Potential Study Topics

I. Possible Individual Studies

1. **Overall System Equity – Analysis:** Who bears the burden of Hawaii's taxes? The study would show the incidence of the taxes imposed by the State and by the counties, by income class. That is, the study would show the burden of each tax as a percent of total income by income class. The study would also show the burden percentages for all of the taxes combined. Any request for the study should be accompanied by reference to the most recent studies on the topic: (a) the "Study on the Progressive or Regressive Nature of Hawaii's Taxes" in the report of the 2005-2007 Tax Review Commission, and (b) "Distribution of State and Local Tax Burden by Income Class" in the report of the 1989 Tax Review Commission (Miklius, Moncur, Leung study). This study would address S.R. 103 and parts of S.R. 138.

   Note: A tax is regressive if the tax burden as a percentage of income is higher for lower income classes than it is for higher income classes. It is proportional if the burden is the same percent of income for all income classes, and it is progressive if the burden as a percentage of income is higher for higher income classes.

2. **Overall System Equity – Solutions:** In practice, this would be a study on how to reform Hawaii's Individual Income Tax. If the tax system is judged to be too regressive, there are two possible solutions. One is to reduce reliance on taxes that are more regressive in favor of taxes that are more progressive. The other solution is to alter some taxes to make them less regressive. As a practical matter, the best way to address regressive taxes is to make the individual income tax more progressive. This can be done by increasing the standard deduction and personal exemption, and changing the tax brackets to make the income tax more progressive. The reform can be accomplished while simultaneously raising the amount of revenue from the tax, or it can be made revenue neutral. The reform can also be accompanied by a loss in revenue from the tax, but to be a practical alternative, the revenue loss should be minor. This study would address S.C.R. 59 and the Governor's recommended additional points.

   Note: The personal exemption and standard deduction in Hawaii's income tax have been eroded by inflation and are now well below the federal levels. As such, they are no longer serving their purpose, which is to give people enough income to live on before we start to tax their income. Bringing the standard deduction and personal exemption up to appropriate levels is a main purpose of reforming Hawaii's individual income tax. (For tax year 2016, Hawaii's personal exemption is $1,144, whereas the federal is $4,050. Hawaii's standard deduction is $2,200 for single individuals and $4,400 for married couples filing jointly, whereas the corresponding federal amounts are $6,300 and $12,600.)

3. **Additional Revenue Sources:**

   <u>A.</u> A study on how to generate more revenue. The study should also consider, at least broadly, how much revenue the State will need to maintain current level of government services (tax

adequacy), including all unfunded liability obligations (Health Benefits Trust Fund), to fund the very rapidly expanding Medicaid costs, to maintain competitive wages for government workers, to allow the infrastructure to grow with the economy, etc., so that proposed solutions are of an appropriate scale. It should also include a qualitative analysis of effects on the economy or specific sectors.

B. Alternatively, the study could focus on finding revenue to fund the annual required contribution for the Employer-Union Health Benefits Trust Fund, as will be required by Act 268, SLH 2013 starting July of 2018. Taxes are assumed to be adequate in all respects, with the single exception of this Trust Fund.

Note: One option for this study is to have PFM update its study of tax adequacy and proposed solutions. A sole-source contract might proceed faster through the procurement system. Additionally, note that either A or B could address possibility of both "Tax Effect of Timeshare versus Hotel Rentals" and "Erosion of Certain Tax Types Due to Inflation," as per Gov. Ige request of June 27, 2016.

4. **GET/Exemptions:** A study on GET exemptions. The study would address the question of which GET exemptions are tax expenditures, as opposed to exemptions that prevent the GET from applying to income that is not properly part of an excise or sales tax base (such as wages or income from sale of unimproved land) or that are in place to prevent pyramiding of the GET (such as the subcontractors' deduction). The Department may have several months of data on GET exemptions by the end of the year, so it may be possible to undertake quantitative work on the economic costs of some of the exemptions.

   Note: One option for this study is to have Dr. Fox update his study on selected GET exemptions done for the 2011-2013 TRC. The present Commission may decide to add to, or subtract from the list of GET exemptions included in the previous study by Dr. Fox.

5. **Income Tax Credit/Exemptions:** A study on tax credits, exclusions and deductions in the income tax. The study would, among other things, assess the costs and benefits of the tax credits, exclusions, and deductions, including the tax credits designed to promote social welfare (such as the food/excise tax credit, the tax credit low-income renters, and the tax credit for child and dependent care expenses) and the tax credits designed to encourage certain industries or activities (such as the film production tax credit, the renewable energy technologies tax credit, and the enterprise zone credit). The Commission could select the tax credits, exclusions and deductions it wants the contractor to study. This study would address S.C.R. 58.

6. **Neutrality:** A study on the neutrality of Hawaii's taxes. The study would try to determine if the state's tax code favors some industries or sectors over others. Ideally, taxes have as little effect as possible on business decisions. The study could also be made to address the costs and benefits of current policies that deliberately encourage certain industries or sectors, such as the tax credits for film production and for renewable energy.

Note: Doing #6 would include the parts of #4 and #5 that have uneven effects across business. Doing #4 and/or #5 would include items that don't affect one business more than another – e.g., food excise tax credit, exemptions for charitable donations, and others for social goals.

7. **<u>Sublease Deduction for Transient Accommodations:</u>** A study on whether the sublease deduction can and should be applied to hotels in a manner similar to other subleased real property. This study would address the second part of S.C.R. 138.

<u>II. Possible Packages of Inter-Related Studies</u>

P1: #1 (Overall System Equity – Analysis) and #2 (Overall System Equity – Solutions)

P2: #1 and #2 <u>and</u> #3A and/or #3B (Additional Revenue Sources)

P3: #4 (GET/Exemptions) and #5 (Income Tax Credits/Exemptions) and #6 (Neutrality)

<u>III. Initial Guesses About Extent to Which Each Study or Package Would Consume Budget</u>

NOTE: The amount we budget for the study will tell the researchers about the expected level of effort.

1. Relatively small study – likely would allow several others.

2. Relatively small study – likely would allow several others.

3. A stand-alone (without #1 and #2) would require a rough tax adequacy study. It would probably would allow several other studies to be done.

4. Probably same or less than any of the preceding three on stand-alone basis.

5. A quantitative study of costs and benefits could require substantial funds, but 1-2 other smaller studies might still be possible.

6. Depends on how deeply the scope is written. A qualitative analysis (identification of tax distortions) could be fairly affordable. A quantitative analysis of the magnitude of effects could be very costly.

7. Relatively small study – likely would allow several others.

P1. This would probably allow at least one other study to be done.

P2. This would likely consume the entire budget, if it could be done for that. (Going to a package with #3B instead of #3A could be much less expensive.)

P3. This <u>might</u> also consume the budget.