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February 27, 2017

Ms. Maria Zielinski, Director
State of Hawaii, Department of Taxation
830 Punchbowl Street
Honolulu, Hawaii 96813

Dear Director Zielinski,

The State of Hawaii Department of Taxation (DOTAX) has assisted the Hawaii Tax Review Commission (TRC) over the years in various forms. One form of assistance that has been helpful has been the preparation of various analytical reports and studies that have assisted the TRC in its mandate to conduct a comprehensive review of the system of taxation in Hawaii.

We request that DOTAX provide assistance to the TRC by **updating** the following DOTAX prepared reports.

| Year of TRC | Title of Study |
|-----------------|--|
| 1 - 2010-2013 | Adequacy of Hawaii Tax Structure |
| 2 - 2005 - 2007 | Revenue Costs for Selected General Excise Tax and Use Tax Exemptions and Deductions |
| 3 - 2005-2007 | Study on the Question "Should Hawaii Replace Its Income and Franchise Taxes With an Increase in the General Excise Tax?" |
| 4 - 2005-2007 | Study on the Progressive or Regressive Nature of Hawaii's Taxes |
| 5 - 2010-2013 | Effect of Eliminating Income Tax for Those Below Poverty Level |

It is imperative that the first three studies listed above are updated.

The 2005-2007 TRC recommended eliminating the Hawaii Corporate Income Tax. *See excerpt from the 2005-2007 TRC report below.* We request that DOTAX assist the TRC by conducting a study into the topic of "The Effects of Eliminating the Hawaii Corporate Income Tax." This study should consider the impact of tax revenue lost, internal costs savings to the State from NOT having to enforce the Hawaii Corporate Income Tax, positive benefits to the State of Hawaii from enhanced perception of its business-friendly environment and increased tax revenue to the State from additional economic activity due to eliminating the Hawaii Corporate Income Tax.

We also request DOTAX assistance in providing information and/or statistics for the following:

1. Written update on the Tax System Modernization Program. We would like to know the Department's assessments of the positive and negative aspects of the GET rollout in August 2016. By now, there should be a summary of the progress of the rollout as the next scheduled portion of the rollout is in a few month - August 2017.
2. With the Tax System Modernization Program, will Forms W-2 and 1099 be included? We have heard concerns about problems with identity theft. Wouldn't the electronic processing of Forms of W-2 and 1099 be helpful in detecting identity theft so that the Department could match up the income with the source documents?
3. We understand that the GET exemptions were reported through the DOTAX computer system starting with the filing due in January 2017. We would like a report of the results of the exemption reporting. We do understand that the January 2017 filing was for the period ending December 31, 2016. We would be extremely interested in the amounts reported for each type of exemption and by month. Also, by May 2017, the calendar year exemption filing will be due. Please provide us with a similar report for this period as soon as it is available.
4. We request information regarding the amount of revenue collected from Hawaii Corporate Income taxes for the past 10 years by year – both as raw numbers and as a percentage of total tax revenues for those years.
5. We request information regarding the amount of deductions claimed on individual income tax returns for pensions not taxable to Hawaii. We would like the information for the past 10 years summarized by year; married vs. single, head of household and married filing separate; number of returns and by the following levels:
 - \$1 to \$50,000
 - \$50,000 to \$75,000
 - \$75,000 to \$100,000
 - Over \$100,000
6. We request information regarding the amount of taxes withheld through HARPTA for the past 10 years by year.

The Tax Review Commission has a contract with PFM Group to prepare a report. There may be some overlap on the items listed above. If the information requested above will not be addressed by the PFM Group, we ask that the Department of Taxation address the request for information noted above.

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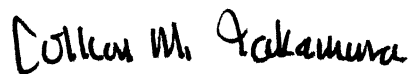
We do realize that your department is extremely busy at this time due to the legislature being in session. As such, we do not expect the information from your department until after the 2017 legislature closes.

We would appreciate a response of what can be provided to the Tax Review Commission by April 21, 2017.

Thank you for your consideration.

Sincerely,

Colleen M. Takamura



Tax Review Commission, Chair

Vaughn G.T. Cook



Tax Review Commission, Vice-Chair

EXCERPT FROM 2005-2007 TRC REPORT (PAGES 19 – 21)

E. RECOMMENDATIONS ON HAWAII'S NET INCOME TAXES

Background

Hawaii's Individual Income Tax and Corporation Income Tax follow closely the federal definitions of taxable income. The Individual Income Tax is the second most important tax for the State, producing just over a third of tax revenue in the State's General Fund. The Corporation income tax is much less important, providing only about 2 percent of the tax revenues in the General Fund. Generally speaking, with the exception of withholding taxes on sales of real property by nonresidents, the Commission recommends closer adherence to the federal individual income tax. This would ease the burden of administering the tax and also make it more progressive. The Administration and the Legislature recently made some changes to move the tax closer to the federal model (by increasing the standard deduction and widening the tax brackets), but more needs to be done.

In addition to its recommendations, the Commission also investigated the effects of eliminating the net income taxes entirely, and of replacing the revenue with increases in the State's taxes on gross income.

Recommendation 1

The State should continue to study and evaluate the option of eliminating the Hawaii Individual Income Tax. It should eliminate the Hawaii Corporation Income Tax.

Discussion

The Commission received a suggestion that all Hawaii income taxes (corporate and personal) be eliminated, with the revenue to be replaced by increases in the GET and the portion of the PSCT that is deposited into the General fund. The Commission is not ready to make that recommendation at this time, but believes that the idea deserves further consideration. The Commission requested an internal study on the topic,²³ which concluded that the statutory rate of the GET and PSCT would need to rise from its current rate of 4 percent to a value ranging from 6.7 percent to 6.9 percent, depending on whether the bank franchise taxes and the Tax on Insurance Premiums were eliminated along with the corporate and individual net income taxes. The tax regime change would reduce compliance costs for taxpayers and the costs of tax administration for the Department of Taxation.²⁴ It would also yield a more stable stream of revenue for the State and shift a greater portion of the total burden of Hawaii's taxes from residents to nonresidents. While not formally recommending this change, the Commission believes that the idea merits further study and consideration.

The Commission recommends eliminating the Corporation Income Tax, on grounds that the tax is too complex. The static effects on the State's tax revenues would be fairly small. From 1972 to 2005, the Corporation Income Tax has provided on average only about 2.3 percent of total revenues paid into the General Fund. Moreover, collections were strongly cyclical, being large when the State's economy was strong and tax revenues were high, and being small when the State's economy was weak and tax revenues were low.

²³ Tax Research and Planning Office, Hawaii State Department of Taxation, "Study on the Question 'Should Hawaii Replace Its Income and Franchise Taxes With an Increase in the General Excise Tax,'" report to the 2005-2007 Tax Review Commission, November 2006. (See *Appendix E*.)

²⁴ Businesses and individuals file more than 760,000 tax returns annually and the net income and franchise taxes account for roughly 60 percent of the 230 forms and instructions now issued by the Department of Taxation. See *Ibid*, page 18.

The academic literature on the topic indicates that small open economies, such as individual states, shoot themselves in the foot when they tax corporate income, because in the long run the burden of the tax is borne by local landowners and workers, not, as popularly believed, by the corporate shareholders.²⁵ Such jurisdictions can improve the competitiveness of their economies and the welfare of their residents by exchanging corporate income taxes for taxes on wages and land.²⁶ Popular notions of equity may explain why many small jurisdictions continue to apply corporate income taxes.

²⁵ These arguments are presented in greater detail in Tax Research and Planning Office, Hawaii State Department of Taxation, "Study on the Progressive or Regressive Nature of Hawaii's Taxes," *Op. cit.*, pages 5 and 6.

²⁶ In a letter to the 2001-2003 Tax Review Commission (included in the last two pages of the report), Lowell Kalapa, President of the Tax Foundation of Hawaii, argued that the Commission should consider reducing or eliminating the Corporation Income Tax, on grounds that it contributed little to the State's revenue, but that reducing the rate would "go a long way toward improving the attractiveness of Hawaii as a place to invest and do business."