and responsibilities for providing services should be divided between the State and counties, and provided a breakout as to how much of the public outlays that directly support tourism is from the counties and the State.[12]

Working Group observations based on investigative group work

General observations were made by the Working Group during presentations by investigative groups of their findings and final reports. These observations compare, contrast, and draw conclusions based on information provided by the three investigative groups formed to evaluate the division of duties and responsibilities between the state and counties.

Total county and state expenditures on tourism far exceed revenue collected by the TAT. Both the counties and State are subsidizing tourism. Overall, county expenditures on tourism compared to all county expenditures are generally much higher than State expenditures on tourism compared to all State expenditures (City & County of Honolulu, 5.77 percent; Maui, 10.62 percent; Hawai‘i, 7.99 percent; Kaua‘i, 19.06 percent; State, 4.4 percent). In fact, if the State’s *welfare, lower education,* and *higher education* categories are removed from the State’s list, the percentage of expenditures on visitors by the State and counties is roughly 53 percent to 47 percent. The allocation of tourism-related expenditures is not a precise number, however, and could be closer to a 60/40 split, depending on the methodology used.

[11] *1998 Tax Review Commission Report, Advisory Commission on Intergovernmental Relations*, p. 300, Hawai‘i Tax Review Commission (1988).
[12] See *id.*, p. 301, Table VIII.1 Public Services With Direct Benefits for Visitors, Fiscal Year 1987, Hawai‘i Tax Review Commission (1988).

The present allocation of $93 million of TAT revenues to the counties does not cover county total expenditures on visitors of almost $236 million. In fact, $93 million falls short of the City and County of Honolulu's tourism-related expenditures of almost $116 million. The visitor industry is particularly important for Kaua‘i and Maui counties, where on any given day one in four persons is a visitor. Current allocation of TAT revenues among the counties is not tied to population, even though TAT legislative history reflects reliance on population. Rather, current distribution correlates roughly with visitor arrivals per county.

County Working Group members seek retention of the current TAT distribution rate among the counties. Current allocation of TAT revenues among the counties (City & County of Honolulu, 44.10 percent; Maui, 22.80 percent; Hawai‘i, 18.60 percent; Kaua‘i, 14.50 percent) is almost the same as the individual county expenditures on visitors to all counties' expenditures on visitors (City & County of Honolulu, 49.05 percent; Maui, 25.09 percent; Hawai‘i, 13.10 percent; Kaua‘i, 12.75 percent).

Finally, most of Hawai‘i's visitors are leisure travelers as compared to other destinations with a higher percentage of business travelers. The consensus among Working Group members is that general tourism marketing and promotion of Hawai‘i is a high priority. The visitor industry identified three priority categories of visitor-related needs for State and county services: (1) transportation and parks and recreation, including airports, highways and roads, public transportation, harbors, and state and county parks; (2) public safety and housing, including police presence and addressing homelessness; and (3) culture, education, sanitation, and individually advertised units.

Investigative group report summaries

County Duties and Responsibilities Investigative Group

The County Duties and Responsibilities Investigative Group performed a line-item by line-item review of each county's 2014 CAFR, identifying both total costs and those with a nexus to the visitor industry. CAFR category expenditures reflected the cost of public services provided by category. Each county normalized its CAFR reporting for consistency and to enable comparison, with some exceptions.[13] To calculate the visitor allocation of each county CAFR category expenditure, each expenditure was multiplied by the degree of visitor nexus as determined by the county group as *high*, applying a factor of 1.00, *moderate* of 0.50, *low* of 0.25, or *none* of 0.00. Both County and State Duties and Responsibilities Investigative Groups applied the same methodology for determining the visitor allocation on expenditures based on nexus, but carried out their work and analyses separately in their respective groups.

The county investigative group also relied on 2013 Hawai'i Tourism Authority (HTA) visitor-day data[14] and 2013 Department of Business, Economic Development and Tourism (DBEDT) resident data[15] to determine the ratio of visitors to residents, visitor expenditures to total expenditures, and visitor expenditures statewide, among other analyses. Exhibit 2 shows FY2014 total expenditures, visitor expenditures, and FY2013 visitor to resident ratio, by county.

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[13] For example, Maui County includes *public works* in its *highways and streets* category; thus, Maui did not report in the *public works* category. On Kaua'i, the *public welfare* category includes transportation and bus service; thus, Kaua'i did not report in the *utilities/transportation* category. See Appendix_ for details of each county's normalized CAFR values.

[14] By dividing the total visitor days on each county by 365, the investigative group converted visitor days to a de-facto resident: City & County of Honolulu – 96,054 visitors; Maui County – 54.233; Hawai'i County – 29,255; and Kaua'i County – 23,334.

[15] City & County of Honolulu – 983,429 residents; Maui County – 160,292; Hawai'i County 190,821; and Kaua'i County 69,512.

Exhibit 2 County Total Expenditures and Expenditures on Visitors (FY2014) and Visitor to Resident Ratio (FY2013)

County	Total Expenditures	Expenditures on Visitors	Visitor to Resident (%)
City & County of Honolulu	$ 2,004,574,421	$ 115,670,580	8.9
Maui County	$ 557,071,759	$ 59,170,783	25.28
Hawaiʻi County	$ 386,564,579	$ 30,888,669	13.29
Kauaʻi County	$ 157,769,811	$ 30,076,408	25.13
Total	**$ 3,105,980,570**	**$ 235,806,440**	**12.63**

Source: County Duties and Responsibilities Investigative Group's final report

The county investigative group reported on five major areas:

1. County expenditures on visitors to total operating expenditures;
2. Individual county expenditures to aggregate expenditures of all counties;
3. Individual county expenditures on visitors to total county expenditures statewide on visitors;
4. Percentage of total county TAT allocation; and
5. Percentage of each county's portion of total TAT after allocations for debt service and the Hawaiʻi Tourism Authority (HTA).

The county investigative group's report is attached as Appendix A.[16] The report provides dollar figures and other data used in calculating reported percentages.

[16] Additional information and Working Group discussion can be found in the April 1, May 6, and June 3, 2015 meeting minutes posted at http://auditor.hawaii.gov/task-forceworking-group/.

County expenditures on visitors to total operating expenditures. Each county determined its total operating expenditures for visitors, not including capital improvement projects and divided it by the total operating expenditures for each county, as shown in Exhibit 3.

Exhibit 3 County Expenditures on Visitors to Total Operating Expenditures, FY2014

County	County Expenditures on Visitors to Total Operating Expenditures (%)
City & County of Honolulu	5.77
Maui County	10.62
Hawai‘i County	7.99
Kaua‘i County	19.06
Average	**7.59**

Source: County Duties and Responsibilities Investigative Group’s final report

Individual county expenditures to aggregate expenditures of all counties. Each county determined its total operating expenditures, divided by total operating expenditures of all four counties, as shown in Exhibit 4.

Exhibit 4 County Expenditures to All County Expenditures, FY2014

County	County Expenditures to All Counties’ Expenditures (%)
City & County of Honolulu	64.54
Maui County	17.94
Hawai‘i County	12.45
Kaua‘i County	5.08
Total	**100**

Source: County Duties and Responsibilities Investigative Group’s final report

Individual county expenditures on visitors to the total county expenditures statewide on visitors. Total operating expenditures for visitors in each county was divided by the operating expenditures for total visitors for all four counties, as shown in Exhibit 5.

Exhibit 5 County Expenditures on Visitors to Total County Expenditures Statewide on Visitors, FY2014

County	County Expenditures on Visitors to Total County Expenditures Statewide on Visitors (%)
City & County of Honolulu	49.05
Maui County	25.09
Hawai‘i County	13.10
Kaua‘i County	12.75
Total	**100**

Source: County Duties and Responsibilities Investigative Group's final report

Percentage of total county TAT allocation. Exhibit 6 reflects the FY2014 allocation rate among the counties to all county TAT allocations.

Exhibit 6 County TAT Allocations to All County TAT Allocations, FY2014

County	County TAT Allocation to All Counties' TAT Allocations (%)
City & County of Honolulu	44.10
Maui County	22.80
Hawai‘i County	18.60
Kaua‘i County	14.50
Total	**100**

Source: County Duties and Responsibilities Investigative Group's final report

Percentage of each county's portion of total TAT after allocations for debt service and the Hawai‘i Tourism Authority. Exhibit 7 shows each county's portion of the total TAT after allocations to the Convention Center Enterprise Special Fund for Convention Center debt service and the Tourism Special Fund for Hawai‘i Tourism Authority.

Exhibit 7 County's Share of Total TAT After Allocations for Debt Service and HTA, FY2014

County	County's Share of Total TAT After Debt Service and HTA Allocations (%)

City & County of Honolulu	19.76
Maui County	10.21
Hawaiʻi County	8.33
Kauaʻi County	6.50
Total	**44.80**

Source: County Duties and Responsibilities Investigative Group's final report

Overall, the analyses highlight how important the visitor industry is for Maui and Kauaʻi Counties by showing the amount of expenditures allocated to the industry, as compared with the City & County of Honolulu and Hawaiʻi County. The county group also observed that the existing TAT allocation distribution rate among the counties is very similar to the percentage of each county's expenditures on visitors to the aggregate counties' expenditures on visitors, as shown in Exhibit 8.

Exhibit 8 TAT Allocations Among Counties and County Expenditures on Visitors to Total County Expenditures Statewide on Visitors, FY2014

County	TAT Allocations Among Counties (%)	County Expenditures on Visitors to Total County Expenditures Statewide on Visitors (%)
City & County of Honolulu	44.10	49.05
Maui County	22.80	25.09
Hawaiʻi County	18.60	13.10
Kauaʻi County	14.50	12.75
Total	**100**	**100**

Source: County Duties and Responsibilities Investigative Group's final report

Finally, the Working Group observed that the current $93 million of TAT allocations to the counties falls short of funding needed for all counties' expenditures on visitors as shown in Exhibit 9; in fact, $93 million does not cover the City & County of Honolulu's expenditures on visitors. However, the county group pointed out that the counties also generate revenues through real property taxes, including those levied on hotels and resorts.

Exhibit 9 County Expenditures on Visitors and TAT Allocations to Counties, FY2014 (in millions)

County	County Expenditures on Visitors	TAT Allocations
City & County of Honolulu	$ 116	$__
Maui County	$ 59	$__
Hawai'i County	$ 31	$__
Kaua'i County	$ 30	$__
Total	**$ 236**	**$ 93**

Source: County Duties and Responsibilities Investigative Group's final report

State Duties and Responsibilities Investigative Group

The State Duties and Responsibilities Investigative Group performed a line-item by line-item review of the State's 2014 CAFR. Utilizing the same methodology as the county group, the state group identified both total costs and those with a nexus to the visitor industry. To calculate the visitor allocation of the CAFR expenditure, the expenditure was multiplied by the degree of visitor nexus, as determined by the state group as *high* and applying a factor of 1.00, *moderate* of 0.50, *low* of 0.25, or *none* of 0.00. Exhibit 10 shows FY2014 total state expenditures and visitor expenditures. The state group's final report is attached as Appendix B.[17]

Exhibit 10 Expenditures on Visitors to State Total Expenditures, FY2014 (in thousands)

	Total Expenditures	Expenditures on Visitors	Expenditures on Visitors to Total Expenditures (%)
State of Hawaii	$10,302,377	$453,152	4.4

Source: State Duties and Responsibilities Investigative Group final report

The State group raised three questions for the State-County Functions Working Group to address when determining TAT allocations:

[17] Additional information and Working Group discussion can be found in the April 1, May 6, and June 3, 2015 meeting minutes posted at http://auditor.hawaii.gov/task-forceworking-group/.

1. Act 61 (SLH 2009) increased the TAT rate by 2 percent—from 7.25 percent to 9.25 percent—and required all additional revenues collected to be deposited to the State general fund.

   Question: Should the additional 2 percent in TAT revenues be excluded from the Working Group's study and analysis and allocation recommendations?

2. The TAT allocation can be based on tourism-related services or general government services provided.

   Question: Should the Working Group's final report provide information on both allocation methods—tourism-related and general government services provided—so the Legislature has information to make an informed decision?

3. **Question**: Should TAT allocations be based on expenditures or on both expenditures and revenues?

The Working Group discussed but did not reach final decision or consensus on these three issues at its May 6, 2015, meeting. Instead, it deferred the issues, agreeing to consider them later as part of its allocation deliberations.

Visitor Industry Investigative Group

The Visitor Industry Investigative Group members reached out to each member's contacts with a common and open-ended request to identify priority visitor-related needs for State and county services. Contact groups included Outrigger Enterprises employees at 31 properties on four islands; members and others on the mailing lists of the Hawai‘i Lodging & Tourism Association and the Waikiki Improvement Association; the Hawai‘i Tourism Association and other organizations focused on the tourist industry; and visitor industry retail and other partners, among others. Outreach was conducted online and through surveys on the neighbor islands. Members reviewed the outreach results and compared them against each member's own anecdotal information and overall view of the visitor industry. Finally, members agreed on an overall summary of the results organized generally according to State and county CAFR expense categories.

In general, visitor industry and other views on visitor-related needs for State and county services break down into three priority categories:

Priority 1 – Direct needs that are most important across the board (transportation and parks and recreation);

Priority 2 – Direct needs that are very important but not as important as priority 1 and/or not universal (public safety and housing); and

Priority 3 – Some or all of direct needs not as important as priorities 1 and 2, direct needs targeted at more specific areas that are not universal, and indirect needs which are important to laying the foundation for addressing direct visitor needs (culture, education, sanitation, and individually advertised units).

Priorities were further broken down into focus areas, as shown in Exhibit 11.

Exhibit 11 Visitor Industry Priority Categories and Focus Areas

Priority	Focus Area
1. Transportation and Parks and Recreation	**Airports** – maintain and improve airports, especially general conditions, signage, restrooms, and visitor assistance.
	Highways and roads – maintain and improve highways and roads, both general conditions and specifics, including directional signage, non-vehicular access, and litter and overall beautification.
	Public transportation – assure fair and accessible public transportation.
	Harbors – for cruise visitors especially, improve major harbors.

	State and county parks – improve general conditions of State and county parks, especially beach parks and trails. Related areas include lifeguards, restrooms, trash and beach erosion, and park-specific public safety.
2. Public Safety and Housing	**Police presence** – increase police presence in destinations focused on or frequented by visitors, especially in Waikīkī but also across all islands, including parks and other visitor destinations.
	Housing – address homelessness, especially in Waikīkī but also in non-Waikīkī tourist destination areas statewide.
3. Culture, Education, Sanitation, and Individually Advertised Units (IAUs)	**Culture** – educate to preserve and enhance the diverse cultures of Hawai‘i that contribute to Hawai‘i's unique visitor experience.
	Education – train visitor industry workforce.
	Sanitation – address sanitation specifically at visitor destinations, including airports/roads and parks/recreation areas, but also generally to handle visitor and resident demand.
	IAUs – eliminate illegal rentals and assure full compliance with visitor-specific requirements, including TAT payment.

Source: Visitor Industry Investigative Group final report

The visitor industry group's report also recognized that government contributes in other ways—both direct and indirect—to fulfillment of visitor-related needs for services. Finally, the group did not address general tourism marketing and promotion of Hawai‘i, although the visitor industry continues to view this as a high priority, visitor-related need for State and county services. The group's full report, *Visitor Industry Views on Visitor-Related Needs for State and County Services*, is included as Appendix C.[18]

[INSERT BCH DRAFT - OBJECTIVE 2]

Recommend to the Legislature the Appropriate Allocation of the TAT Revenues Between the State and Counties That Properly Reflects the Division of Duties and Responsibilities Relating to the Provision of Public Services

[18]Additional information and Working Group discussion can be found in the April 1, May 6, and June 3, 2015 meeting minutes posted at http://auditor.hawaii.gov/task-forceworking-group/.