



# State of Hawaii

## Tax Review Commission

### PFM Studies Kick-off Meeting

March 6, 2017

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PFM Group Consulting LLC

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## Discussion Topics

- Introductions
- Background: National Tax Policy Issues
- Proposed Project Approach
- Project timeline
- Project reporting
- Discussion



# Introductions



## PFM Project Team

**John Cape, Managing Director**, joined PFM in 2006. John has led multiple projects with the Commonwealth of Pennsylvania Governor's Office, Governor's Budget Office and Department of Public Welfare. His clients have also included the States of Delaware, Virginia and Minnesota. Prior to joining PFM, he served from 2004 to 2007 as Director of the Budget for New York State, overseeing a \$113 billion operating budget. John served in state government for more than 30 years.

**Randall Bauer, Director**, joined PFM in 2005. Randy leads the Management and Budget Consulting Practice related to tax and revenue policy and has led related projects for the States of Hawaii, Oklahoma, Pennsylvania and Washington as well as the Cities of Aurora, Baltimore, Colorado Springs and St. Louis. Prior to joining PFM, he was the State of Iowa Budget Director and spent nearly 20 years in state government in both the legislative and executive branches.

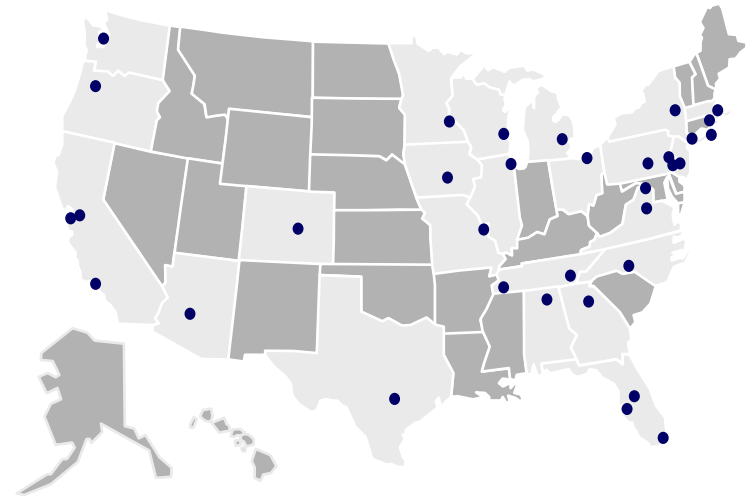
**Deanna Yocco, Senior Analyst**, joined PFM in 2015. Deanna provides quantitative, analytical, and research support for governmental performance improvement, including recent projects for the States of Illinois, Kansas and Oklahoma. Prior to joining PFM, she was a Budget Analyst at the University of Pennsylvania and a Budget and Management Analyst for the State of Ohio's Office of Budget and Management.



## About PFM

- PFM was founded in 1975 on the principle of providing sound, independent financial advice to state and local government;
- PFM's mission is focused on public sector excellence;
- The PFM Management and Budget Consulting group is a dedicated team of experienced professionals focused on the unique challenges of financial management in the public sector;
- MBC clients have included half the states, including Hawaii.

**PFM has over 600 professionals located in 35 locations nationwide**





# National Tax Policy Issues



# The Traditional 'Three Legged Stool'

- Individual income tax, sales and use tax, corporate income tax
  - Taxes various types of economic activity and outcomes
  - Paid by both the business and the consumer portions of the economy
  - Provides balance for pluses and minuses of each type of tax
  - Individual income tax 36.0 percent state level taxes, sales and use taxes 47.6percent, corporate income taxes 5.4 percent in 2014 (and declining)
- Key Issues
  - Diminishment of corporate income tax as a share of total state tax revenue
  - Erosion of the sales tax base
  - Volatility of the individual income tax
  - Federal tax changes' impact on major state taxes



# Trends in the Individual Income Tax

## ■ Recent Changes

- Rise of flat tax rates (8 single rate, 3 compressed brackets)
- Increase in 'millionaire brackets' (12 increased top bracket since 2009)
- Rethinking of exemptions and credits (multiple states formalized reviews)
- Concerns about volatility
- Consumption taxes as replacement in many states (see below)

## ■ Key Issues

- Rate cuts to spur economic activity (passed in Georgia, Kansas, Oklahoma, Ohio, North Carolina – proposed in Alabama, Maine, Michigan)
- Often done in conjunction with an increase in consumption taxes (Georgia, Kansas, Louisiana, Missouri, Nebraska, North Carolina)
- Federal deduction for state taxes – increase the effective cost of state income taxes





# Trends in Broad-Based Consumption Taxes

## ■ Sales, Gross Receipts, General Excise Taxes

- Economic/Demographic Erosion of the base
  - Changes in what we consume (tangible goods versus intangible goods and services)
  - Changes in how much we consume (older population consumes less)
  - Changes in how we purchase what we consume (electronic commerce)
- Legislated Erosion of the base

## ■ Current Issues

- Legislated economic nexus (42 bills introduced in 16 states, 4 enacted)
  - This is being litigated and will likely be decided by the US Supreme Court
  - Amazon appears to have 'thrown in the towel' (39 states through February 1, 2017), but still not Hawaii
- Taxing services continues to get legislative attention



## Trends in Business Taxes

- Corporate Income Taxes – the Incredible Shrinking Revenue Source
  - Highly volatile, susceptible to tax planning
    - Income apportionment
    - Ability to carry forward (and backward) for profits/losses and credits
  - Has become a much smaller percentage of overall collections
    - In many states, the traditional three factors (sales, property and payroll) for apportioning a business's share of profits to that state has been modified – generally to add extra weight to sales
    - States also provide a variety of specific exemptions and credits that can reduce taxable corporate income
    - Less interest of late in combined corporate reporting
  
- Alternate Forms of Broad Business Taxes
  - Gross receipts taxes (Primarily Ohio, Texas, Washington but some variants in other states)
  - Franchise tax, business privilege tax, individual business taxes



# Reinforcing the Legs of the Stool

- Individual Income Tax
  - Reducing exemptions and credits
  - Focus on tax incidence and impact
- Sales and Use Taxes
  - Legislated nexus for compulsory collection of sales tax on e-commerce sales
  - Broadening education/enforcement around payment of use tax
  - Broadening the base to include more services (particularly consumer purchased)
- Corporate Income Tax
  - Rise of gross receipts tax
  - Other ways to 'skin the corporate tax cat' such as unclaimed property



# Replacing Legs of the Stool?

- Excise Taxes

- Traditional 'sin taxes' such as tobacco, cigarettes and alcohol and newer levies on marijuana and sugary drinks
- 'Visitor taxes' such as hotel-motel (Hawaii's TAT), rental cars, events, parking

- 'User Fees'

- Motor fuel taxes (19 states increased in past four years)
- Tolls and similar charges

- 'Voluntary Taxes'

- Gambling (casinos, horse racing on and off-track betting, professional sports betting)
- Lotteries

- Federal Tax Changes Contain both Opportunities and Threats



# Project Approach



# Four Phase Project Approach

- 1. Planning and Project Management (largely complete)
  - Execute the contract
  - Provide a detailed information request
  - Schedule phone interviews with the members of the Commission
  - Schedule and hold a project kick-off
  - Schedule initial on-site meetings with stakeholders
  - Establish written project reporting process



## Four Phase Project Approach - continued

- 2. Information Gathering (underway)
  - Background research on Hawaii revenue issues
  - Completing the data request
  - Benchmarking peer governments
  - Conducting on-site interviews with key stakeholders
  - Conduct additional interviews with internal and external stakeholders
  - Follow-up Q&A as needed with subject matter experts and stakeholders
  - Develop financial models related to tax burden, regressivity and tax alternatives for use in the analytical and recommendations phases



## Four Phase Project Approach - continued

### ■ 3. Evaluation

- Weigh Hawaii-specific issues in relation to benchmark governments and best practice research
- Identify/analyze options and opportunities
  - Relationship to tax burden
  - Impact on regressivity
  - Impact on Hawaii revenue
- Evaluate opportunities for revenue generation through improved administration
- Weigh qualitative and quantitative factors for possible additional revenue
- Develop and communicate project high level findings





## Four Phase Project Approach - concluding

### ■ 4. Recommendations

- Develop and communicate detailed outlines for draft reports
- Finalize project models
- Draft, communicate and modify reports (as needed)
- Draft and submit final reports
- Assist the Commission, as needed, in communicating the final reports
- Assist the Commission, as needed, in drafting its final project report



# Project Timeline

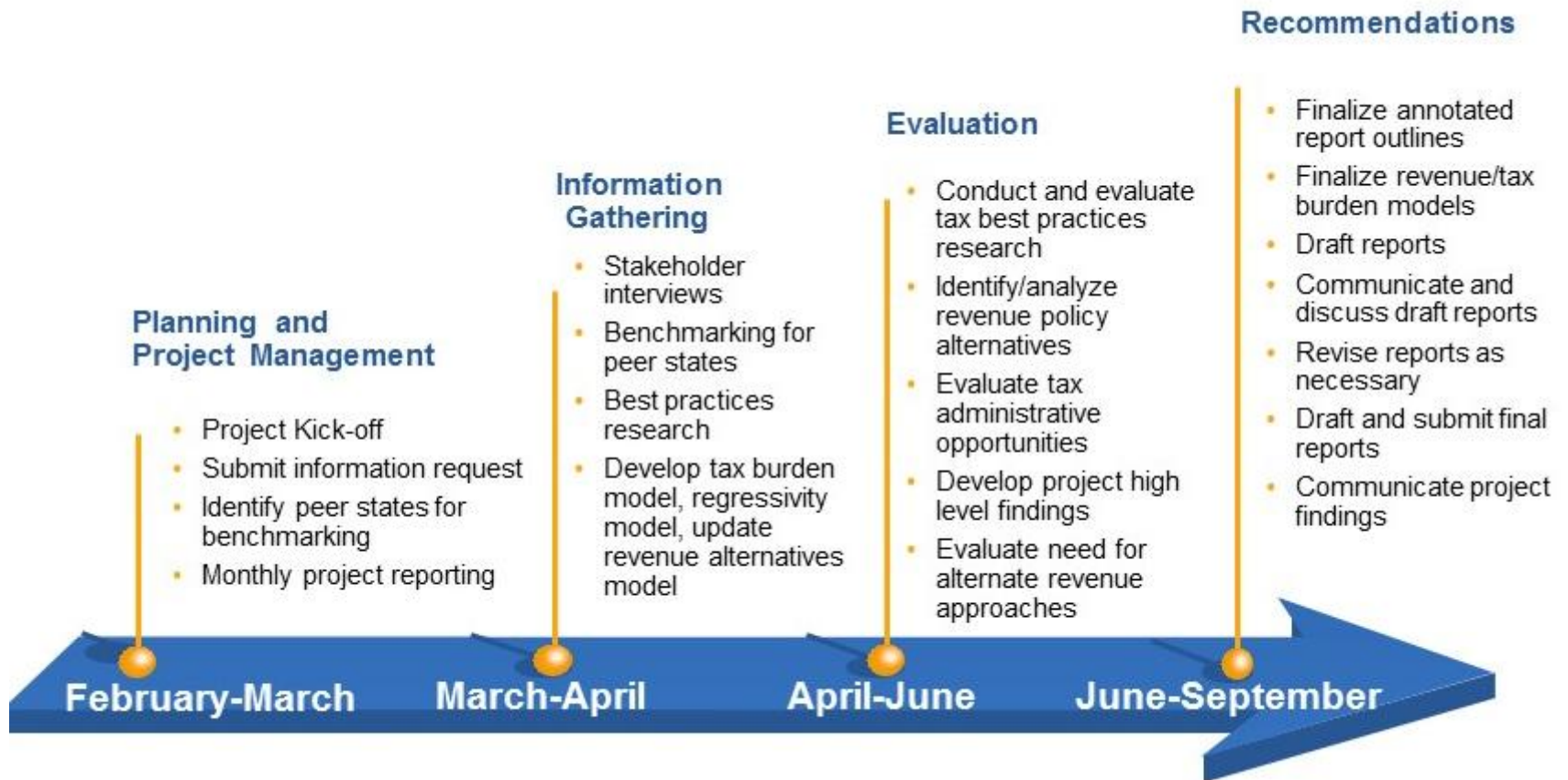


## RFP Required Milestones

Date	Description
1 <sup>st</sup> Week of February 2017	Contract Signed
2 <sup>nd</sup> Week of February 2017	Interviews TRC Members
3 <sup>rd</sup> Week of February 2017	Interviews Key Stakeholders
4 <sup>th</sup> Week of February 2017 or 1 <sup>st</sup> Week of March 2017	Attend TRC Meeting in Person to Discuss Project Plan and Strategy
1 <sup>st</sup> Week of August 2017	Draft Report Due
1 <sup>st</sup> Week of August 2017	Attend TRC Meeting in Person to Present Draft Report
1 <sup>st</sup> Week of September 2017	Final Report Due



# Project Timeline





# Project Reporting



# Project Reporting

- Twice-monthly written project reports
  - Activities during the reporting period
  - Planned activities for the next reporting period
  - Overall project calendar, with any identified revisions from the project plan
  - Issues in need of resolution to maintain satisfactory progress
  - Overall summary of project to date
  - Provided to all members of the Commission as well as the Department of Taxation Project Manager
  
- Participation in Commission meetings
  - Video or telephonic conference, webinar
  - Will present in person at the August meeting to present draft reports, findings and recommendations



# Recap

## ■ Project Status

- Activities are underway
- Project team is already engaged on information gathering and analysis
- Project team will be on-site the remainder of this week

## ■ Project Next Steps

- Subject matter interviews this week
- Data gathering and model development
- Regular feedback with State and Tax Review Commission stakeholders

## ■ Summary

- PFM has dedicated a senior, experienced project team for this effort
- The project team is excited by this important State effort
- State tax policy is at a critical juncture, both in Hawaii and nationally
- These studies can help advance the dialogue, locally and nationally



## Questions and Discussion

