Thomas H. Luten
1215 South Kihei Road, Unit O-836
Kihei, Hawaii 96753
808-874-5959
Email: thl@luten.com

September 26, 2011

Tax Review Commission
Via email: titin.l.sakata@hawaii.gov

Dear Chairman Iwase and Commissioners:

I enclose several things. First, my resume. Second, a letter written to Representative Joe Bertram several years ago concerning Hawaii's tax structure. And third, updated tables and a graph showing how and why Hawaii's income tax rate structure so unfairly burdens Hawaii's working poor.

The balance of this letter is a description of something I think the Commission desperately needs if it is to do its very important work of reviewing Hawaii's tax system.

For the last 30 years, I have consulted to venture capital, investment banking, venture capitalized businesses, public utilities, and others. The focus of my consulting has been corporate financial planning models. These models are really highly specialized computer programs that simulate the financial effects of corporate policy making and external events. They answer questions like: what happens if my receivables take 90 days to collect instead of 45? What happens if sales grow so fast that I need to hire 500 people in the next two years? What is the effect of tax loss carry forwards on taxes due? When do taxes first become due? How much equity investment from investors will I need over the next five years? At what point does cash flow turn positive?

These models are always custom constructions, but they always follow a familiar template. I have built scores of them.

It seems to me that if the Commission is to review Hawaii's tax system, it needs a tax policy simulation model. It is obvious in these troubled times that you can't responsibly make policy proposals for the legislature unless you have some idea what the implications of the proposals are. For example, if we reduce the number of tax brackets, and reduce revenues from tax payers making less than $50,000, where will the lost revenue be made up? If we, as a policy matter, increase overall corporate income tax revenue, what do the appropriate tax brackets look like? What would happen if we grant a partial tax credit to Hawaii tax filers to offset the regressive effects of GET, and simultaneously raise the rate so as to shift the tax burden to visitors? What effect would a more conventional sales tax, instead of GET, have on the overall tax revenue package? What would the rate have to be in order to be revenue neutral? How should the overall income tax structure be made to conform more closely to federal structure and what would the effect of the changes be? These are the kinds of questions that a well-constructed tax policy simulation model could answer.

Such a model seems critical to the work of the Commission. If the Department of Taxation doesn't have such a model, it should. Because the model has to be extremely detailed in order to capture the true effects of policy shifts, it's not likely to be cheap. But it is important. I look forward to reading the Commission's Request for Proposal to be released this week to find out what its current thinking is.

Respectfully,
/s
Thomas H. Luten

THOMAS H. LUTEN

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Kihei, Hawaii 96753
Tel: 808-874-5959
Email: thl@luten.com

Business Experience

3/02 – Present: **INDEPENDENT CONSULTANT** focusing on financial and operational planning needs of young, venture capitalized companies. Clients include Sphera Corp. (Tel Aviv), Atempo (Paris), Virtutech (Silicon Valley, Stockholm), Vision Capital (Silicon Valley, Geneva), Commprove (Florence).

1/00 – 3/02**: METARA INC. Vice President, Chief Financial Officer, Secretary.** Performed all duties of the CFO for this Silicon Valley semiconductor equipment startup. Established initial accounting systems, did early Controller work, early HR work, managed payroll (including multi-state payroll taxes), payables, income taxes, contracting, investor relations, outside counsel, SEC filings, equity accounting. Established the company's ISO and benefits plans. Managed the company's first outside audit. Co-wrote the company's business plan. Long range financial planning and short range cash flow planning. Author of the company's financial planning models.

9/92 – 12/99: **INDEPENDENT CONSULTANT.** Clients included: Pentech Financial as deal and due diligence analyst for equipment leases to young venture capitalized businesses; Technology Funding Inc. as member of the Board of Directors of one of its portfolio companies and occasional advisor on industrial deals; Vision Capital in a workout situation; a San Francisco-based pharmaceuticals company exploring a build-vs.-buy decision for a manufacturing plant; a San Francisco law firm in need of expert testimony regarding valuation of a young medical device company; a Seattle-based software start-up as CEO; M&A work for a Santa Clara semiconductor company.

2/88 - 9/92: **TECHNOLOGY FUNDING INC. Manager of Financial Analysis, Senior Investment Officer.** Responsible for all the financial analysis connected with screening and making investments for this $300 million technology-oriented venture capital firm. Managed a team of four. Designed and built the firm's pro forma, cash flow, valuation, pricing, and capitalization models. Also directed or performed analyses connected with managing the firm's portfolios and the firm's internal business. Also responsible for managing the relationships between the firm and some of its portfolio companies, including board membership, follow-on investments, restructurings, etc.

3/83 - 12/87: **KIDDER, PEABODY & CO. Assistant Vice President**, Utility Corporate Finance Department. Senior Financial Analyst. Analytical projects included: sale and leaseback of nuclear generating facilities; acquisition of a municipal utility by a private utility; the economics of Generation and Transmission subsidiaries; the economics of hybrid convertible securities. Designed and built four generations of the department's utility financial forecasting model. Responsible for the preparation and presentation of detailed financial forecasts for clients.

3/81 - 3/83: **THE PLANNING DECISIONS GROUP**, San Francisco office. **Director of Marketing** (9/82 - 3/83), **Director of Client Development** (3/81 - 9/82).

3/80 - 3/81: **INDEPENDENT CONSULTANT** specializing in financial planning models. Built systems for capital budgeting, production and market planning, network and financial analysis for power plant site selection, for a variety of industrial clients.

7/76 - 3/80: **DATA RESOURCES, INC**. **Area Manager**, Los Angeles (1979-1980); **Managing Consultant**, San Francisco (1977-1979); **Consultant**, San Francisco (1976-1977) for this pre-eminent econometric and financial modeling and forecasting consulting company. Managed a team of seven; responsible for client relationships including service, education, contracts, revenues, and secondary marketing of products and services. Responsible for selling, performing, and managing consulting projects, including study or design of: optimal product pricing policies; country financial risk analysis; expected cost behavior of new products in the semiconductor industry; M&A analysis.

Education

STANFORD UNIVERSITY, GRADUATE SCHOOL OF BUSINESS, MBA, 1976. Emphasis in finance, international business, economics.

UNIVERSITY OF CALIFORNIA, SANTA BARBARA, BA, 1974. Majors: International Relations, Economics. Dean's List, Scholars' Program, Political Science Honors Program. Honors Thesis: *Energy Policy in the European Communities.*

Other

U.S. Army. Honorably discharged in 1969 as E-5. Accepted applicant, U.S. Foreign Service. Registered securities rep (NASD Series 7, lapsed). Director, SunPower Corp (1991-2004).; Director, Vulcan Power Company (2009); former Commodore, Berkeley Yacht Club; former Commissioner, Berkeley Police Review Commission; former Commissioner, Berkeley Fair Campaign Practices Commission; former Campaign Treasurer, Shirley Dean for Mayor. 8/10

Thomas H. Luten
1215 South Kihei Road, Unit 0-836
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Email: thl@luten.com
Tel: 808-874-5959

November 28, 2007

Representative Joe Bertram III
House of Representatives
State Capitol
Honolulu, HI 96813

Dear Representative Bertram:

I write to respond to your most courteous invitation to me to offer my ideas for new legislation in the up-coming session. Thank you for this opportunity.

My suggestion is this: that the Hawaii legislature pass an act committing it to a complete, from scratch, rewrite of the Hawaii income tax statutes within 24 months after passage. I have attached a short analysis of the shockingly unfair state income tax burden borne by the poor in Hawaii. Briefly: a person making $40,000 per year in Hawaii pays **over 8 times** as much in state income tax as the same worker in California would pay. Not only that, the Hawaii tax owed will be greater than the federal tax! When I realized this, I was stunned. I find it incredible that Hawaii, with its progressive traditions, would tax the working poor in this way.

My second proposal is that the legislature commit to the complete repeal of the General Excise Tax, to be replaced with something else within 24 months of passage.

The Department of Taxation piously pronounces that the GET is a tax on business for the privilege of doing business in Hawaii. But that's a lie. Let me say it again: **THAT'S A LIE.** It is a sales tax. When I buy nearly anything, the tax is added at 4.166% , and I pay the tax. It might be the most regressive tax in America. The tax is paid on literally everything but postage. California does have a sales tax (which they admit is a sales tax), but they don't charge it on groceries, medicines, services, and a wide variety of other necessities of life, nor do they layer it on at each stage of production. It is collected once, when the thing is finally sold to an end-user.

I am a relative newcomer to Hawaii, but my experience and education in economics and finance leads me to conclude that Hawaii's tax rate structure must be an artifact of pre-statehood days. It was probably cooked up by Alexander-Baldwin and the other plantation owners to keep the field hands in their places. It looks to me like a scheme to tax the poor to keep them poor.

Representative Bertram, I'm not joking. This situation is disgraceful. I am embarrassed by these facts, and you should be, too. And all of your legislative colleagues as well. If my facts are wrong, I'm eager to be corrected, but I don't think I'm wrong.

Respectfully submitted,

Thomas H. Luten

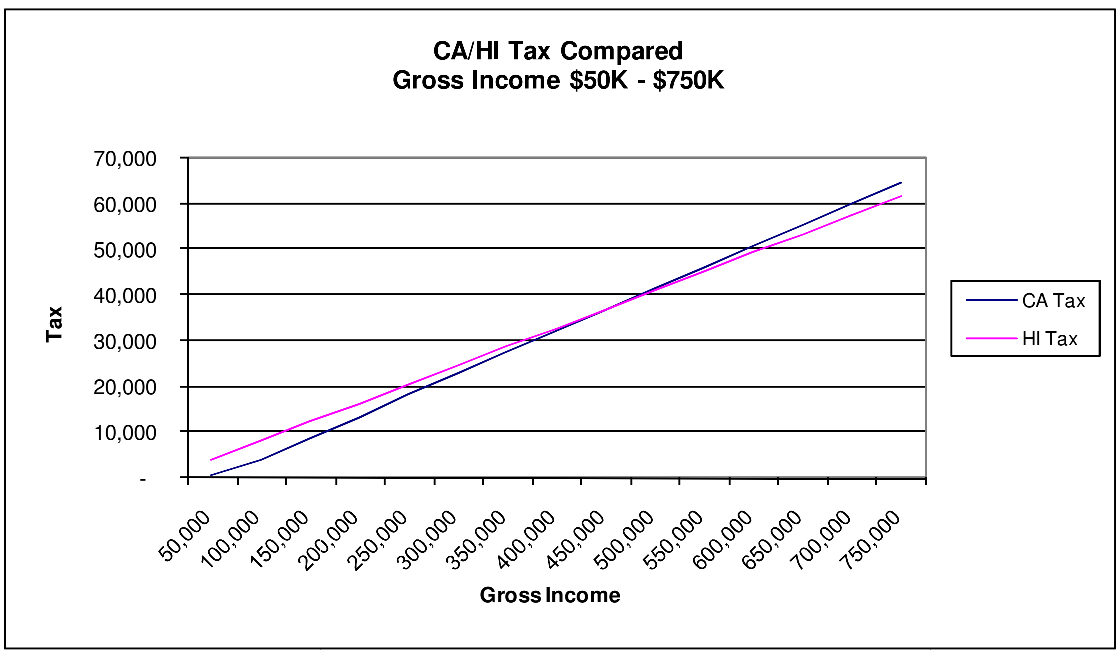
Cc: Governor Linda Lingle
Senator Rosalyn Baker

State Income Tax Incidence: Hawaii vs. California

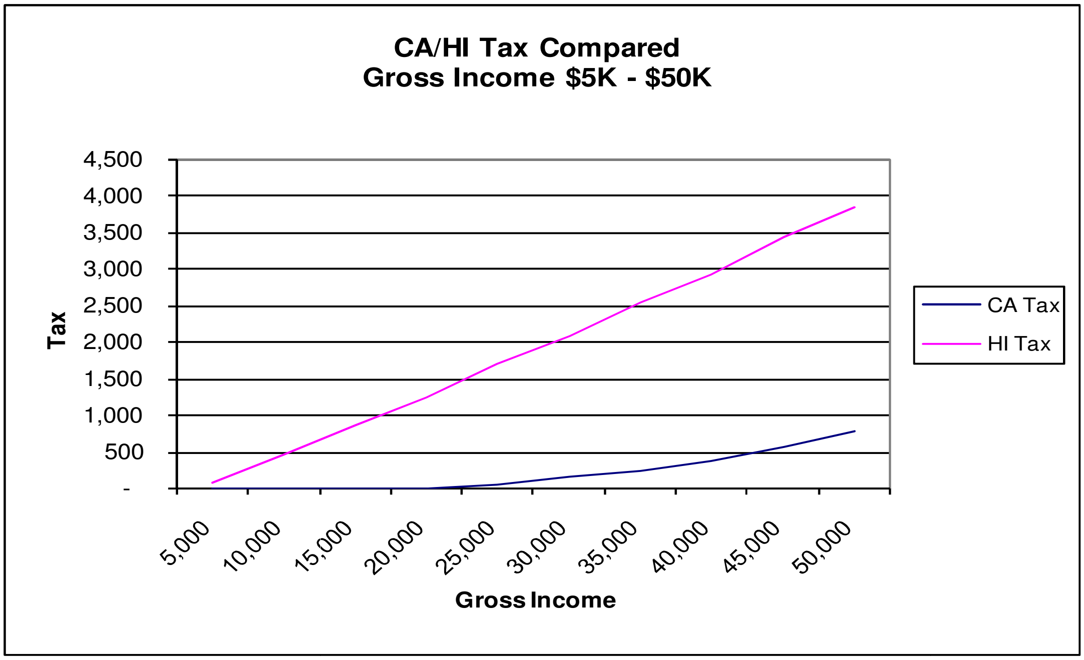
Below are the pertinent tax tables for Hawaii and California.

	2006 California tables			Hawaii Tables		
			Bracket			Bracket
	Txbl Inc	Rate	Base Tax	Txbl Inc	Rate	Base Tax
	-	1%	-	-	1.40%	-
	13,645	2%	136	2,000	3.20%	28
	32,370	4%	511	4,000	5.50%	128
	51,088	6%	1,260	8,000	6.40%	440
	70,920	8%	2,450	12,000	6.80%	768
	89,628	9.3%	3,946	16,000	7.20%	1,088
				20,000	7.60%	1,440
				30,000	7.90%	2,280
				40,000	8.25%	3,160
Std. Exemption		6,820		1,900		
Pers. Exemption Cr.		182				

While the top California rate is somewhat higher than Hawaii's top rate (9.3% vs. 8.25%), California's top rate doesn't kick in until taxable income reaches nearly $90,000. In Hawaii, the top rate applies to taxable incomes above $40,000. A chart showing applicable taxes on gross incomes between $50,000 and $750,000 is shown below.



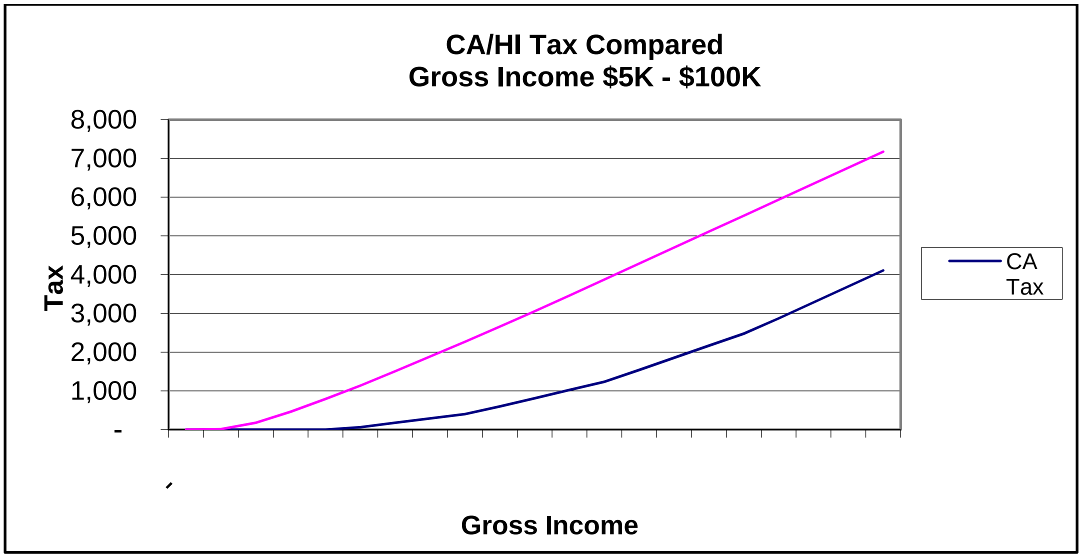
The chart above shows two tax structures that are superficially largely similar: they have about the same slope, about the same levels, and are essentially identical at gross incomes of $450,00 0. At the highest income levels, Hawaiians pay somewhat less than Californians in similar circumstances. But the story is quite different at the bottom end of the income scale. The chart below shows the details at gross incomes below $50,000:

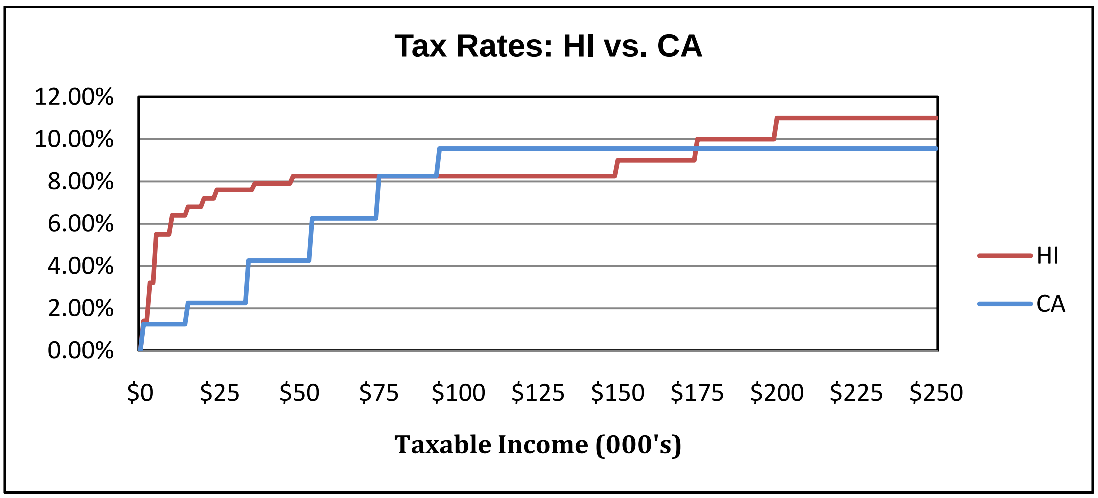


This analysis was done using ordinary simplifying assumptions: taxpayers were joint filers with no dependents, and took the standard deduction, and in California, the standard personal exemption credit. This credit is a feature with no parallel in Hawaii law as far as I know. Below is a table showing gross incomes from $5,000 to $50,000 and the applicable income tax in each state:

Gross Inc.	CA Tax	HI Tax	Ratio
5,000	-	63	
10,000	-	446	
15,000	-	843	
20,000	-	1,239	
25,000	45	1,676	37.1
30,000	145	2,056	14.2
35,000	245	2,525	10.3
40,000	361	2,920	8.1
45,000	561	3,416	6.1
50,000	761	3,828	5.0

The results speak for themselves: the Hawaii income tax structure is criminal abuse of the working poor and needs to be repealed and replaced.





These charts show the tax effects of two different tax structures that are superficially similar, but that have very different impacts and incidence. The real story is best told by the chart immediately above. What it shows is that California's marginal tax rate is lower than Hawaii's up until $75,000 in taxable income, after which point the two rate structures aren't materially different. The pronounced shoulder in Hawaii's tax brackets below $75,000 is what causes a Hawaiian taxpayer with $40,000 in gross income to pay 5.65 times as much state income tax as he would if he lived in California.

Respectfully,

/s
Thomas H. Luten