TAX REVIEW COMMISSION

PUBLIC COMMENTS ON (1) STUDY BY DR. WILLIAM FOX AND (2) DRAFT STUDY BY PFM GROUP

NO.	NAME	ORGANIZATION
1.	Stephanie Doughty	President, Hawaii Association of Realtors
2.	Edward Pei	Executive Director, Hawaii Bankers Association
3.	Gregg Serikaku	Executive Director, Plumbing & Mechanical Contractors Association of Hawaii
4.	Russel Yamashita	Hawaii Dental Association
5.	John Romanowski	President, General Contractors Association of Hawaii
6.	Issac Choy	Representative, House of Representatives
7.	Members of the House of Representatives	House of Representatives
8.	Calvin Say Marcus Oshiro	Speaker, House of Representatives Chair, Committee on Finance, House of Representatives
9.	Lowell Kalapa	President, Tax Foundation of Hawaii
10.	Stefanie Sakamoto	Legislative Officer, Hawaii Credit Union League
11.	John Roberts	State President, Hawaii Association of Public Accountants
12.	Bill Walter	President, W.H. Shipman, Limited Member, Chamber of Commerce
13.	Gladys Quinto Marrone	Government Relations Director, Building Industry Association of Hawaii
14.	Gilbert Keith-Agaran	House of Representatives
15.	Peter Fritz	(No written comment)
16.	Max Sword	Outrigger Hotels
17.	Van Tomokiyo	Retired (No written comment)
18.	George Szigeti	President & CEO, Hawaii Lodging & Tourism Association
19.	Doug Meller	Self (No written comment)
20.	Gene Ward	House Minority Caucus, House of Representatives
21.	Lisa Maruyama	President & CEO, Hawaii Alliance of Nonprofit Organizations
22.	Norman Bruckmann	Self (No written comment)
23.	Gil Riviere	House of Representatives
24.	Natalie Iwasa	CPA
25.	James Coon	President, Ocean Tourism Coalition
26.	Carol Reimann	Executive Director, Maui Hotel & Lodging Association
27.	R. Allan Raikes	President, Condominium Rentals Hawaii
28.	Nane W. Aluli	General Manager, The Mauian Hotel
29.	Matt Bailey	Managing Director, Grand Wailea| A Waldorf Astoria™ Resort
30.	Dan Monck	Exclusive Getaways

Hawaii Association of REALTORS®
1259 Aala Street, Suite 300
Honolulu, Hawaii 96817

Phone: (808) 733-7060
Fax: (808) 737-4977
Neighbor Islands: (888) 737-9070
Email: har@hawaiirealtors.com

September 11, 2012

Mr. Randall Iwase, Chair
Hawaii Tax Review Commission
State Capitol, Room 309
Honolulu, Hawaii 96813

RE: Draft Study of the Hawaii Tax System by PLM and Study on Selected Issues of Hawaii GET by Dr. William Fox

HEARING: Wednesday, February 17, 2010 at 4:30 p.m.

Aloha Chair Iwase, Vice Chair Imanaka and Members of the Commission:

I am Stephanie Doughty, President of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, submitting comments on behalf of our 8,800 members in Hawai'i.

HAR strongly opposes the *Draft Study of the Hawaii Tax System by PLM* to the extent it increases the General Excise Tax (GET) and Use Tax by .5 percent. HAR believes that a GET increase will financially burden companies and residents to a point they cannot sustain at this time. An increase to the GET may further hurt businesses and residents in the long run and destabilize Hawaii's economy.

Hawai'i businesses are struggling to stay afloat – they are still struggling to keep up with operating expenses and the costs of doing business in Hawai'i. These businesses may be particularly sensitive to additional burdens that may break a business already struggling to survive. Similarly, Hawai'i homeowners face many challenges, including those who have lost jobs and must still maintain their mortgage payments.

HAR understands the States' fiscal situation and the need to balance the needs of our constituencies. However, HAR believes that increases in taxes, especially the GET, will ultimately hinder our State's economic recovery.

HAR supports the *Study on Selected Issues of Hawaii GET by Dr. William Fox* to the extent that it levels the playing field for local merchants who must deal with the high cost of doing business in Hawai'i and still compete with mail order and e-commerce merchants from outside of the State.

Mahalo for the opportunity to submit comments.

Stephanie Doughty, President

HAWAI'I ASSOCIATION OF REALTORS®

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

Hawaii Bankers
Association

TEL:
808-524-5161
FAX:
808-521-4120
ADDRESS:
1000 Bishop Street, Suite 301B
Honolulu, HI 96813-4203

September 7, 2012

TO: Hawaii Tax Review Commission

RE: Testimony for September 11, 2012 Hearing

The Hawaii Bankers Association (HBA) is opposed to an increase in either the General Excise Tax (GET) or the Individual Income Tax (IIT). HBA is the trade organization that represents all FDIC insured depository institutions with offices in Hawaii.

HBA is opposed to the proposed tax increases presented in the PFM Group report, especially in these strained and fragile economic times. The report acknowledges that economic conditions continue to pose daunting challenges into the foreseeable future. Increasing the tax burden will do nothing to stimulate the economy and restore our economic vitality.

It is consumer confidence and spending that will revitalize and strengthen our economy. But, the proposed changes will take $480 million out of the pockets of our consumers. Our priority should be to restore consumer confidence and we cannot do so with a significant tax increase.

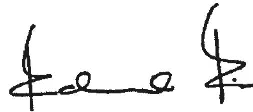
While the GET rate is seemingly low, relative to the sales tax rate assessed in other states and municipalities, studies have shown that, with the pyramiding effect, the effective rate is considerably higher. A 0.5% increase, equivalent to a 12.5% increase in the tax rate, raises the stated rate to 4.5% (or 5.0% on Oahu), but increases the effective rate even more drastically. Consumers can ill afford this tax increase at this time. The PFM report also acknowledges that the GET in Hawaii is applied to 160 of 168 good and services, the most of any state in the nation. Our citizens cannot afford a 12.5% increase in their general excise tax burden, when they are struggling today to afford other necessities.

The PFM report also reveals that Hawaii's population is aging and, in fact, we rank 12th among all states in the percentage of population ages 65 and over. We all know that the demographic shift towards an older population will accelerate in the years to come. Our senior citizens have worked hard all their lives and now rely on their pension incomes to survive the ever increasing cost of living in Hawaii. These seniors cannot afford to have their fixed pension incomes reduced by a tax on those incomes.

The PFM report and recommendations suggest these two revenue increasing measures as the most effective means of increasing revenues for the State. And, we realize it is important to maintain a balanced budget, generating sufficient revenues to offset the State's expenses. But, there is no mention in this report to suggest that we first should look towards reducing the State's expenses before we look to raise the revenues to match the expenses. We just cannot continue to place the burden of rising costs on already overtaxed citizens.

Thank you for the opportunity to voice our concerns.

Respectfully Submitted,



Edward Y. W. Pei
Executive Director

PLUMBING & MECHANICAL CONTRACTORS ASSOCIATION OF HAWAII

TELEPHONE: (808) 597-1216
FAX: (808) 597-1409
1314 S. King Street, Suite 961
Honolulu, Hawaii 96814

GREGG S. SERIKAKU
EXECUTIVE DIRECTOR

September 7, 2012

Via Email: tax.rules.office@hawaii.gov

Mr. Randall Y. Iwase, Chair
Tax Review Commission

Chair Iwase and Members of the Commission:

SUBJECT: Public Comment on Tax Study

My name is Gregg Serikaku, I am the Executive Director of the Plumbing and Mechanical Contractors Association of Hawaii, and the Association for which I speak strongly supports the specific findings in the PFM Group Tax Study which recommends that the temporary suspension of offset deductions for contractors in Act 105 be allowed to sunset as scheduled.

On a typical construction project, the customer negotiates one contract with a general contractor for the entire work involved. This general contractor will have numerous subcontracts with specialty contractors, and these specialty contractors will in turn have sub-sub contracts with other specialty contractors and so on. Prior to Act 105 contractors at each level were allowed to deduct the value of subcontracts from their total contract value received and only paid the excise tax on their respective net portion of the contract. This system resulted in excise tax being paid on 100% of the total contract value. Act 105, which suspends the offset deduction for transactions between contractors and subcontractors, now requires contractors at each level to pay the excise tax on the gross contract value from that tier and below. This change created an onerous cascading of the tax that leads to higher costs for consumers and an added burden for construction contractors who are already financially stressed in the current tight bidding environment. Further, the cascading of the excise tax inevitably discourages new construction and renovation work due to significantly higher costs, which not only hurts the construction industry but also hurts the State, which loses out on the potential excise tax revenue on postponed projects as well as on the associated business and personal income taxes which would have been generated.

The PFM study also raises the real concern that many general contractors have been pressured to vertically integrate in an effort to reduce the effect of tax cascading. This integration has caused general contractors to attempt specialized work which has traditionally been performed by subcontractors. The general contractors do not have the necessary training or skills to perform the specialty work which puts their workers in jeopardy, and ultimately harms the consumer who ends up with an inferior and potentially unsafe building or home. In fact, the State of Hawaii created the contractor licensing law, HRS444, specifically to ensure that the consumer receives quality work performed by properly skilled contractors, and Act 105 undermines the intent of this law.

In closing, our Association agrees with the PFM study which states that the cascading of taxes distorts market decisions, reduces overall market efficiency, discourages consumer spending, and has an overall negative tax consequence.

We respectfully urge the commission to recommend the sunset of Act 105 as scheduled.

Respectfully yours,

Gregg S. Serikaku
Executive Director

Russel H. Yamashita

ATTORNEY AT LAW

2733 East Manoa Road
Honolulu, Hawaii 96822
E-mail: rhyamashita@hotmail.com

Phone: (808)524-5200
Fax : (808)524-4639
Cellular: (808)351-5200

September 8, 2012

Hawaii Tax Review Commission
Hawaii State Capitol
Conference Room 309
415 South Beretania Street
Honolulu, Hawaii 96813

**TESTIMONY OF THE HAWAII DENTAL ASSOCIATION
RELATING TO THE FINAL REPORT OF THE
HAWAII TAX REVIEW COMMISSION
DATED AUGUST 28, 2012**

Gentlemen:

The following are the comments on behalf of the Hawaii Dental Association and it over 970 practicing dentists through out the state regarding the proposals of the 2010-2012 Tax Review Commission reported dated August 28, 2012.

First, the proposal to increase the Hawaii General Excise tax from 4.0% to 4.5%. On page 15 of your report, the proposal for the increase is based on an "apples and oranges" comparison when the report states that "**Hawaii's GET rate is among the lowest in the country**". That is **BLATANTLY FALSE**. There is no other state or jurisdiction that has a general excise tax like Hawaii's. Most states, cities, counties and municipalities have **sales taxes** which are based on sales on the retail level only. Only in Hawaii is the GET applied to all economic transactions that are exclude in most states and counties. For example, sales taxes are **not applied** to professional fees, housing rental income, food and drugs in jurisdictions which impose sales taxes.

Obviously, you do not understand the first thing about tax policy if you do not understand even the basic differences between Hawaii's GET and sales taxes. Given the regressive nature of the Hawaii General Excise Tax and the compounding effect it has on the taxable income, the gross up effect of the proposed increase of the Hawaii GET to an effective rate of 4.712% will have an exponential effect on the cost of living for the entire state and especially for neighbor island residents by the time the final sale is made. The so called "Pyramiding Effect" of the State General Excise tax is calculated by the Hawaii Tax Foundation to have a four times multiple to give a fair comparison to a traditional "Sales Tax" which most states and counties impose. Given the situation for the neighbor island purchases of goods and services in Honolulu, the real effect is, in reality a compounding effect, which would have an exponential effect on neighbor island cost of living.

With the effective tax rate of 4.166% for the current State Excise Tax, a comparable Sales Tax would be 16.66%. Given the proposed increase in the Hawaii GET to 4.712%, a comparable Sales Tax would be 18.84%. Additionally, the real effect of the proposed increased Hawaii GET will be in excess of 18.84% for goods and services on the neighbor islands due to their higher cost of living.

Factoring in the additional burden Oahu residents have with the Honolulu "Rail Tax" of 0.5%, Honolulu residents will be paying an effective tax rate of over 22% if compared to the mainland version of a "sales tax". Add to this misguided assessment by your commission, the so called "Pyramiding Effect" is compounded on the citizens of Hawaii when neighbor island residents have to do business with Oahu and are subject to the "Rail Tax".

Second, the so called proposals by this commission to lessen or reduce the impact of the regressive nature of the Hawaii GET on page 14 are laughable examples of you failure to understand the true impact of the GET on the citizens of Hawaii. Increasing the refundable tax credit on "food" from $25 to $85 is a slap in the face to most residents. The elimination of the 0.5% GET and Use Tax is in reality a tax increase that will even further burden the taxpayers and make the "Pyramiding Effect" even worse, not better. Add to that the permanent elimination of the "business to business" transactions exemption will only further increase the tax burden on the tax payers in the State.

Third and finally, the bottom line effect of the proposed GET increase, along with other misguided tax increases and changes, will add to the cost of living to the people of Hawaii of at least 2%. It may not be of concern to you to see what appears to be a minor "Cost of Living Increase", but anyone who lives and works in Hawaii understands that a "minor" increase in on top of what Hawaii residents have to pay can be a monumental when compared to living on the mainland where the cost of living can be as much as 40% less than Hawaii's.

In conclusion, the Hawaii Dental Association and its members strenuously oppose the implementation of any of the proposals of this Tax Review Commission as against sound public policy.

Yours truly,

Russel H. Yamashita

1065 Ahua Street
Honolulu, HI 96819
Phone: 808-833-1681 *FAX: 839-4167*
Email: info@gcahawaii.org
Website: www.gcahawaii.org

GCA of Hawaii

GENERAL CONTRACTORS ASSOCIATION OF HAWAII

Quality People. Quality Projects.

Via E-mail: tax.rules.office@hawaii.gov
Titin.L.Sakata@hawaii.gov

September 11, 2012

Honorable Randall Y. Iwase
Chair
Tax Review Commission
State of Hawaii
Department of Taxation
830 Punchbowl Street
Honolulu, Hawaii 96813

Subject: Public Comment on (1) Draft Study of the Hawaii Tax System by Public Financial Management & (2) Study on Selected Issues of Hawaii General Excise Tax by Dr. William Fox regarding Act 105, SLH, 2011
Tax Review Commission Meeting: Tuesday, September 11 at 9:00 a.m.

Dear Chair Iwase and Members,

My name is John Romanowski, and I am the President of the General Contractors Association of Hawaii (GCA), an organization comprised of over six hundred (600) general contractors, subcontractors and construction related firms. GCA was established in 1932 and is celebrating its 80th anniversary this year. GCA is the largest construction association in the State of Hawaii. The mission of GCA is to represent its members and be a strong, but reasoned voice in matters related to the construction industry.

GCA offers comments regarding (1) Draft Study of the Hawaii Tax System by Public Financial Management (PFM Analysis) and (2) Study on Selected Issues of the Hawaii General Excise Tax by Dr. William Fox (Fox Study). GCA remains concerned about Act 105 (SLH, 2011), which suspended several exemptions from the General Excise Tax for two years, beginning July 1, 2011, which included the subcontractor exemption for construction. GCA supports the scheduled sunset of Act 105 on June 30, 2013. GCA's remains confident that the Commission will recommend allowing Act 105 to sunset as scheduled on June 30, 2013 based on the findings of the PFM Draft Study and Fox Study as detailed in our letter below.

As the PFM report points out the General Excise Tax (GET) paid by subcontractors are the result of business to business transactions and leads to pyramiding with negative tax consequences. Both the Fox Study and the PFM Analysis agree that continued long term elimination of the subcontractor exemption could result in more vertical integration and the likely loss of some business. The elimination of this exemption may have severe impact on smaller subcontractors, who would face the loss of work from a general contractor who would seek additional licenses to avoid payment of the tax currently paid by their subcontractors.

The GCA whole heartedly supports the recommendation by the PFM Analysis to allow the Act 105 (SLH, 2011) to sunset and agrees that there are better options available to the State to meet its revenue requirements, without the negative impacts that the elimination of these exemptions cause.

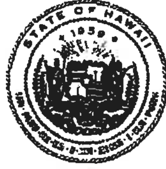
As you may be aware, construction activity has been declining every year since 2008, and is expected to lead economic recovery in the coming years. The GCA believes that the suspension of the general excise tax exemption for construction has a chilling effect on new developments that are not released due to the added cost. Some projects may be waiting for the suspension to be lifted before the projects are released.

Any delays in ending the suspension may permanently shelve those projects to the detriment of the languishing economy of the State. The GCA urges the Commission to have the Act 105 suspension of the subcontractor exemption lifted no later than the two (2) years envisioned under Act 105.

Thank you for the opportunity to share our views on this matter.

Very truly yours,

John Romanowski
President



HOUSE OF REPRESENTATIVES

STATE OF HAWAII
STATE CAPITOL
HONOLULU, HAWAII 96813

September 8, 2012 VIA EMAIL

Mr. Randall Y. Iwase, Chair
and Members
2010-2012 Tax Review Commission
c/o Department of Taxation
State of Hawaii
P.O. Box 259
Honolulu, Hawaii 96809-0259

TESTIMONY IN DISAGREEMENT TO THE CONCLUSIONS REACHED IN THE DRAFT STUDY AND REPORTS

Dear Chair Iwase and Members of the Tax Review Commission:

Thank you for the opportunity to testify and comment on:

1. The *Draft of the Study of the Hawaii Tax System* By Public Financial Management.

2. *Study on Selected issues of Hawaii General Excise* Tax By William Fox.

I would like to thank Chair Iwase and the members of the Tax Review Commission for all of their hard work serving on the commission. Having been on the Tax Review Commission, I can appreciate all of the time, effort and hard work this commission has had to endure.

I have great reservations about the hypothesis used by the drafters of the study. If I understand the authors correctly, they are saying, because of unrestrained government spending, our tax system is not adequate. They cite the areas concerning accrued liabilities, specifically, employee's pension benefits, employee's health insurance costs, and possible Medicaid cost increases as examples for the need of additional revenues. In other words, government services provided by the State of Hawaii cannot be sustained by the current tax system, and if they continue to spend as they do, they will not be able to pay their bills. Using this hypothesis of unchecked spending, no tax system would even be adequate. The reality being, there is an insatiable appetite for government services.

Manoa – University - McCully - Moiliili
Hawaii State Capitol, Room 404 / Honolulu, HI 96813
Phone: (808) 586-8475 / Fax: (808) 586-8479 / Email: repchoy@capitol.hawaii.gov

The authors fail to take into consideration the steps that the legislature can take to manage these liabilities. For example, if you study the attached report titled, **Projection Results Based on the June 30, 2012 Actuarial Valuation by Gabriel, Roeder, Smith & Company**, the actuaries for the Hawaii State ERS, you will see that accrued pension liabilities start trending downwards in 2021 and will eventually be zero. This is the result of the pension reform legislation passed by the state legislature.

This example of how the Hawaii State Legislature can mitigate government obligations can also be applied to all of the other liabilities that are used in the study. It is important to note that it is the obligation of the state legislature to manage the expenditures of the state.

Currently, our tax system is evaluated by studying the elasticity of revenues to total personal income. Simply put, when the taxpayers of Hawaii get a raise, the state gets a raise. This method, although not perfect, is a good guide line, not only for testing the adequacy of the tax system, but also makes a good guide line for the amount of expenditures that should be made.

For their hypothesis to be applied completely, the authors should define what are core government services and what the related costs are, to justify the need to raise taxes. If the authors had defined what additional core services are needed, then I believe, it would be prudent to increase revenues. Without examining every expenditure and defining core services, it is very difficult to accept the need for raising revenues as proposed in this report.

Therefore, I do not agree to the conclusions in this report.

Comment on Study on Selected issues of Hawaii General Excise Tax by William Fox:

I do not agree that the State of Hawaii is losing $145,000,000 in tax revenue for e commerce and catalog sales. If this amount was divided by 4%, it would amount to $3,625,000,000 in sales.

Dr. Fox's method of guessing the total of amount of e commerce nationally, and then trying to allocate those lost sales to specific states, is not an accurate way of forecasting e commerce sales in Hawaii.

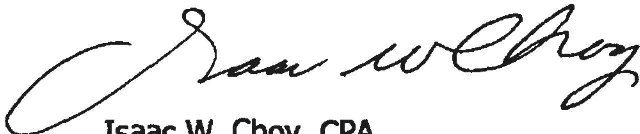
Talking with other state tax administrators at a Federal Tax Administrators conference, their experiences have been, they have been collecting an average of about ten percent of Dr. Fox's estimate.

Manoa – University - McCully - Moiliili
Hawaii State Capitol, Room 404 / Honolulu, HI 96813
Phone: (808) 586-8475 / Fax: (808) 586-8479 / Email: repchoy@capitol.hawaii.gov

IN CONCLUSION, I disagree with Dr. Fox's estimate of the amount of taxes that is lost from e commerce and catalog sales.

Thank you for allowing me the opportunity to testify and share my comments with you.

Sincerely,



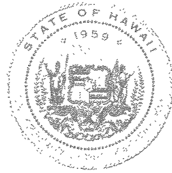
Isaac W. Choy, CPA
State Representative, District 24

Attachment

HI All Employees
Projection Results Based on June 30, 2010 Actuarial Valuation

Market Earnings: 7.75% for All Years

Valuation as of August 31,	Market Return for FY Beginning on Valuation Date	Employer Contribution Rate for Fiscal Year Following Valuation Date	Compensation (in Millions)	Employer Contributions (in Millions)	Actuarial Accrued Liability (AAL, in Millions)	Actuarial Value of Assets (AVA, in Millions)	Unfunded Actuarial Accrued Liability (UAAL, in	Benefits and Refunds (in Millions)	External Cash Flow	External Cash Flow as Percemage of Assets
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
2011	7.75%	15.52%	$ 3,955.5	$ 614	$ 20,070	$ 11,943	$ 8,127	$ 1,023	$ (212)	-1.82%
2012	7.75%	16.11%	4,093.4	660	20,999	12,564	8,435	1,099	(226)	-1.84%
2013	7.75%	16.67%	4,210.3	702	21,931	13,234	8,697	1,177	(247)	-1.90%
2014	7.75%	17.23%	4,338.0	747	22,867	13,946	8,922	1,259	(269)	-1.95%
2015	7.75%	17.79%	4,473.8	796	23,804	14,700	9,104	1,345	(290)	-1.99%
2016	7.75%	17.90%	4,616.9	826	24,729	15,500	9,229	1,433	(331)	-2.15%
2017	7.75%	17.90%	4,767.5	853	25,670	16,325	9,345	1,523	(376)	-2.31%
2018	7.75%	17.90%	4,926.6	882	26,596	17,173	9,424	1,613	(418)	-2.45%
2019	7.75%	17.90%	5,094.7	912	27,519	18,046	9,473	1,703	(459)	-2.55%
2020	7.75%	17.90%	5,272.4	944	28,437	18,947	9,490	1,795	(498)	-2.64%
2021	7.75%	17.90%	5,459.7	977	29,352	19,880	9,472	1,887	(536)	-2.70%
2022	7.75%	17.90%	5,656.4	1,012	30,262	20,849	9,413	1,980	(571)	-2.74%
2023	7.75%	17.90%	5,862.5	1,049	31,168	21,857	9,311	2,074	(604)	-2.77%
2024	7.75%	17.90%	6,078.3	1,088	32,069	22,910	9,159	2,168	(636)	-2.78%
2025	7.75%	17.90%	6,304.3	1,128	32,966	24,013	8,953	2,264	(667)	-2.78%
2026	7.75%	17.90%	6,540.5	1,171	33,856	25,169	8,687	2,358	(693)	-2.75%
2027	7.75%	17.90%	6,787.7	1,215	34,742	26,389	8,353	2,452	(716)	-2.72%
2028	7.75%	17.90%	7,046.4	1,261	35,625	27,680	7,945	2,546	(736)	-2.66%
2029	7.75%	17.90%	7,317.0	1,310	36,507	29,051	7,456	2,638	(750)	-2.58%
2030	7.75%	17.90%	7,600.2	1,360	37,389	30,513	6,877	2,729	(761)	-2.49%



HAWAII STATE LEGISLATURE
STATE CAPITOL
HONOLULU, HAWAII 96813

September 8, 2012
(Update -- September 10, 2012)

Mr. Randall Y. Iwase, Chair
and Members
2010-2012 Tax Review Commission
c/o Department of Taxation
State of Hawaii
Post Office Box 259
Honolulu, Hawaii 96809-0259

Dear Chair Iwase and Members:

Please find attached our opposition to the recommended tax increases in the draft report entitled Study of the Hawaii Tax System: Final Report, dated August 28, 2012, by The PFM Group.

Submitted by the following Members of the House of Representatives, State of Hawaii:

Henry J.C. Aquino, Karen L. Awana, Rida T.R. Cabanilla
Pono Chong, Isaac W. Choy, Ty Cullen
Heather H. Giugni, Sharon E. Har, Mark J. Hashem
Robert N. Herkes, Linda Ichiyama, Ken Ito
Jo Jordan, Derek S.K. Kawakami, Marilyn B. Lee
Sylvia Luke, John M. Mizuno, Mark M. Nakashima
Marcus R. Oshiro, Calvin K.Y. Say, James K. Tokioka
Clift Tsuji, Ryan I. Yamane, Kyle T. Yamashita
Gregg Takayama (Representative-Elect)
Tom Brower, Mele Carroll, Dee Morikawa
Jessica Wooley

c.: The Honorable Neil Abercrombie, Governor
Mr. Frederick D. Pablo, Director, Department of Taxation

Attachment

ATTACHMENT

We oppose the recommendations to increase taxes in the draft report entitled Study of the Hawaii Tax System: Final Report, dated August 28, 2012, by The PFM Group. The recommendations are intended to generate net general revenues of approximately $481 million in 2014 and, apparently, at least that amount annually thereafter.

We emphasize our opposition to the following specific recommendations:

(1) The increase of the general excise tax rate by 0.5 per cent;

(2) The imposition of the income tax on pension income;

(3) The increase of the corporate income tax rate; and

(4) The elimination of the income tax deduction for real property taxes paid.

The list above should not be regarded as exhaustive. We reserve our right to oppose other recommendations in the draft report.

We feel that such a significant net tax increase probably will be detrimental to private businesses, residents, or both, and that PFM has not sufficiently analyzed the impact of the tax increase on the economy, businesses, and residents.

CALVIN K.Y. SAY
SPEAKER

HOUSE OF REPRESENTATIVES

STATE OF HAWAII
STATE CAPITOL
HONOLULU, HAWAII 96813

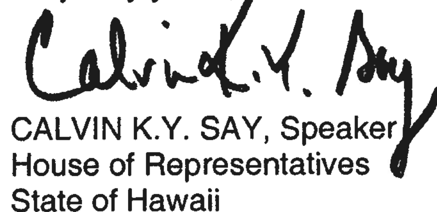
September 7, 2012

Mr. Randall Y. Iwase, Chair
and Members
2010-2012 Tax Review Commission
c/o Department of Taxation
State of Hawaii
Post Office Box 259
Honolulu, Hawaii 96809-0259

Dear Chair Iwase and Members:

Please find attached our comments on the draft report entitled Study of the Hawaii Tax System: Final Report, dated August 28, 2012, by The PFM Group.

Very truly yours,



CALVIN K.Y. SAY, Speaker
House of Representatives
State of Hawaii

MARCUS R. OSHIRO, Chair
Committee on Finance
House of Representatives
State of Hawaii

cc: Governor Neil Abercrombie
Mr. Frederick D. Pablo, Director
State Department of Taxation

Attachment

ATTACHMENT

I. OPPOSITION TO RECOMMENDATIONS

We oppose the recommendations to increase general revenues in the draft report entitled Study of the Hawaii Tax System: Final Report, dated August 28, 2012, by The PFM Group. The recommendations are intended to generate net general revenues of approximately $481 million in 2014 and, apparently, at least that amount annually thereafter (this is assumed because the PFM report does not identify the projected net revenue increases in the out-years, and the appendices are not available for review).

In particular, we oppose the following: the increase of the general excise tax rate by 0.5 per cent, the imposition of the income tax on pension income, the increase of the corporate income tax rate, and the elimination of the income tax deduction for real property taxes paid.

II. REASONS FOR OPPOSITION

Our disagreement with the recommendations is based on the following major reasons.

Significant Tax Increase Detrimental

(1) Such a significant net tax increase probably will be detrimental to private businesses, residents, or both. The transfer of about $481 million annually to the public sector likely will have adverse impacts on the private sector. Specifically, PFM has not analyzed the impact of its recommendations on the Hawaii economy. PFM also has not

analyzed who will actually bear the burden of the tax increases, whether residents, businesses, or tourists.

Tax Increase Difficult To Justify In Near Term

(2) A significant net tax increase will be difficult to justify in the near term. Because of the 14.9 per cent actual increase of general fund revenues in fiscal year 2010-11 and the Council on Revenues' out-year projections, the State government, if executing a judicious financial plan, has the opportunity to generate sufficient annual ending balances into the near future without any tax increase. Consequently, public acceptance of a $481 million tax increase, additional to the expected ending balances, will be highly unlikely.

Budgetary Impact Of Tax Increase Difficult To Ascertain

(3) The budgetary impact of the recommended tax increase is difficult to ascertain from the PFM Report.

The table on page 150, entitled "baseline projection with full implementation of recommendations", shows unbelievably huge annual surpluses and ending fund balances. For example, in fiscal year 2019-20, the surplus (revenues minus expenditures) is projected at $520 million and the ending balance is projected at $3.693 billion.

The table on page 150, however, apparently does not include annual expenditures for accrued pension and OPEB liability. See the table on page 98, entitled "FY 2012 - FY 2025 general fund budget projections: accrual basis scenario - full pension and OPEB liability".

PFM appears to justify the recommended tax increase partly on the need to amortize the accrued liability through annual required contributions in the State budget. The report, however, does not make clear the sufficiency of the tax increase to fund the baseline expenditures plus the accrued liability contributions.

If the tax increase generates excessive revenues, as suggested by the table on page 150, then the recommendation should be appropriately altered to reduce the tax increase.

If the tax increase generates insufficient revenues, then a strategy other than the recommended tax increase may have to be pursued.

Annual Revenue Growth Without Tax Increase Is Fairly Healthy

(4) Even without the recommended tax increase, annual general revenue growth is projected to be fairly healthy. The table on page 91, entitled "key revenue growth rates", indicates that general revenues will annually increase by more than 4.0 per cent between 2013 and 2017 and then by 5.2 per cent annually until 2025 (most residents would be delighted with 4.0 to 5.0 per cent annual increase of their personal income).

Recommendations "Expenditure Driven"

(5) The recommended tax increase is "expenditure driven", an inappropriate way to make public policy. The methodology is biased towards balancing the State budget by revenue increases exclusively. PFM rightfully notes that expenditure reductions

alone cannot balance the future State budget. PFM then, however, erroneously takes the approach of relying solely on tax increases rather than combining expenditure reductions and revenue enhancements.

The present Tax Review Commission should not rely on PFM's methodology to address the question of whether the tax structure is adequate. Instead, the present Commission should use the same methodology as past Tax Review Commissions. Our understanding is that those Commissions measured tax adequacy by comparing the growth of general revenues to personal income. Those Commissions did not base their analyses on projecting future State expenditures, which is properly the jurisdiction of elected policymakers.

Misunderstanding Of General Excise Tax

(6) PFM does not inspire confidence because of its apparent misunderstanding of the general excise tax.

PFM seems to equate the general excise tax to a sales tax, calling the general excise tax a "consumption tax" and the 4.0 per cent rate low in comparison to sales tax rates elsewhere. This is erroneous, as the general excise tax is a tax on the seller's gross income, not buyer's purchase price.

PFM also appears to believe that pyramiding will be reduced by repealing the 0.5 per cent wholesale rate and increasing the final consumer rate by 0.5 per cent (for a State rate of 4.5 per cent from 4.0 per cent). This recommendation ignores the effect on business-to-business transactions, all of which will be subject to the 0.5 per cent increase. PFM has not done any

analysis of the net effect on businesses from the exacerbated pyramiding that its recommendation likely will cause.

PFM also has not studied whether the tax increase will be passed on by businesses to consumers or whether businesses will have to absorb the increase and compensate by reducing other costs, such as labor costs.

Finally, PFM does not make any recommendation for an increase of the public service company tax or insurance premium tax, both of which are imposed in-lieu of the general excise tax.

Lack Of Studies On Issues

(7) PFM makes statements about the regressivity and exportability of taxes, but has not conducted its own study of those issues. Nor has PFM conducted a tax incidence study. As such, the statements are without solid bases. Such studies would have been much more helpful to the Legislature.

III. COMMENDATION FOR EMPHASIS ON TWO POINTS

Notwithstanding the comments above, PFM deserves commendation for emphasizing two points that the House of Representatives has been attempting to address over the years.

(1) The first is the unfunded liability problem of the employees' retirement system and Hawaii employer-union health benefits trust fund. (One comment, however, is that PFM seems to assume that the public employer's entire annual required contribution for the retirement system and health fund will be paid exclusively from the general fund. Non-general funds

should be assessed for a fair, proportionate share of the public employer's contribution.)

(2) The second is the necessity for better control of tax credits.

TAX FOUNDATION
OF HAWAII
126 Queen Street, Suite 304, Honolulu, Hawaii 96813, Telephone 536-4587

September 11, 2012

Mr. Randall Iwase, Chair
Tax Review Commission
Conference Room 309
State Capitol Building
415 S. Beretania Street
Honolulu, Hawaii 96813

Re: Draft Study of the Hawaii Tax System by Public Financial Management, and Study on Selected Issues of the Hawaii General Excise Tax

Mr. Chair and Committee Members:

We have had the opportunity to review both studies and understand that the directive given both consultants were those of the Commission. However, it is our understanding that the task of the Tax Review Commission is to evaluate the "State's tax structure, recommend revenue and tax policy" as provided for in Article VII, Section 3, of the State Constitution.

Statutory law further provides in HRS Section 232E-3 that the "commission shall conduct a systematic review of the State's tax structure, using such standards as equity and efficiency . . . shall submit to the legislature an evaluation of the state's tax structure and recommend revenue and tax policy . . .. " Nowhere, either in the State Constitution or in the Hawaii Revised Statutes, is the Commission directed to evaluate state spending or forecast what state expenditures will be in the not too distant future. While many of the predecessor Commissions had wanted to opine about state expenditures, they were all advised by legal counsel that this topic was beyond their mandate.

Public Financial Management Study

Although the Commission may argue that it was necessary to make such forecasts of state expenditures, we note that the level of spending now and into the future is solely the province of the state legislature which takes the spending requests of the Executive and Judicial branches of government and metes out a spending plan that it, the legislature, determines necessary to provide the services and programs the community needs for state government to provide.

If the Commission's directive to the consultant group was indeed to forecast state expenditures into the future, then it has done a great disservice to not only the public at large, but to both the Executive and Legislative branches of state government, as it sets targets for collective bargaining negotiations, off-budget requests made by the constituency of elected officials and unforeseen expenditures by the Legislature and the Judiciary.

If the Commission wanted to determine whether or not the current tax structure is adequately providing resources for state expenditures, then it should have evaluated the constitutional general fund expenditure ceiling, the growth in special fund financed programs and services, the elasticity of the tax structure, and the impact of cyclical fluctuations of general fund taxes.

Therefore, we believe the forecasting of state expenditures to be inappropriate and not within the jurisdiction of the constitutional mandate to the Commission. We also then question the need to make recommendations with respect to alternatives to generate additional revenues.

While we do question whether or not these recommendations are appropriate, we will nonetheless go on to opine on all of the revenue enhancement recommendations as we believe many are without merit and demonstrate what little research was done in arriving at these recommendations as they reflect a basic lack of understanding of each of the taxes selected for increase and an overall lack of understanding of the state tax system. This is indeed unfortunate since many of the previous Commissions conducted exhaustive studies of the various aspects of the state tax system and it appears that the current Commission and their consultant did not avail themselves of this wealth of research. In other words, much of the groundwork had already been done and it appears that both the Commission and the PFM consultants did not avail themselves of the tomes of research previously conducted.

Base Expansion

Reduce the Exemption for Pension Income under the Net Income Tax

Of all the recommendations made by the consultant, this recommendation deserves serious consideration as the defined benefit pension plans are going the way of the dinosaur with only public employees continuing to receive such pension plans moving into the future. A proposal to reduce the exemption for defined benefit pension payouts was made by the administration in the previous year's session and was met with substantial resistance. Because future retirees will not have defined benefit pension plans, implementation of this recommendation could be made prospective with phase in starting with a high threshold for the exemption and reducing that threshold over a period of time.

Eliminate the Deduction for the Real Property Tax

While the consultant argues that this is a state subsidy of the counties because local governments in Hawaii are not responsible for education as local governments on the mainland are, this is not an issue about the state subsidizing the counties in Hawaii. The more critical issue is efficiency in the administration of the state tax law. For nearly 35 years it has been the policy of the state to maintain conformity between state law and the federal Code to minimize the differences between the two allowing for ease of compliance and administration of the net income tax law. The current administration decided to digress from that policy when it proposed disallowing the deduction of state income and sales taxes for certain high-income earners without realizing that in doing so a difference was created that will affect the state's reliance on federal audits of a taxpayer's return. Eliminating the deduction of the real property tax will create yet another difference between the two laws and runs counter to the state's policy to conform to the federal Code.

Cap or Replace Tax Credits with Grant Programs

Again, this is a policy move that we have long advised the legislature to undertake. The state has struggled with the proliferation of targeted business tax credits, such as the tax credit for high technology, renewal energy technologies, motion pictures and destination resort development. If one sees these tax credits or incentives as nothing more than expenditures of public dollars, then those incentives should be subject to the same scrutiny and limits as do appropriations of public funds. Therefore, we would agree that the targeted business tax incentives should be repealed and appropriations for such projects be made if that is the policy of the state.

Provide Tax Relief to Low-Income Taxpayers.

Increase the Income Threshold to Eliminate those with $20,000 or less of Adjusted Gross Income

There is no doubt that Hawaii has for years taxed families whose income was at or below the poverty line as income tax rates and brackets were not adjusted for more than 20 years after they were first increased after Hawaii became a state. However, that first adjustment came not because inflation had spurred the income of families in Hawaii beyond the income brackets that had been adopted in 1965 as much as it was the change in the income tax base brought about by the 1986 Federal Tax Reform Act which broadened the income tax base. Even then the rates and brackets were never fully adjusted for the base broadening, as policymakers at the time were unsure of the revenue impact adjustments to the rates would have on the state treasury. Instead, the first permutation of the food tax credit was adopted to offset the increase in income taxes brought about by the base broadening.

It appears that the $20,000 threshold was selected as it is just above the poverty level calculated for a family of four. One would assume that a lower threshold would be set for single individuals and heads of households. Given the fact that Hawaii temporarily has the highest individual income tax rates, adjustment of the entire system of rates and brackets should be undertaken at the same time that the adjustment of the basic threshold is made. It should be remembered that the rates and brackets were not sufficiently adjusted in 1986 when the income tax base was broadened and for many in what might be called the middle class were provided very little relief especially after the general food tax credit was limited to only the low-income tax brackets.

Double the Refundable Food Tax Credit

While doubling the food tax credit would indeed offset the regressivity of the general excise tax for the poor, whether or not it should be doubled is highly dependent on what policy makers decide with respect to the adjustment of the general excise tax rate. Instead of doubling the food tax credit, consideration should be given to a more progressive adjustment of the low and middle-income tax brackets to provide relief across the board.

Eliminate the 0.5% General Excise Tax Rate on Business-to-Business Transactions

The consultant report seems to think that the elimination of the 0.5% wholesale rate will provide relief to businesses, especially if the overall retail rate is increased to 4.5%. Apparently, the consultant believes all business-to-business transactions are taxed at the lesser half percent rate. That is true if the purchase is for resale, but not so if the business is making a purchase for consumption. This latter purchase is taxed at the full retail rate of 4%. Thus, raising the retail rate to 4% as the consultant suggests, would exacerbate the pyramiding of the tax as that additional cost would have to be recovered in the sale of goods or services sold by the business.

Moreover, while the lesser half percent rate may seem like a nuisance, it serves a very important purpose in that it allows the tracking of the activity in the economy. Years ago the head of the Tax Research and Planning Office of the Department of Taxation decided that the Department didn’t need to collect the general excise tax by type of activity or industry. After a year’s worth of foregone information, the Department realized it had lost an important tool in understanding how the economy was doing and where activity was occurring. Thus, the half percent rate is an important tool to gather that type of information.

Allow the Suspension of Certain General Excise Tax Exemptions to Sunset

The reference in this recommendation is to Act 105, SLH 2011, which suspended nearly two-dozen exemptions under the general excise tax law, exemptions that were adopted to mitigate the pyramiding of the tax. The suspension was adopted in the hopes that it would generate an additional $300 plus million to close the general fund budget shortfall. These estimates were originally made by the Department of Taxation. However, subsequent to the adoption of the suspension, the Council on Revenues downgraded that estimate to about half, or $150 million. After the first year of the implementation of the suspension, the Department came back and downgraded that estimate by nearly two thirds, or about $50 million.

Some of this overestimate was due to grandfathering of existing contracts which prevented the pass on of any increase and continues to be exempt while other taxpayers found ways to circumvent the imposition of the tax. Therefore, the continued suspension of the exemptions would merely cause taxpayers to conduct business in an inefficient manner in order to avoid the tax and for those who cannot avoid the tax, the continued suspension would merely increase the cost of doing business and in the end may put people out of business and their workers out of jobs.

Eliminate the Three-Tier Corporate Tax Rate and Adopt a Single Rate of 9%

The consultant observed that currently the net corporate income tax makes a relatively small contribution to the general fund and noted that the three-tier rate structure had rather small increments. I believe we must remember that the net income tax is a tax on profits, that is gross revenue less expenses. If, indeed, the net corporate income tax contributes so little, it is a comment on the fact that it is difficult to make a profit in Hawaii. Raising the tax rate to 9% will insure that there is little left over for reinvestment in a business in Hawaii. We also note that the consultant was silent on the in-lieu tax imposed on financial institutions which are taxed at a rate of 7.92%. If the net corporate income tax rate in increased to 9%, the financial institutions tax rate will, no doubt, have to be increased in excess of 9% as the tax is in-lieu of both the net corporate income tax and the general excise tax.

Rather than raising the net corporate income tax rate because it contributes so little, consideration should be given to making Hawaii unique among the fifty states by doing away with the tax altogether.

EXPORT TAX BURDEN

Increase Cigarette, Tobacco, and Alcohol Taxes

The consultant believes that an increase in these taxes will shift the burden to visitors to Hawaii and, therefore, export the tax burden to nonvoting consumers. At the same time, the consultant also acknowledged that Hawaii already has among the highest tax rates on these products. As a result, there should be concern about how such high rates contribute to a decline in consumption and, therefore, tax collections. We note that for the first time in history, the collection of cigarette taxes appears to have declined for the past fiscal year. We have asked the Department to verify this be it because of collection or time issues or whether or not there has been a decline in the purchasing of taxed products.

With respect to alcoholic products, again, Hawaii has among the highest rates in the nation. While it may be assumed that visitors will purchase alcoholic beverages while on vacation, what concerns us is the on-premise consumption if the cost of that beverage rises. We have learned

anecdotally that visitors who stay in time shares and condominiums have learned to purchase their alcoholic beverages in quantity at outlet stores, consume what they will during their stay here in Hawaii and return any unopened product when they leave.

This erodes sales of alcoholic beverages served on premise which tend to carry a higher margin that is used to offset losses incurred on food served. Should this happen, it will, no doubt, have an effect on employment and the business itself. It may not stop purchases on-premise altogether, but it will, no doubt, have an effect on the volume of sales.

Eliminating the Sunset on the 9.25% TAT Rate Increase

It should be remembered that unlike many other states, Hawaii imposes the general excise tax in addition to the TAT on hotel rentals. Therefore, on an apples-to-apples comparison, the tax on hotel rentals approximates 14% statewide and nearly 15% in Honolulu. It should also be remembered that Hawaii has the second highest room rates in the nation behind only New York which is not considered a leisure destination as is Hawaii. Finally, it should be remembered that the TAT was originally adopted to finance the state's convention center and later when the rate was increased, the money was earmarked for visitor promotion and to assist the counties in maintaining visitor-related infrastructure such as parks and beaches. The temporary 2% rate increase has not been used for any of these programs rather, the receipts are earmarked for the general fund.

Inasmuch as the tax was supposed to have been a temporary imposition, going back on that promise certainly will damage the credibility, as well as the integrity, of the legislature that adopted that temporary increase. If the increase is to be continued, it should be returned for use for tourism related programs and services.

Restore the Surcharge on Rental Cars

Apparently the consultant did not research this tax very well or they would have found that as a result of legislation that was vetoed this year, the temporary increase of $4.50 per day earmarked for the general fund was allowed to sunset and as a result, the $4.50 per day tax on rental motor vehicles earmarked for the construction of a consolidated rental car facility was reinstated. Thus, the impost on rental cars continues to be a total of $7.50 per day. If viewed in a vacuum and similar legislation is not enacted repealing the facility tax on rental cars in turn for an increase in the rental car surcharge, the total tax per day for a rental car would be $12.00, with $7.50 imposed under the rental car surcharge and another $4.50 for the rental car facility tax.

Further, it should be remembered that this tax is not entirely exportable as many business persons traveling between the islands use car rentals to conduct business while local families traveling to other islands utilize rental motor vehicles as part of their vacation purchases.

Finally, a note about "exporting" Hawaii's tax burden via the visitor industry. Placing a greater dependence on the fortunes of one industry which has been described as "fragile," places the future of state finances in jeopardy and undermines the stability of the public finance picture in Hawaii. The state's substantial reliance on the general excise tax already underscores the impact of the visitor industry on those collections. To shift even more reliance on the fortunes of the visitor industry creates even more volatility in tax collections.

RATE CHANGE TO RESTORE STRUCTURAL BALANCE

Increase the General Excise Tax Rate to 4.5%

The consultants demonstrate their lack of knowledge in making this recommendation when they cite Hawaii's 4% rate as being lower than the median state rate of 6%. A statement they make despite acknowledging numerous times throughout their report that Hawaii has the broadest base of any "sales tax" type of tax. Therefore, the consultant should have attempted to calculate what an equivalent tax rate would be if Hawaii indeed had a true "sales tax" as found in more than 40 other states.

The consultant even point out that Hawaii taxes 160 categories of services out of 168 listed by the Federation of Tax Administrators. This is more than any other state. They also note that the tax base of the general excise is even greater than the state's Total Personal Income (TPI) and the next closest state is New Mexico where its sales tax base is 79% of its TPI.

As a result, if they had inquired with those who are familiar with the general excise tax and how it is often compared with the "retail sales tax" found on the mainland, Hawaii would need a double-digit tax rate under a retail sales tax structure to generate the same amount of revenues that Hawaii's 4% rate generates.

The consultant cite another reason for raising the general excise tax rate as it has not been raised in 35 [sic] years whereas "over half of the states have raised this rate since the year 2000 in many cases multiple times." Hawaii has not had to raise the 4% in 45 years - make that 47 years - because of its broad base. Other states have had to raise their rates because the retail sales tax usually applies only to goods and not to services. As consumption patterns have changed over the years, moving from the consumption of goods to the consumption of services, retail sales tax states have seen a decline in revenues from this source. As a result, those states have had to raise their respective tax rates as the percentage of the base representing purchase of goods shrinks.

In fact, Hawaii is the envy of many sales tax states. One state even attempted to tax services more than 25 years ago and failed miserably because they attempted to apply the retail sales tax regime to the taxing of services.

The downside of raising the general excise tax rate to 4.5% is the fact that the tax pyramids and is imposed on business inputs. The added cost of the increased rate increases the cost of living and doing business in Hawaii as the increased rate imposed on business overhead costs must be recovered in the shelf prices of the goods and services sold. The people of Oahu have already seen its impact on some basic costs, such a food and durable goods, as well as on all services from automotive repairs to professional services.

Thus, to say that the rate should be raised merely because it has been a long time since it was last raised or that the rate is well below the median rate for all sales tax states is uninformed and ludicrous. It reflects poorly on the consultants as it is evidence they have not done adequate research or made a major attempt to understand the impact of the tax.

Changes to Improve System Administration

Develop Tax Gap Systems to Identify Under-Payment and Nonpayment of Taxes

This recommendation, along with the next, is an integral part of the Department's need to upgrade its technology systems. That said, it should be remembered that conformity with the

federal Code with respect to the net and gross income taxes will go a long way in accomplishing this goal. The more the state diverges from conformity, the less likely it is that technology will be able to bridge the gap easily and the technology and software will have to be more costly.

Create a Compliance and Productivity Account to Fund Staff and Technology Improvements to Foster Taxpayer Education, Understanding, and Compliance.

It seems that the consultant is suggesting that the Department be given a fund to undertake initiatives to better improve taxpayer compliance with the tax laws by acquiring technology and staff. The consultant expects that a portion of the additional realizations resulting from improved compliance be used to replenish the fund. The real challenge will be tracking the improvements and the previously unrealized collections in ascertaining how much will be redeposited to the credit of the fund. Given the state's track record with special funds and accounts, the mechanism to undertake this recommendation should be carefully crafted.

Provide Tax Expenditure Reports on a Scheduled Regular Basis

Depending on how extensive a report the consultant envisions, this may or may not be achievable given the recent history of reporting statistical information. Given the developing technology, one would think this goal could be achieved even with minimal staffing increases. No doubt, such regular reports would be helpful for lawmakers to understand the impact of the tax law changes they adopt and propose.

It should be noted that most of the statistical reporting in the past consisted of net and corporate income tax statistics or income patterns gleaned from returns, report of tax collections, and more recently, data on some of the many tax credits. In the case of the latter, the plethora, as well as vaguely drafted legislation, made it difficult to track the targeted business tax credits.

SELECTED ISSUES WITH THE HAWAII GENERAL EXCISE TAX

This study, unlike the previous consultant report, is more of a report than one that makes recommendations. It is a good review of the issue of taxing e-commerce sales and where the issue is as far as the development of agreements under the simplified sales tax project (SSTP) and other approaches to taxing cross border sales. Local advocates of the SSTP approach seem to forget that Hawaii does not have a retail sales tax, but a general excise tax. The SSTP would require that changes be made to the general excise tax in order to conform to the provisions of the SSTP. These changes would jeopardize the integrity of the general excise tax and bring into question case law which helped define the tax over the last 80 years.

Although Dr. Fox attempts to put a price tag on the estimated amount of lost revenue, it is nothing but that, an estimate. Such large numbers are meant to be attractive to garner support for the effort. But as the study points out, there are a number of major hurdles before states can begin to capture sales tax revenues from such cross border sales.

Uniform application of the collection process, definitions of what is taxable, sourcing - that is whether to collect the tax in the state where the product originates or where it is delivered, determining the applicable rate, and the issue of nexus are some of these major hurdles. While the National Conference of State Legislatures has pushed for a resolution of this problem as it members decry the loss of revenue and main street retailers complain about the unfair tax advantage of such cross border sales, the very issue that spawned the debate of whether or not states can collect their sales taxes is that of barriers to interstate commerce.

The second half of Dr. Fox's study attempts to update estimates of seven exemptions extended under the general excise tax. This part of the Fox paper is in response to a request made by the Tax Review Commission. In addition to the update of the revenue impact the repeal of these seven exemptions would have, Dr. Fox discusses the policy implications of the repeal of each of these exemptions and, if repealed, how the additional revenues generated could reduce the overall general excise tax rate. Dr. Fox also raises the prospect of how consumers and businesses may react should the exemptions be repealed.

Finally, Dr. Fox discusses the possible replacement of the corporate and personal net income tax with an increase in the general excise tax rate. Again, this appears to merely be an exercise in calculating the revenue potential of raising of the general excise tax to eliminate the net income tax. As Dr. Fox notes, the dynamic of replacing the net income tax with an increase in the general excise tax would require a general equilibrium model that was not available for his study. Dr. Fox does allude to some of the ramifications of moving from an income tax to a consumption tax which are by no means comprehensive. As a result, this part of the study is nothing more a hypothetical exercise with little substantiation as to whether or not this would be a worthy policy consideration.

A QUESTIONABLE EXERCISE

As we noted earlier in our testimony, the constitutional provision governing the Tax Review Commission makes no mention of estimating what future expenditures will be. The task of the Commission is to evaluate the state tax system with an emphasis on equity and efficiency and make recommendations with respect to tax policy. To attempt to forecast future expenditures usurps what should be the exclusive province of the state legislature. It leaves future policymakers and administrators exposed to requests from various interest groups to be a part of those forecasted expenditures.

If the forecasting of future expenditures was an attempt to measure adequacy, this is sorely misguided as adequacy of the source of revenues can only be measured against what are actual expenditures. Thus, to measure a state tax structure's adequacy requires a look back as to how capable the tax structure was to meet the demands for state expenditures.

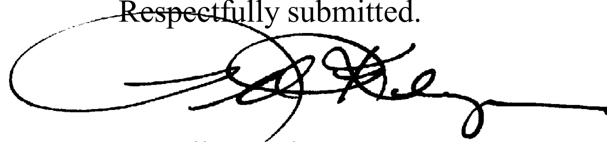
The studies commissioned by this Tax Review Commission amount to nothing more than a beating of the bushes for additional revenues. Certainly, a lack of understanding of Hawaii's tax system is evident. Citing the general excise tax rate of 4% being lower than the state median rate of 6% is telling that they do not understand that the general excise tax is not a retail sales tax and, therefore, the rate is not comparable to those of retail sales taxes. Moreover, where this consultant believes elimination of the 0.5% general excise tax will mitigate the general excise impost on business-to-business transactions without acknowledging business-to-business transactions are also taxed at the full 4% rate is also telling that the consultant truly does not understand the tax.

Where the consultant states how important it is to measure tax burden as a product of both state and local governments, it goes on to note that the state fuel tax at 17 cents is among the lowest in the nation, totally ignoring the county fuel tax rates which puts Hawaii among the highest combined fuel tax rates. Similarly, suggesting that the deduction for real property taxes should be repealed because it represents a subsidy of the counties when the counties do not provide for education is specious at best as the counties do provide other services that might otherwise have to be provided by state government. The consultant also totally ignored the importance of conformity with respect to ease of compliance and administration, but more importantly the fact

that conformity allows the state to rely on federal audits of the income tax, a cost that would otherwise have to be incurred by state government.

Thus, we believe both reports to be a questionable exercise in searching for revenue raising alternatives rather than pursuing initiatives to improve equity and efficiency in Hawaii's tax structure.

Respectfully submitted.



Lowell L. Kalapa
President

LLK/jad

1654 South King Street
Honolulu, Hawaii 96826-2097
Telephone: (808) 941.0556
Fax: (808) 945.0019
Web site: www.hcul.org
Email: info@hcul.org

September 11, 2012

Tax Review Commission
Randall Y. Iwase, Chair
Mitchell A. Imanaka, Vice-Chair
Members of the Tax Review Commission

Testimony of the Hawaii Credit Union League
In Opposition to a General Excise Tax Rate Increase

Dear Chairman Iwase and Members of the Tax Review Commission:

On behalf of the Hawaii Credit Union League, the trade association representing 80 Hawaii credit unions and their approximately 812,000 members, we stand in opposition to an increase of the general excise tax rate.

Credit unions are not-for-profit, member-owned financial cooperatives with the sole purpose of serving member needs. The philosophy of credit unions has always been to first serve those of modest means. A tax increase could potentially result in a significant negative financial impact on many of our members. For this reason, we oppose any proposal of a general excise tax increase.

Thank you very much for the opportunity to comment.

Mahalo,

Stefanie Y. Sakamoto
Legislative Officer

HAWAII ASSOCIATION OF PUBLIC ACCOUNTANTS

Organized August 7, 1943
P.O. BOX 61043
HONOLULU, HAWAII 96839

September 10, 2012

Chair Randall Y. Iwase and
Members of the Tax Review Commission
State of Hawaii
Hawaii State Capitol
Conference Room 309
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Iwase and Commissioners:

The Hawaii Association of Public Accountants' (HAPA) Board of Directors opposes two recommendations contained in the *State of Hawaii Tax Review Commission Study of the Hawaii Tax System Report*, dated August 28, 2012. HAPA has roughly 500 members with chapters in every county of the State of Hawaii. Our members are primarily Certified Public Accountants, Enrolled Agents, and other accounting and tax practitioners.

Against - Increasing the GET rate to 4.5 Percent:

HAPA opposes the recommendation to increase the GET rate from 4.0 to 4.5 percent. Our members have their fingers on the financial pulse of privately-held businesses across the State of Hawaii through the work that they perform for their clients. They receive nearly real-time information about the financial health of their clients well before the financial information is reported to the Hawaii Department of Taxation, to the U.S. Internal Revenue Service, and to public economic databases.

During chapter meetings and our annual convention held this summer, our members reported that many of their business clients have yet to recover from the recent deep economic recession. Many of the owners of these privately-held businesses have had to resort to extraordinary measures to keep their doors open and to try to replace working capital lost after local banks reduced or cancelled their business lines of credit. Some of the common extraordinary measures taken by Hawaii's business owners to provide additional business capital include eliminating or severely cutting back owners' salaries, drawing funds early out of their personal retirement accounts, borrowing from their personal pension plans, and borrowing from relatives. These businesses and their owners have no reserves left to weather another blow to their financial health. HAPA believes that the proposed 12.5 percent increase in the GET rate to 4.5 percent would be the straw that breaks the camel's back, forcing many of these local businesses to either layoff employees or close their doors altogether.

Rather than increase the GET rate, HAPA raises three alternatives for your consideration. First, the State of Hawaii should continue to examine existing State expenditure programs with an eye towards reducing or eliminating redundant or lower priority programs. Second, broaden the GET base by reducing the number of GET tax exemptions and curtailing overly generous tax credits that have grown over the years. Third, increase compliance efforts to reduce underreporting of income because our members still observe that this is a problem. Simply stated, the Hawaii State Department of Taxation should have more auditors.

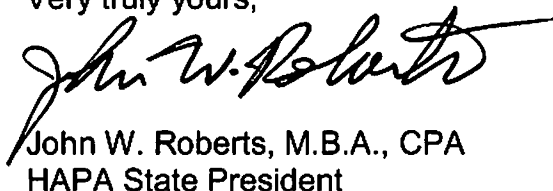
Against - Elimination of Net Operating Loss Carrybacks:

HAPA members widely report that a leading obstacle to economic recovery for their clients is the shortage of capital. This is particularly true in Hawaii's construction industry where contractors and sub-contractors are living hand to mouth. As you know, under the accrual method of accounting mandated for many in the construction industry, revenues are recognized for tax reporting purposes when the related goods and services are provided, regardless of when payments are actually, if ever, received. As a result, many contractors have had to pay taxes on income for which they have not, and may never, receive payment. Accounts receivable for many businesses have ballooned, and taxes have been paid on the accrued income without any cash payments on the related receivables. At the same time, banks and other financial institutions have been reluctant to loan funds to provide liquidity due to stricter regulations imposed on lending. This has depleted the capital reserves of many businesses and their owners.

Being able to apply for net operating loss carrybacks and recover some past taxes paid has mitigated the above income recognition problem as well as provided a partial source of working capital after local banks reduced or eliminated business lines of credit. If the State of Hawaii eliminates net operating loss carrybacks, it will compound the shortage in working capital for local businesses at the exact time when they are in greatest need, which is when they have sustained business losses. The unintended consequences of more layoffs and bankruptcies are all too apparent.

Thank you for your consideration.

Very truly yours,



John W. Roberts, M.B.A., CPA
HAPA State President

Tax Review Commission Report
Bill Walter
to:
titin.l.sakata
09/10/2012 01:59 PM
Cc:
Miles Yoshioka, "Vaughn G.T. Cook"
Hide Details
From: Bill Walter <wwalter@whshipman.com>

To: titin.l.sakata@hawaii.gov

Cc: Miles Yoshioka <admin@hicc.biz>, "Vaughn G.T. Cook" <vgc@torkildson.com>

As a member of the Hawaii Island Chamber of Commerce, I have reviewed the Draft Study of the Hawaii Tax System Final Report dated 8/28/2012. I have the following comments for your consideration:

- **Page 10 - 1**. The system should be equitable (equity) - This is a common purpose when evaluating tax systems among others. It is also common that "equity" is not defined in objective, reasonable or meaningful ways. This report has the same problem. If we are trying to achieve something - in this case equity - we need to first define what equity means and how we would measure it. Lacking this all comments on equity are essentially without merit.
- **Page 10 - 11** on GET - A bullet point suggests that the State "actively pursue nexus" - I could find nowhere in the report an analysis (or at least one I could readily link) between events or taxes and actions that relates to this goal. If the report indicates that we should take this action - where does it do so and based on what? This seems like a hanging idea that is not really closed.
- **Page 11** - Eliminate net operating loss carry back - This seems like a particularly bad idea for those of us who operate here in Hawaii. Our operations are particularly susceptible to gyrations in revenues (just like the State's are). The loss carry back helps us to smooth out our own cash flow issues. (Further, the loss carry forward typically affects income in "boom" years when the State is not struggling for income). When this is done we are in a better position to reinvest in our operations. Note that many of our business expenses are fixed, in other cases (i.e. personnel) we tend here to be much more likely to carry expenses through downturns - we are all in this together. Losing the loss carry back provisions would make us take a much stronger look at staff/expense reductions during down turns. I see this suggestion as one that would reduce investment and increase unemployment as a minimum.
    - Broaden definition of nexus - define it at all
- **Page 12** - Observations and Recommendations - the report gives very passing thought to the

other side of the issue: government expense reduction. On the one hand I can understand this as the apparently assignment was to review taxes not expenses. On the other hand the report does note:

- average earnings per government employee (includes Federal, State and Local) of nearly $81,000 ranking third (behind utilities and business services). (Page 5 under economy) This suggests that it is probable that there is room to move expenses down by reductions or moderations in government employee pay.
- later the report talks of the liabilities for State and Local employee pensions and assumes that this is not really changeable or controllable. We may not like it - but other States have found ways to bring this area under control and to reduce this liability.
- In short before taxes are increased State cost of government (including more than employee costs) needs to be analyzed for savings

- **Page 14** Reduce Regressivity - This is a reasonable goal, but it is tied to "equity" above and really needs definition.
    - Exempt the first $20,000 from IIT - while there is reason in this, I do not agree with the recommendation. Our Federal Government started down this path (even adding credits up to a point) and has taken us to a point where over 40% of residents pay no income tax. My opinion is that everyone should participate in the income tax process even if in the end they only end up paying $100 - at least they are contributing. I understand the argument that at the State level they are already paying GET, but we all need to also participate in IIT.
- **Page 14** - Cap or replace with Grant programs - understand the thrust of this. We need to carefully think this one through. In some cases, for instance the Film Production industry, if done improperly we stand to lose literally hundreds of millions of dollars that this industry pays out in wages, services, etc. (We have had movies - Indiana Jones/Predators - filmed on our property. When asked how to get more film productions here the answer is consistent: increase the credits). If we make it harder for these industries one probable result is that we lose the business entirely. At that point we have lost much more than we have gained. Understand that many of these industries can and will go elsewhere. We need to be careful about how this is executed.
- **Page 14** Reduce Pyramiding - Increase the Corporate Net Income Tax - Many corporations can and will go elsewhere. This needs to carefully done if at all. Note the Federal goal which is the opposite (reduce corporate rates) for good reason. Further additional taxes will result in less cash for reinvestment here and may encourage investment elsewhere. Note further that the combination of removing the deduction for property taxes and increasing the tax rate will reduce the ability (cash) available for quality buildings and equipment which in turn reduces future income and income taxes.

Final comment is that taking steps to increase government revenue based on future revenue shortfalls is dangerous. The primary danger is that if such steps are taking at periods when balance can be achieved without revenue increases - the assured political response will be to find ways to spend the new revenue. When we, then, get to the place where the revenue may actually be needed - we will need another round of increases because the revenues enhancements for that period have already been put in place and spent!

Bill Walter
President
W.H. Shipman, Limited
www.whshipman.com
808-966-9325 x 2026

808-345-1890 (cell)
808-966-8522 (fax)

September 11, 2012

Tax Review Commission
Hawaii State Department of Taxation
P.O. Box 259
Honolulu, HI 96809
Email: titin.l.sakata@hawaii.gov

RE: Comments on "Study of the Hawaii Tax System" Final Report

Dear Chair Iwase and Members of the Tax Review Commission,

The Building Industry Association of Hawaii (BIA) is the voice of the construction industry. The BIA promotes our members through advocacy and education, and provides community outreach programs to enhance the quality of life for the people of Hawaii. The BIA is a not-for-profit professional trade organization chartered in 1955, affiliated with the National Association of Home Builders.

The BIA commends the Tax Review Commission (hereinafter "Commission) in producing "Study of the Hawaii Tax System," (hereinafter "Report") as you play a very important role in the development of tax policy. The issues identified in your reports serve as a basis for discussion and debate within the Legislature as well as among the people of the State of Hawaii. It is the belief of the Commission members that the work reflected in your report will provide direction for the development of a long term tax policy plan which will allow all of the taxpayers of Hawaii to **be treated equally and fairly while encouraging economic growth.**

While the Report has a list of recommendations, BIA respectfully submits comments that focus on the Report's input on Act 105, which was passed during the 2011 legislative session. BIA **strongly supports** the Report's recommendation that Act 105 be allowed to sunset on June 30, 2012.

As you are well aware, Act 105 temporarily suspended, among other things, *"Amounts deducted from the gross income received by contractors as described under section 237-13 (3) (B)."* According to the Legislature, this particular suspension alone was expected to generate over $135million in revenue over the next two years to help cover the $1.3billion budget deficit. This $135 million is 33% of the projected new revenues of $400 million. This is neither equal nor fair for the construction industry, by any means.

However, at their May, 29, 2012 meeting, the State Council on Revenues announced that, by that time, Act 105, which suspended 29 general excise tax (GET) exemptions and deductions, was bringing in about $50million. Furthermore, the Department of Taxation revised its revenue estimate for FY 2013 down by $70 million.

In April, Hawaii Business Magazine published an article on Act 105, entitled "Hawaii's Tax Pyramid plan crippling small businesses." Interviewing construction industry leaders, a few of which are members of BIA, the article highlights the impact of Act 105 on the construction industry, as well as unintended consequences.

Act 105 has made it difficult for small- and mid-sized contractors to compete with large contractors since bigger contractors usually have in-house staff to do the work that smaller contractors need to subcontract out. Doing so makes the price of work for smaller contractors higher because the subcontractor's GET is included in the contractor's bids. The article is included for your reference.

Act 105 has likely resulted in an unintended consequence, as reported in the article. Due to the additional cost to the contractor, and thus the owner, owners may opt to pull an owner-builder permit and hire unlicensed individuals, who get paid in cash. These unlicensed individuals do not pay taxes on this cash transaction and, thus, are able to charge less than what a licensed contractor would charge. This is contrary to the intent of Act 105.

The construction industry is by no means requesting an exemption from paying any general excise tax. Rather, as was approved by the legislature in the past, the exemption was to prevent the "pyramiding" of the GET, as is typical in construction-related projects where work is performed by various specialty contractors. The Report states that economists agree that pyramiding distorts market decisions and reduces overall efficiency. Therefore, allowing Act 105 to sunset would reduce pyramiding and seek to benefit Hawaii businesses that are negatively impacted. We believe that this Commission is the appropriate body to review the pyramiding of the GET on construction related projects and whether it is equitable and fair.

Based on its unfairness to the construction industry and its impact to Hawaii's economy, we respectfully request that the Commission adhere to the recommendation in the Report that the Legislature sunset Act 105 as planned.

Thank you for the opportunity to submit our comments.

BUILDING INDUSTRY ASSOCIATION OF HAWAII

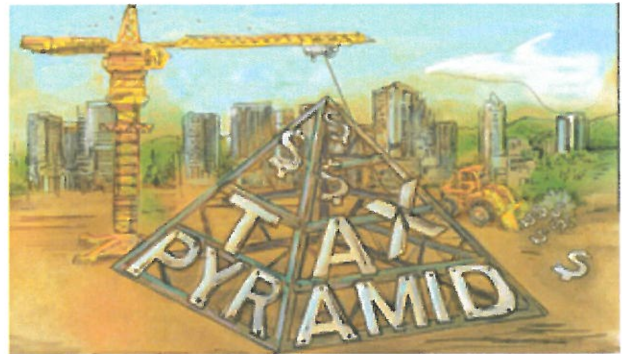
Send to printer Close window

Hawaii's Tax Pyramid plan crippling small businesses

State's answer to its budget deficit is crippling small construction companies

MARCIE KAGAWA

A state tax increase imposed last year is killing off construction projects, raising the cost of other projects and encouraging law-breaking, say leaders in the construction industry, who want to make sure the tax increase is not extended after its planned two-year run.



Illustrations by Andrew J. Catanzariti

They say the full consequences of the law are not yet evident because many projects now under way were launched quickly last year to avoid the tax law's start date of July 1.

"The government is effectively killing more activity by having this act in place," says Greg Thielen, president of Complete Construction Services Corp. and president-elect of the Building Industry Association of Hawaii. "That's going to more than offset any gain (in tax revenue) they're going to see coming in."

"It just makes it that much harder to start projects, to make that decision to go forward," adds Quentin Machida, VP of Gentry Homes Ltd.

Small general-contracting companies are the hardest-hit victims of the law, which ended some exemptions on the 4 percent General Excise Tax. Now the contractor and all its subcontractors must pay the full tax, creating what is called "pyramiding." That means more revenue for the state government, but higher costs for construction projects and/or lower revenues and profits for construction companies.

The building industry is the main victim, but not the only one. Transportation companies such as Matson and Hawaiian Airlines, plus businesses in other industries, are also hurt by the pyramiding tax.

For some contractors, it means less business, as customers are unwilling to OK new projects that cost 4 percent more at every level of work. Other companies are gritting their teeth and absorbing the tax increase without passing it on.

Last year's state Legislature needed to balance the budget but faced a shortfall of what was estimated at $1.3 billion for fiscal years 2012 and 2013 (the fiscal years run from July 1 to June 30). Despite opposition from local businesses, lawmakers passed Act 105, Gov. Neil Abercrombie signed it into law and it took effect July 1, 2011. The law suspends 29 GET exemptions and deductions for certain businesses for two years, with the exemptions and deductions being restored June 30, 2013.

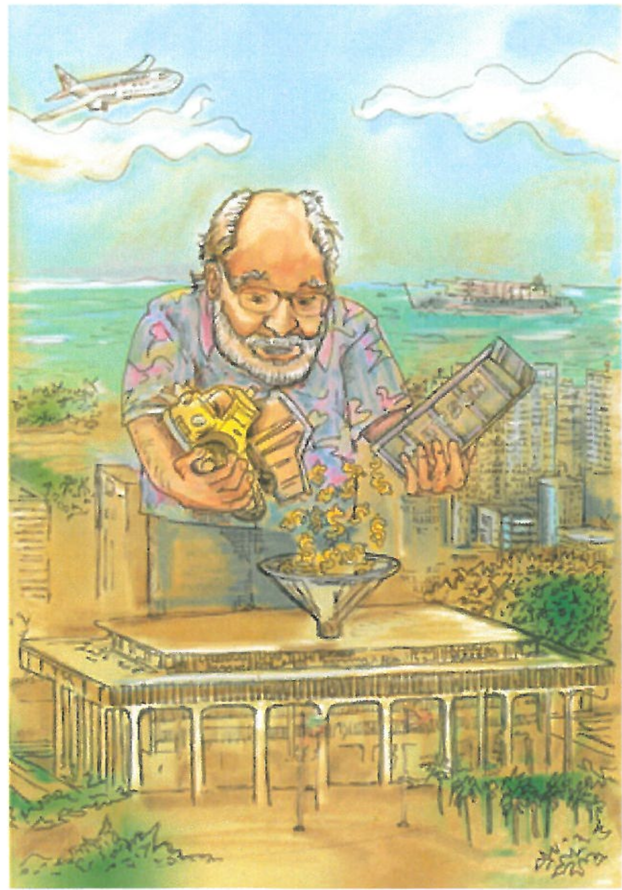
Sen. David Ige, chair of the Senate Ways and Means Committee, defends the law as painful but needed. "You may recall we faced a $1.3 billion deficit over the biennium and we'd already cut $600 million," Ige says. "There weren't any other cuts we could make without hurting other areas like education. We had to generate income and this was the path chosen. ... To the extent that tax is viewed as anti-business, this act ends up being attacked as such."

Weak recovery

The official end to the global recession in June 2009 didn't lead to a recovery in Hawaii's construction industry. Leaders in the industry were optimistic about a recovery in 2011, but Act 105 put some of that optimism on hold.

The suspension of the subcontractors' deduction is expected to provide $135 million in tax revenue to the state's general fund over the next two years, according to the state Department of Taxation, but some contractors believe that estimate is inflated. The Tax Department says it is too early to know how much tax revenue the act has actually brought in so far, but a spokeswoman for the department did not return repeated calls for more information.

Contractors say that to avoid the tax increase, many contracts were pushed through before the act took effect, so the amount and dollar value of work in the first half of 2011 are likely relatively high. However, contractors say that since the law went into effect, the number and dollar amount of contracts, especially in the private sector, have shown no gains and are unlikely to pick up again until the act sunsets.



Ilustrations by Andrew J.. Catanzariti

Act 105's suspension of the subcontractors' deduction has made it difficult for small- and mid-size contractors to compete with large contractors. Smaller contractors need help from consultants and subcontractors because they lack the necessary licenses to complete all aspects of a project themselves, while big contractors often have the staff to do all the work in-house.

"For all jobs, we use subcontractors," says Jaroslaw Jurek, VP of Site Engineering Inc., a small, general-contracting firm based in Honolulu. Act 105 "makes our price high for work because several subcontractors' GETs are in our (contract) bids."

Steve Baginski, president and CEO of Kaikor Construction, shares that perspective. "It (Act 105) unevens the playing field, giving bigger companies an advantage and hurting small, local contractors. Lots of those larger companies aren't even locally owned," he says.

With fewer contracts to go around, competition is fierce and every penny counts. In an effort to cut costs, some contractors have considered applying for more licenses to minimize the need to subcontract work out. This would hurt other subcontractors and could lower the quality of work as contractors do work with which they are less familiar.

Another alternative is cutting the subcontractor markup on tools and materials, making it more difficult for subcontractors to make a profit.

Some companies are doing cumbersome workarounds to reduce taxes. "I can say to my subcontractors, 'Hey, I want you to do this job for so much money,' but I'll purchase the materials directly to avoid their markups on the material," says John Cheung, president of CC Engineering and Construction Inc. "This way, we save money on tax as well."

There is a fear that Act 105 will exacerbate the already rampant problem of some contractors skirting the rules, particularly in the private sector, where monitoring and enforcement are minimal, says Thielen. "The owner-builder exemption is rife with abuse of contractors' licensing requirements, with many owners pulling their own permits and hiring unlicensed individuals who do not pay taxes or maintain insurance as licensed contractors are required to do.

"Even with licensed general contractors," he adds, "there is a lack of adherence to contractors' license laws in the use of subcontractors. Instead, many general contractors see their license as being sufficient to perform all work, except plumbing and electrical trades, and do not hire licensed contractors for much of their work."

Contractors that adhere to the law are at a disadvantage compared to those that do not, because unlicensed subcontractors often work for cash and do not pay taxes on that money, and therefore work more cheaply than licensed contractors. In other words, the unintended consequences of Act 105 may include more law-breaking and less tax-paying.

"We have actually been begging the state for years to come up with a way for them to get more revenue out of the construction industry, and that is by cracking down on unlicensed construction activity," Thielen says. "... But for the state, it's just much easier to put more burden on the guys who are already playing by the rules than go out and try to enforce the rules and collect revenue from those other people."

Act 105 has shaken the construction industry at a time when contractors say that stability and growth are desperately needed. The state government is doing little to aid the ailing industry, says Mike Masutani, president and founder of Site Engineering Inc. "We know (the revenue) doesn't come back to us in capital improvement projects. It's being spent (elsewhere)."

Other industries hurt

The suspension of Hawaii's sublease GET deduction is expected to bring in the second-most revenue from Act 105, according to the Tax Department, at $105 million, over the next two years. It increases the amount of tax paid by sublessors and is often passed on to sublessees, many of whom are small business owners. To recover costs, small business owners try to pass the cost on to consumers, but that is not easily done, says Steven Sofos, president and principal broker at Sofos Realty, because it affects businesses' ability to compete.

Sofos adds that sublessors and sublessees dealing with space in a building on leasehold land – land that is leased by owners such as Kamehameha Schools or Queen Emma Land Co. – are affected the most because of the added layer of cost from the leased land.

Some other GET exemptions that were suspended affected Hawaii ocean and air transport services, but companies have chosen to absorb the costs instead of passing them on to consumers.

Keoni Wagner, Hawaiian Airlines' VP of public relations, says, "Hawaiian is paying millions more in tax now – millions that out-of-state competitors don't have to pay – as a consequence of Act 105."

The air transport-related exemptions existed to level the playing field so locally based airlines could compete with those based elsewhere, as well as to promote more infrastructure investment by local airlines. With the suspension of Act 105's suspension of the those exemptions, some of Hawaiian's competitors have an advantage.

Hawaiian's fares have not been increased as a direct result of the act, but Wagner acknowledges, "Anything that adds to operating costs increases pressure on fares and fees."

To address the added GET expense, Matson, Hawaii's largest shipping company, announced to customers last June that a $52 fee would be added to every container; however, the fee was retracted before it could take effect. Jeff Hull, head of Matson public relations, says the company decided to absorb the cost instead of passing it on to consumers.

Act 105's future

Proponents say Act 105 is necessary so the state can balance its budget, and they stress that the suspension of the GET exemptions is temporary. However, Sen. Sam Slom, the only Republican in the state Senate, who voted against the final version of the bill that became Act 105, says, "They say temporary, it'll sunset in two years, but what will likely happen is it will be extended, or the sunset provision will be taken out."

Sen. Ige says that won't happen without a full discussion. "We'd have to pass legislation again, so there will be lots of debate," he says. "Everybody would know about it and we'd also have answers regarding impacts and revenue by then."

Hawaiian Air's Wagner says his company thinks the exemptions will return. "With tourism and the economy now rebounding strongly, thanks in part to Hawaiian's growth plan, we expect the legislation to sunset next year as it was designed to."

The construction industry also hopes the tax increase will die as scheduled on June 30, 2013, but many in the industry fear it will be extended.

"We have to be optimistic in this industry, but I don't think the state's financial situation is going to improve any next year, so my personal opinion is that there will be another act that will continue this," says Michael Brant, Gentry Homes' VP of engineering and past president of the Building Industry Association of Hawaii. "The state typically looks at 'How can we increase revenues,' but the better alternative is to look at reducing costs. We just don't feel that there was much of an effort put into that."

How Pyramiding Raises Costs

GET exemptions were created in the past to prevent some, but not all, of the excise tax pyramiding on goods and services

in Hawaii. Here's an example:

A company building a custom home would subcontract the foundation work to a subcontractor that is an expert in that area. That company would sub-subcontract the excavation and steel-reinforcing parts of that job to two other experts. Similar subcontracts might go to plumbers and electricians.

In the past, the contractor, subcontractors and sub-subcontractors would pay the full 4 percent state general excise tax only on work they performed themselves. Now, each layer must pay the full GET on the entire value of their contracts. This means part of a job that might have cost, say $76,000, including the tax, might now cost $84,000 with three layers of tax worked in.

It means more revenue for the state, but someone has to foot the bill – either the contractors, subcontractors or homebuyer, or the higher costs kill the project altogether.

Honolulu shows Highest Cost increase

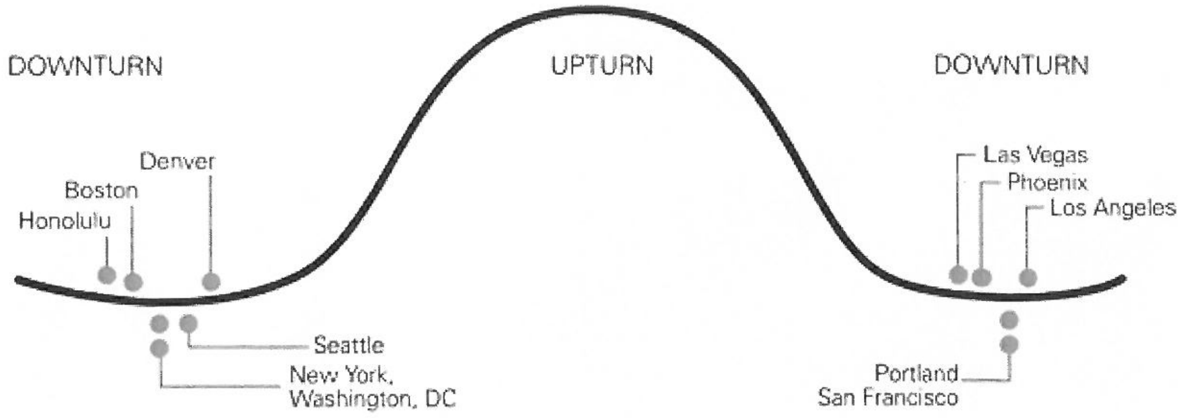
This chart shows the hypothetical cost of similar construction bids in 11 U.S. cities and how those costs have changed since last year. The chart was created by Rider Levett Bucknall, a global property and construction consulting company. It indicates that Honolulu had the biggest construction-cost increase from January 2011 to January 2012 – an increase more than double that of any other city. RLB says this index tracks the true bid cost of construction, including labor and materials, general contractor and subcontractor overhead costs, fees (profit) and the standard taxes for construction contracts in that city.

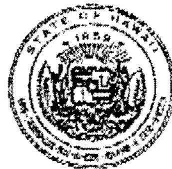
City	January 2011	January 2012	% Change
Boston	16,450	16,728	1.69%
Denver	11,517	11,720	1.77%
Honolulu	**16,669**	**17,556**	**5.33%**
Las Vegas	11,492	11,684	1.67%
Los Angeles	15,488	15,777	1.87%
New York	19,056	15,528	2.48%
Phoenix	11,446	11,686	2.10%
Portland	12,050	12,297	2.05%
San Francisco	17,001	17,294	1.72%
Seattle	13,200	13,348	1.12%
Washington, D.C.	15,404	15,566	1.05%

Source: Rider Levett Bucknall

Honolulu construction: poised for an upturn?

This chart estimates the current position of each city is its construction-business cycle, according to Rider Levett Bucknall, a global property and construction consulting company. RLB says current indicators show that the cities on the left appear poised for an upturn in construction activity; the closer the city is to the rising line, the closer it seems to be to a significant upturn. Honolulu is furthest from the rising line, indicating it may be the last of these cities to rebound. Cities on the right side of the chart are at the end of a construction cycle and there is no evidence yet of a pending rebound in construction activity there. For example, indicators show that Las Vegas is the major city that is furthest away from a construction upturn.


DOWNTURN
UPTURN
DOWNTURN
Denver
Boston
Honolulu
Seattle
New York,
Washington, DC
Las Vegas
Phoenix
Los Angeles
Portland
San Francisco



HOUSE OF REPRESENTATIVES

STATE OF HAWAII
STATE CAPITOL
HONOLULU, HAWAII 96813

September 10, 2012

Via Facsimile 587-1584

Mr. Randall Y. Iwase, Chair
and Members
2010-2012 Tax Review Commission
c/o Department of Taxation
State of Hawaii

Dear Chair Iwase and Members:

I have concerns regarding the assumptions regarding State spending levels and the consequential recommendations to increase taxes in the draft report entitled Study of the Hawaii Tax System: Final Report, dated August 28, 2012, by The PFM Group. The recommendations are intended to generate net general revenues of approximately $481 million in 2014 and, apparently, at least that amount annually thereafter.

In light of the lingering sluggish recovery in Hawaii's economy, I would advise some due caution about the impacts such a significant net tax increase would impose on private businesses and residents. While I understand that the scope of and assumptions in PFM's study may have been limited, I would expect that the legislature and the Abercrombie Administration would need to carefully analyze the impact of the tax increase on the economy, businesses, and residents.

I especially note the following specific recommendations would raise significant concerns:

(1) The increase of the general excise tax rate by 0.5 per cent;

(2) The imposition of the income tax on pension income;

(3) The increase of the corporate income tax rate; and

(4) The elimination of the income tax deduction for real property taxes paid.

Mahalo,

Gilbert S.C. Keith-Agaran
State Representative
District 9

cc: The Honorable Neil Abercrombie, Governor
State of Hawaii

Mr. Frederick D. Pablo, Director
Department of Taxation
State of Hawaii

HAWAII TAX REVIEW COMMISSION
Hawaii State Capitol
Room 309
415 South Beretania Street
Honolulu, Hawaii 96813

Aloha, Chairman Iwase and members of the Tax Review Commission,

My name is Max Sword, here on behalf of Outrigger Hotels, to offer our comments on the draft study of the Hawaii Tax System. I would like to thank the Commission for allowing us to offer our comments at this time.

The study by PFM is disturbing in that it recommends further "punishment" of a successful industry or business, while we continue to fund projects and new programs that produce only a fraction – if not a loss - of what the tourism industry, and particularly the hotel industry, brings to the State coffers.

I direct my comments to the portion of the study that proposes to eliminate the sunset on the Transient Accommodation Tax ("TAT") rate increase with the comment "Based on travel activity, it does not appear that the temporary increase significantly impacted the industry."

This is a total mistaken conclusion. TAT increases greatly impact our overall industry.

Here are a few facts to make my point.

The TAT in Chicago is about 16%, Los Angeles about 15%, New York almost 15%, Hawaii (Oahu) almost 14%, Orlando just above 12%, Las Vegas and San Diego about 12%.

According to the Hawaii Tourism Authority ("HTA"), our marketing is not focused on competing with Chicago, Los Angeles or New York, which are business destinations. Our marketing dollars are spent to compete against similar vacation destinations to ours, like Orlando and San Diego, for example.

Comparing these similar destinations, Hawaii has the highest average room rates. In San Diego, the average room rate is about $115. In Orlando, it's about $91. And in Hawaii (Oahu), the average room rate $201.

Therefore, a visitor's hotel bill in San Diego is about $13 additional a night for the TAT, and about $11 in Orlando, while in Hawaii, the TAT adds an average of $28 to our visitors' bills per night. With an average stay of about a week, the TAT becomes significant enough for some visitors to rethink their destination plans.

2375 Kuhio Avenue, Honolulu, Hawaii 96815-2992 • Phone: 808-921-6600 • Fax: 808-921-6655

We are operating at a disadvantage with our high average room rates coupled with a high TAT.

Why don't hotels discount their room rates to be more competitive with other similar destinations some ask?

We did lower room rates significantly due to the downturn in the economy in 2007 and 2008, but as operational costs only continued to increase, the industry was left struggling.

We revamped, reorganized and did what wecould to maintain what we had. Then, in 2009, when we thought that we could finally see the light at the end of the tunnel,the TAT was raised by 2%.

That brings us to today and the study's dispassionate and ill-informed comment that the increase in the TAT has not significantly impacted the industry. Each and every tax increase impacts the hotel and visitor industry negatively.

HTA has done a good job around the globe to keep brand awareness in the mind ofthe traveling public. However, because we are part of a global economy, we are affected by events beyond our shores.

Due to the flat U.S. economy, the exchange rate of the U.S. Dollarcontinues to drop at an alarming rate, compared to some of the foreign currencies like the Yen, the Canadian Dollar and even the Australian Dollar. If you look at the current statistics from HTA, some of the biggest growth in visitors over the last year are from those areas of the world. That is no coincidence.

Our biggest competitor for the West Coast market, Mexico, is having problems of their own due to the drug cartels.Mexico is spending hundreds of millions of dollars fighting the cartels, and hundreds millions more in marketing a more positive image. If they succeed, we will lose visitors from the western US that will choose their beaches over ours.

Also, if the U.S. economy rebounds, and the exchange rates return to previous levels, we will lose another significant chunk of business from Japan, Canada, and Australia.

Like the global economy – or, rather, as a result of it, our visitor industry is cyclical, and also at risk of other unexpected tragedies, such as 9/11 and the more recent Japan earthquake and tsunami. So the question is not IF, but WHEN will there be another downturn? We suffer serious financial losses when these economic downturns or tragedies occur. The busier times help to sustain us through the bad times, which can still be a considerable challenge.

We sincerely urge you to reject the recommendation of the study, and recommend on a follow through with the promised sunset to the current TAT in 2015.

fka The Hawaii Hotel & Lodging Association
2270 Kalakaua Ave., Suite 1506
Honolulu, HI 96815
Phone: (808) 923-0407
Fax: (808) 924-3843
E-Mail: info@hawaiilodging.org
Website: www.hawaiilodging.org

A Tradition of Kokua for 35 Years
Are You Walking in May 2013
www.charitywalkhawaii.org

TESTIMONY OF GEORGE SZIGETI
PRESIDENT& CEO
HAWAI`I LODGING& TOURISM ASSOCIATION

September 11, 2012

Good morning Chairman Iwase and members of the Tax Review Commission. I am George Szigeti, President & CEO of the Hawai`i Lodging& Tourism Association.

The Hawai`i Lodging & Tourism Association is a statewide association of hotels, condominiums, timeshare companies, management firms, suppliers, and other related firms and individuals. Our membership includes over 150 lodging properties representing over 48,000 rooms. Our lodging members range from the 2,680 rooms of the Hilton Hawaiian Village Waikiki Beach Resort to the 4 rooms of the Bougainvillea Bed & Breakfast on the Big Island.

The Hawai`i Lodging& Tourism Associationopposes some of the recommendations in the DRAFT Study of the Hawaii Tax System and the Study on Selected Issues of the Hawaii General Excise Tax.

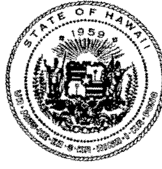
Hawaii has reached the point where added taxes hurt business. Destinations with the highest room taxes are business destinations like New York City, Washington D.C., San Francisco, Chicago and Seattle. In these destinations, most travelers are not paying the hotel bill themselves but rather charging it to their business. In resort destinations like Hawaii, our competitor's tax rates are often lower. This includes resort destinations like Las Vegas and Ft. Lauderdale. All of these destinations also have lower room rates due to lower costs of doing business thus leading to even lower tax bills for the customer. In addition, many state departments also have or are putting to rules a substantial increase in permits costs and fees. These increases will eventually be trickled down to the consumer. As a result, the cost of doing business and the cost of taxes are increasingly making us less competitive and less attractive to our visitor.

Now is not the time to be increasing taxes. Hotels and other businesses throughoutHawaii are finally coming back on line due their hard work, and to the diligent marketing efforts of the Hawaii Tourism Authority and the Hawaii Visitors & Convention Bureau. These marketing efforts and attractive offers we have seen are helping to increase the visitor arrivals and hotel occupancy, which in turn is helping to keep people working and creating new jobs. Anything that increases the cost of doing business will have a negative impact by making it more difficult to attract visitors and could cost jobs.

We oppose any new tax increases at this time and we are opposed to the elimination of the sunset on the TAT rate increase.

Mahalo again for this opportunity to testify.

(6)



HOUSE OF REPRESENTATIVES

STATE OF HAWAII
STATE CAPITOL
HONOLULU, HAWAII 96813

September 11, 2012

Mr. Randall Y. Iwase, Chair
and Members
2010-2012 Tax Review Commission
c/o Department of Taxation
P.O. Box 259
Honolulu, Hawai'i 96809

Dear Chair Iwase and Members:

The House Minority Caucus would like to express its appreciation to The PFM Group for their work in developing their report titled Study of the Hawai'i Tax System: Final Report, dated August 28, 2012. We would like to note that the report contains a number of recommendations we agree with and support including the elimination of the .5 percent GET and Use Tax rate on business-to-business transactions, the elimination of the individual income tax on the first $20,000 of adjusted gross income, the increase of refundable food/excise tax income tax credits, and improvements in tax administration. These recommendations would improve system efficiency and reduce taxes on low-income individuals.

Unfortunately, the report also contains a number of recommendations that we vehemently oppose. The most egregious of these recommendations are the increase of the GET rate from 4.0 percent to 4.5 percent (which is actually an increase to 5 percent for the majority of people of Hawai'i), the implementation of income tax on pension income, the elimination of the income tax deduction for property taxes paid, and the increase of the corporate income tax rate. We find these recommendations, as well as others in the report, disappointing and disagreeable as they increase taxes on individuals and businesses placing a greater burden upon them.

This is especially problematic given the state of Hawai'i's economy and the significant cost of living faced by residents of the state. An increase in taxes would be a detriment to individuals and businesses at this most inopportune of times. Rather than exploring ways to increase revenue, we believe government spending should be curtailed and be done in a smarter and more efficient manner.

Furthermore, we feel the business climate should be improved in the state through improved regulatory procedures and greater government efficiency. A more business-friendly environment would help companies conduct business thereby growing the economy and helping the people of Hawai'i.

Sincerely,

Representative Gene Ward
Minority Leader
District 17: Hawai'i Kai – Kalama Valley

Representative Cynthia Thielen
Assistant Minority Leader
District 50: Kailua – Kāne'ohe Bay

Representative Corinne W.L. Ching
Assistant Minority Floor Leader
District 27: Nu'uanu, Pu'unui, Liliha,
'Ālewa Heights

Representative Barbara Marumoto
Minority Policy Leader
District 19: Waialae Iki, Kalani Valley,
Waialae Nui, Diamond Head, Kāhala

Representative George Fontaine
Minority Whip
District 11: Makena, Wailea, Kīhei

Representative Aaron Ling Johanson
Minority Whip
District 32: Lower Pearlridge, 'Aiea, Halawa,
Hickam, Pearl Harbor, Moanalua Gardens

Representative Gil Riviere
Minority Whip
District 46: Ka'ena Point, Schofield, Mokulē'ia,
Waialua, Hale'iwa, Waimea, Pūpūkea, Sunset,
Kahuku, Kunia Camp, Poamoho, Wheeler, Lā'ie

September 11, 2012

2010-2012 Tax Review Commission
Public comment to the reports of Dr. Wiliam Fox and the PFM Group

Dear Chair Iwase, Vice-Chair Imanaka and members of the Tax Review Commission:

The Hawai`i Alliance of Nonprofit Organizations is a statewide professional association working to strengthen and unite Hawaii nonprofits as a collective force to improve the quality of life in Hawai`i. HANO member organizations provide essential services in every community throughout the state.

We are particularly concerned over points made in the report issued by Dr. William Fox. We have comments on following points:

Dr. Fox asserts that the GET exemptions for nonprofits are essentially "subsidies" that give unfair competitive advantage to nonprofits over their for-profit counterparts. This point misses the fundamental purpose and distinct role of the nonprofit sector, which is not governed by profit, but by service.

There are very few markets where for-profits and nonprofits compete. Where there is competition, for-profits often do not remain in these environments because they are generally not profitable. Also, nonprofits might be paying unrelated business income tax (UBIT) on the areas where they might be in direct competition with for-profits.

Dr. Fox refers to the competitive advantage of the nonprofit sector being responsible for the sector's great expansion, which bypassed the for-profit sector in year-over-year growth. If there is any "expansion" of the nonprofit sector, it is due to an ethical and mission-related response to an increased demand for services in the wake of the economic downturn, as well as governments' rapid devolution of its services to the nonprofit sector.

Dr. Fox also mentions that these so-called "subsidies" are extended to those nonprofits that are not providing valuable services to the general public. I would argue that all nonprofits bring tremendous value to the community that we all avail ourselves of – whether at the preschool, or the elderly care home, or public TV, or public radio. While individual services may not be perceptible to some, together, these services make up the social and cultural fabric that strengthens our community and makes us a reasoned, civil and resilient society.

1020 South Beretania Street, 2nd Floor • Honolulu, HI 96814
info@hano-hawaii.org • hano-hawaii.org
(808) 529-0466

Reasons for Nonprofit Tax-Exempt Status

Nonprofit organizations require tax exemption because they provide necessary programs and services that the government sector is not willing or able to provide. Nonprofit organizations receiving tax-exempt status are required to carry out their charitable activities that benefit individuals, families, and communities.

Every dollar collected for GET is a dollar less that will go to feeding or educating a child, caring for an elderly person, training a disabled veteran, preserving Hawaiian culture, taking care of our aina. Real people, your constituents are helped everyday by the thousands of nonprofits across the state, which are dedicated solely to the public good. Services that we count on today will not be provided tomorrow if GET exemptions are lost.

Economic Impact of Nonprofit Tax-Exemptions

You must ask yourselves: How many dollars will it cost the State to provide the services that nonprofits cannot provide as a result of losing their tax exemption? Nonprofit organizations provide these services with more economical efficiency than government.

It is expected that any revenues incurred from increased taxation of nonprofits will be spent by the state on even more expensive crisis response services.

Government Should Streamline Itself First Before Streamlining Nonprofits

Recent studies by the Urban Institute and the National Council of Nonprofits found that Hawaii is one of the worst states in the country in terms of government mid-stream contract changes and late payments to nonprofits. The reports found that nonprofits that contract with governments in the state are not paid the full costs of the services they provide, are forced to subsidize the government with interest-free loans, as a result of late payments, and suffer excessive bidding burdens and reporting requirements that are not streamlined and consistent across all contracting departments. Nonprofits already pay an unfair share through under funded, overburdened, short-changed government contracts. Taxing nonprofits will only exacerbate this situation.

Essentially, by taxing the revenue received from a government contract, government is decreasing its own contract amount to the nonprofit, providing yet another example of under funding the nonprofit.

Nonprofit Organizations Are Good Corporate Citizens

- Nonprofit organizations DO currently pay General Excise Tax (GET) on gross revenues derived from fundraisers.

- Nonprofit organizations DO currently pay unrelated business income tax (UBIT) on for-profit ventures.

- Nonprofit organizations pay approximately $1.45 billion in wages that DO get taxed on the federal and state level.

- Nonprofit organizations receive much of their funding through fundraising. Most households support fundraising activities using income earned from wages. All such income IS already subject to both federal and state taxes.

Impact of Further Taxation

- Nonprofit organizations are impacted by unexpected increases in at least two ways: 1) Possible closing down of organizations and/or laying off of employees, adding further strain on the state's budget and resources; and 2) Reduction and/or elimination of services that support the state's most vulnerable and needy citizens, further eroding the state's social safety net.

- Nonprofit organizations provide necessary programs and services to the most vulnerable segment of Hawaii's population. If these programs and services cease to exist, those in need will either not receive the service or will go elsewhere, most likely to a government agency.

- Nonprofit organizations receive fewer funds during tough economic times because of the manner in which nonprofits raise revenues (primarily through charitable contributions) and an increase in taxation would further undercut their funds.

- Nonprofit organizations must absorb any tax increase in their existing budgets unless additional sources of financial support can be found through grants or philanthropic donations, which is extremely difficult in the current economic climate.

- Nonprofit organizations cannot pass on additional taxes to customers through price increases like the private sector.

- Nonprofit donors want their charitable contributions to go for community services, not taxes. Taxing nonprofits has the effect of discouraging giving and volunteering. Our community needs more of what nonprofits and volunteers do, not less.

- Removing nonprofit tax exemptions will be precedent-setting nationwide and will earn Hawai`i an infamous reputation of being unfriendly to the charitable sector, government's supposed partner. Quite simply, this commission will not be acting in isolation. The national nonprofit community is watching what Hawai`i does.

For these reasons, we have strong concerns about the concepts included in particularly the Fox report and ask you not to heed this advice in the formulation of your report to the 2013 Legislature.

Thank you for the opportunity to provide late testimony.

Lisa Maruyama
President and CEO

Natalie J. Iwasa, CPA, Inc.
1331 Lunalilo Home Road
Honolulu, HI 96825
Phone/Fax 808-395-3233

Date: September 11, 2012

To: Tax Review Commissioners

From: Natalie Iwasa, CPA

Meeting: 2010 – 2012 Tax Review Commission

RE: Draft Study of the Hawaii Tax System by Public Financial Management and Selected Issues of Hawaii General Excise Tax by Dr. William Fox

The recommendations in these reports should be heavily discounted for the following reasons:

- We should be looking at ways to reduce waste, not how we can continue to fund it;
- We should be looking at ways to simplify our tax system and make it more equitable, not more complex by creating new tax categories; and
- Direct comparisons between the Hawaii general excise tax (GET) and other states' sales taxes indicate a lack of understanding of the significant differences between our GET and sales taxes.

It is also disappointing that the Commission decided to use a Mainland company and Mainland consultant for these reports.

Before the reports are finalized, you might want to ask the authors to correct errors like the one on page 24 of 26 in which "tax" is stated twice, i.e., "the GET tax" should simply be "the GET."

Ocean Tourism Coalition

The Voice for Hawaii's Ocean Tourism Industry
1188 Bishop St., Ste. 1003
Honolulu, HI 96813-3304
(808) 537-4308 Phone (808) 533-2739 Fax
timlyons@hawaiiantel.net

2010-2012 Tax Review Commission
Tuesday, September 11, 2012
9:00 AM
State Capitol, Conference Room 309

In Consideration of Making the TAT Increase Permanent

James E. Coon, President
Ocean Tourism Coalition

Speaking in Strong Opposition

Members of the 2010-2012 Tax Review Commission:

My name is James E. Coon, President of the Ocean Tourism Coalition. The OTC represents over 300 small ocean tourism businesses state wide. I am <u>speaking with strong opposition of making the TAT increase permanent</u>.

Ever since the Great Recession started in 2008 our industry has been fighting for survival. Even though the overall tourist numbers are up significantly, we as an industry have been unable to increase our prices appropriately to reflect the increasing cost of doing business. Everything from fuel to catering expenses has been increasing at double digit rates and we have cut our operating costs as far as possible.

The increased TAT has had a negative effect on the discretionary income available for the visitor to spend on activities such as we provide. We are strongly against making the increased TAT permanent and request you will let it sunset as was envisioned when the bill was promulgated.

Thank you for the opportunity to submit testimony. If you have any questions, please contact me at 808-870-9115.

Sincerely,

James E. Coon, President

Maui Hotel & Lodging
ASSOCIATION

TESTIMONY OF CAROL REIMANN
EXECUTIVE DIRECTOR
MAUI HOTEL & LODGING ASSOCIATION

September 11, 2012

Aloha, my name is Carol Reimann. I represent the Maui Hotel & Lodging Association. Our membership is comprised of over 140 property and allied business members in the County of Maui. Collectively, our membership employs over 10,000 residents.

The Maui Hotel & Lodging Association respectfully opposes the elimination of the sunset on Transient Accommodation Tax. We also oppose any increase to the General Excise Tax.

The visitor industry is the economic driver for Maui County. We are the largest employer of residents on the Island - directly employing approximately 40% of all residents (indirectly, the percentage increases to 75%). We also contribute a significant amount of dollars in taxes each year. Bottom line, the visitor industry provides a large percentage of jobs and contributes our fair share of taxes to the government.

Recent headlines indicate that visitor statistics have improved – however, it is important to note that these headlines are misleading as we have not yet rehired all of the employees who were paid off during the global recession. The financial impact to our properties from the economic downturn that began in 2008 has been severe - reflecting in loss of jobs and wage reductions. Despite increased visitor counts current revenues have not ramped up enough to cover increased expenses. These headlines provide a false sense of security – the visitor industry is not on healthy solid ground yet. In fact, economists forecast that recovery will be a very slow, gradual process.

This economic engine - that provides meaningful jobs for our residents, revenue to the government and business to other industries – is not on solid financial footing yet. We strive to rehire all of the employees that were let go during the recession, and we continue to struggle to remain viable at a time when increased expenses (such as labor, cost of goods and fuel) have outpaced increased revenue..

Conditions outside of a property's control (loans/debts, etc) have changed how our properties can sustain, and - besides ever rising utility costs, necessary infrastructure improvements and other needed capital improvements - **maintaining our labor force remains their major objective**...this is a benefit to our community from all perspectives!

Eliminating the sunset on Transient Accommodation Tax and increasing the General Excise Tax will negatively impact our industry properties balance sheets, affect their future investments, future viability and future employees. For our accommodation properties that are truly the economic engine of Maui County. We ask that you not eliminate the sunset on Transient Accommodation Tax nor increase the General Excise Tax.

Thank you for the opportunity to testify.

1727-B Wili Pa Loop • Wailuku, HI 96793 • 808/244-8625 • 808/244-3094 fax • info@mauihla.org

From: "Allan Raikes" <allan@crhmaui.com>
To: <Tax.Rules.Office@hawaii.gov>
Date: 09/10/2012 01:38 PM
Subject: Sunset of TAT increase

Aloha,

I have just received notice of your hearing on the draft study of the Hawaii tax system this afternoon.

I have read that testimony was due forty eight hours prior to tomorrows' meeting and realize I may be too late for this email to be on record.

On the off chance this can still make the record, I am adamantly **opposed** to dropping the sunset provision in the increase to the Transient Accommodations Tax increase that went into place a few years ago.

Given the late notice I received of this hearing, I will leave my comments at that. I will hopefully have another opportunity to submit testimony before any decision is made on this matter.

Mahalo

R. Allan Raikes

President
Condominium Rentals Hawaii
362 Huku Li'i Place, Suite 204
Kihei, Maui, Hawaii 96753
Tel. no 800-367-5242 ext. 236 or 808- 874-6332
Fax no. 808-879-7825
www.crhmaui.com

From: "Nane W. Aluli" <naluli@mauian.com>
To: <Tax.Rules.Office@hawaii.gov>
Cc: <naluli@mauian.com>
Date: 09/10/2012 04:08 PM
Subject: Please Let The Extended TAT Sunset

I realize that we pass the TAT and GET on to our guests and therefore don't DIRECTLY bear the burden of the TAT and GET. However, because the consumer views the charge for their room with the tax included, the lump sum of the room rate and the tax as one charge, the combined cost is creating resistance to making reservations. Our entire tax burden continues to grow and sure is making it difficult to maintain any kind of operating profit.

Please, please let the increased TAT burden end and let us at least go back to the 7.25% TAT rate.

Nane W. Aluli
General Manager
The Mauian Hotel
naluli@mauian.com
www.mauian.com
808-669-6205

From: Matt Bailey <Matt.Bailey@waldorfastoria.com>
To: "Tax.Rules.Office@hawaii.gov" <Tax.Rules.Office@hawaii.gov>
Date: 09/10/2012 07:19 PM
Subject: TAT SUNSET

Aloha,

I have read that one of the recommendations in front of the Tax Review Commission is the elimination of the scheduled sunset of the "temporary" increase of the TAT. Not that this comes as a surprise, but it is a disappointment.

As you are well aware, Hawaii's tourism industry was hard hit by the recession. While business has improved, we have a long way to go to achieve business levels akin to those of 2006 and 2007. During the intervening five years, while rates have lagged, virtually all our costs have increased, putting tremendous pressure on our profitability. Many properties lose money - and will continue to do so for years to come.

One of the most important lessons of the past five years was the importance of group business to the state. Groups allow us to place a base of business on our books, which in turn allow us to yield our transient rates. It is only through increases in rates that we can restore our profitability. To a meeting planner budgeting for a conference of thousands of rooms, the additional 2% of TAT is a huge amount. Our TAT rate puts Hawaii's hotels on a par with the most expensive cities in the country. The difference is that our transient guests pay their own guest folios and groups look at the entire cost of a stay, including taxes. We are not competitive.

The pervasive attitude of "soak the visitors" isn't a healthy one. We need to let this temporary increase sunset to add some value back into our guests' stays. I hope you will look at other means to fill the state's coffers, including modest increases to the GET.

Sincerely,
MB

Matt Bailey
Managing Director
Grand Wailea| A Waldorf Astoria™ Resort
3850 Wailea Alanui, Wailea, Maui, Hawaii 96753
Office: 808.875.1234 ext 4558 | Fax: 808.874.2479
Email: matt.bailey@waldorfastoria.com | Website: www.grandwailea.com

From: Exclusive Getaways <mail@ExclusiveGetaways.com>
To: Tax.Rules.Office@hawaii.gov
Date: 09/11/2012 09:48 AM
Subject: Testimony on codifying 9.25% TAT instead of "Sun setting" this emergency measure as previously promised

Dear Sirs,

I became aware of your hearing this morning just last night concerning the 9.25% TAT tax increase, which was put in place as an emergency revenue measure during the economic collapse of 2008. This measure increased the TAT 27.5% upon visitor lodging at exactly the moment when visitor's became hypersensitive to price, at the collapse of the economy. These visitors many who were concerned about losing their homes or their jobs, were not surprisingly "pinching" every penny on any vacation trip they took during this time.

This being the case, this tax increase was not paid for by the visitor, but by the Hawaii lodging establishments who sought to secure this person's business by reducing their nightly room rate to offset some or all of this tax increase. A perfect example of unplanned consequences. So while our businesses was being brought to their knees due to the economic troubles, we were forced to bear the burden of this addition cost.

The economy is improving, all be it slowly, and the State is not in the immediate and dire financial straits it was when this emergency measure was put in place. As shown above, it wasn't a good idea then, and not permitting this measure to Sunset would be a bad idea as well. It would also be a breach of faith of a commitment made by the State to its people that this was a short term measure, and with an election upon us, every Senate and House candidate should be mindful of this commitment.

Mahalo,

Dan Monck
Exclusive Getaways

PETER L. FRITZ
200 NORTH VINEYARD BOULEVARD, #430
HONOLULU, HAWAII 96817
E-MAIL: PLFLEGIS@FRITZHQ.COM

2010-2012 Tax Review Commission

Public Comment On:
Draft Study of The Hawaii Tax System By Public Financial Management
and
Study on Selected Issues of Hawaii General Excise Tax by Dr. William Fox

My name is Peter L. Fritz. I am an attorney in private practice concentrating on disability and tax law. I have previously worked for the Department of Taxation and am familiar with Hawaii's tax system and structure. This written testimony memorializes my oral testimony at the hearing on September 11, 2012 in opposition to the adoption of the "Draft Study of The Hawaii Tax System by Public Financial Management." My reasons for opposing the adoption are as follows:

Public Financial Management's ("PFM") statement on page 15 of their report about how Hawaii's 4.0% General Excise Tax ("GET") is low is misleading because the statement fails to consider the large number of items (the base) that are subject to taxation in Hawaii as compared to other states that do not tax those items. PFM stated:

> Hawaii's GET rate is among the lowest in the country for states with this sort of broad-based consumption tax. While Hawaii has not raised its rate in over 35 years, over half of the states have raised this rate since 2000 – in many cases multiple times.

Because of the large base, Hawaii's low GET rate collects as much tax as higher rates in states that have a smaller base. In the "Selected Issues with The Hawaii General Excise Tax" report by William Fox, he wrote that the base in Hawaii is equal to 100.7% while the average state has a base of 33%. The effect of this large base is illustrated by the following example:

A taxpayer purchases $100.00 of items. State A has a tax rate of 12% and a base of 33%. Hawaii has a tax rate of 4.00% and a tax base of 100. How much tax is paid in State A and Hawaii?

State A.

The value of the items subject to taxation is $33.00. ($100*.33 State A's base). The Tax Rate is 12%. The tax on the taxable items is $3.96.

Hawaii:

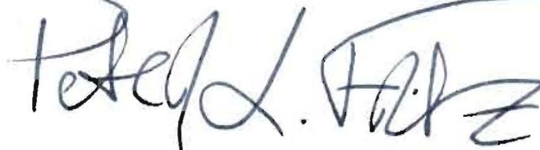
The value of the items subject to taxation is $100.00. ($100*1.0 Hawaii's base). The effective tax rate is 4.0%. The tax on the taxable items is $4.00.

As is evident from the above example, a tax rate that is 3 times higher than Hawaii's rate produces less tax revenue. While Hawaii may not have adjusted its rate in a long time, it has adjusted the base almost every legislative session. Implying that other states have raised their rates over the years while Hawaii has not, appears to be intended to justify an attempt to raise the GET rate in the next legislative session because it omits any consideration of the base. A fair and balanced analysis would have taken Hawaii's broad base into consideration when making a comparison with other states. A report that is not fair and balanced should not be accepted by the Tax Review Commission.

Furthermore, PFM's report fails to suggest adequate methods to address the regressiveness of Hawaii's GET and the new burden imposed by any increase in the GET. With its broad base, Hawaii's GET taxes items such as school supplies, medical care, shoes for the children, and just about every item in commerce. Increasing the food credit and housing credit does not provide adequate relief for the new burden for other items subject to the GET low income taxpayers that will be created by increasing the GET rate. If the Commission is going to recommend an increase in the GET, then it needs to have PFM study relief mechanisms such as an Earned Income Credit tied to the federal Earned Income Credit and/or other relief alternatives. Furthermore, such credits are available only after the tax return is filed. Many individuals below the poverty level may not file an income tax return. The report needs to address how to make it easier for these low income taxpayers to claim credits

Finally, on behalf of all individuals with vision impairments, I protest the holding of a meeting when the reports for public comment that were posted on the Tax Review Commission's webpage were not accessible visually disabled individuals. I advised the Commission in advance that the documents needed to be accessible. When I received the Notice for public hearing, I clicked on the links in the notice and upon determining that the documents were not accessible, I advised the Commission that the documents were not accessible and the reasons why the documents were not accessible. It is very disconcerting that the Commissioners choose to ignore their obligations under Title II of the Americans with Disabilities Act and state law by holding a hearing knowing that the reports that were the subject of public comment were inaccessible, especially since it was very easy to make the reports accessible.

Very truly yours,



Peter L. Fritz