

## **TAX REVIEW COMMISSION**

**MINUTES OF THE FIRST MEETING OF THE  
TAX REVIEW COMMISSION  
HELD AT 830 PUNCHBOWL STREET, ROOM 221  
IN THE CITY AND COUNTY OF HONOLULU  
STATE OF HAWAII, ON TUESDAY, JULY 26, 2005**

The Commissioners of the Tax Review Commission met at the Department of Taxation Director's Conference Room, in the City and County of Honolulu, State of Hawaii, on Tuesday, July 26, 2005.

**MEMBERS PRESENT:** Carolyn Ching, Isaac Choy, Christopher Grandy,  
Ronald Heller, Lon Okada, and John Roberts

**STAFF:** Tu Duc Pham, John Molay, Barney Wilson, and Lynne Farm

**OTHERS:** Yvonne Chow, DOTAX  
Craig Hirai, Bowen Hunsaker Hirai  
Ray Kamikawa, Chun Kerr Dodd Beaman & Wong  
Kurt Kawafuchi, DOTAX  
Titin Liem, DOTAX  
Johnnel Nakamura, DOTAX  
David Pendleton, GOV  
Gail Sasaki, DOTAX  
Tom Smyth, DBEDT  
Mary Ann Teshima, DOTAX  
Jayna Uyehara, DOTAX

### CALL TO ORDER

The meeting was called to order at 10:06 a.m. by Mr. Kurt Kawafuchi, Director of Taxation. (Note that a Commission Chair had not been elected yet.)

### COMMUNICATION TO THE COMMISSION

Mr. Kawafuchi introduced commissioners and staff. Dr. Tu Duc Pham, Tax Research and Planning Officer, and John Molay, Acting Rules Officer (patent attorney, former per diem judge, litigator), are the Commission's Co-Executive Directors. Technical Coordinator who will be assisting the Commission is Barney Wilson, Research Statistician of the Tax Research and Planning Office (TR&P). Lynne Farm is the secretary of TR&P and will be assisting the members with recording, scheduling, parking, reimbursements, etc.

Mr. Kawafuchi asked the members to introduce themselves to everyone. Lon Okada is Manager of Taxes from Hawaiian Electric Industries; John Roberts is a C.P.A./Principal with Niwao &

Roberts on Maui; Chris Grandy is a Professor in the Public Administration Program at the University of Hawaii at Manoa; Carolyn Ching is a C.P.A. with her own tax practice; Ron Heller is a practicing attorney with the Torkildson Katz firm and holds a C.P.A. license; Isaac Choy is a C.P.A./local practitioner from the Manoa Consulting Group.

Mr. Kawafuchi continued on with other members of the audience. Mary Ann Teshima is DOTAX's Administrative Services Officer and will be assisting with procurement and contracting out research studies; Titin Liem is DOTAX's special assistant and holds an M.B.A. in Finance; Tom Smyth is from DBEDT; Craig Hirai was the chairman of the 2001 – 2003 Tax Review Commission; Johnnel Nakamura is DOTAX's Administrative Rules Specialist; Ray Kamikawa is a former Director of Taxation; Yvonne Chow is a Research Statistician from TR&P; Gail Sasaki is a Research Statistician from TR&P; and Jayna Uyehara is DOTAX's Legislative Coordinator.

Mr. Kawafuchi welcomed everyone to the Tax Review Commission and looked forward to working with, supporting, and providing whatever help the Commission needs in fulfilling its duties.

#### DISCUSSION OF COMMISSION STATUTORY DUTIES AND AVAILABLE RESOURCES

Mr. Wilson distributed copies of Chapter 232E, which explained the Tax Review Commission's establishment, term, and primary duties.

The term of each member lasts until May 2007, which seems like a long way off; however, one of the most pressing matters would be to consider the type of studies the Commission is interested in and whether or not anything will be done by outside, independent studies. Decisions would have to be put in place by November, or at the latest, December 2005, in order for the studies to be completed by next summer 2006.

Basically, the duties are to conduct a systematic review of the State's tax structure using standards such as equity and efficiency. Thirty days prior to the convening of the second regular session of the 2007 legislature, a report is expected at that time. Any loose ends would need to be wrapped up a month or two prior to this date.

One of the most important things that the Commission needs to do today is discuss the resources available in terms of the budget, and previous recommendations could be reviewed. Another pressing matter is the consideration of a chair and vice-chair.

Mr. Kawafuchi reviewed what was discussed so far. The target date to print the report would be around December 2006. The previous Commission tried to have their studies completed by the preceding summer. The summers would work out well for professors if the Commission chooses to hire them to write the studies. Another item was a seventh member who has been recommended to the governor. As background information, during the last session, the deadline

to submit the names advanced, and while waiting for others to make their decisions, the deadline arrived so the seventh member was not named before the end of the session. The governor is aware of this and the well-qualified seventh member will be named in an interim capacity and will have to go through the confirmation process next legislative session.

The statute says thirty days before the legislature convenes; however, Mr. Heller noted that if we are to make any recommendations that the legislature enacts, then thirty days before the session is pretty late to put something on the table if it were to be considered in the 2007 session. We may want to think about trying to have anything specific in terms of proposed legislation ready by some earlier date. Mr. Kawafuchi agreed that DOTAX could provide the support and help with the drafting, yet it would help if it were prior to thirty days before the session. Dr. Pham added that if the Commission wanted to submit bills to the legislature, DOTAX could provide the Rules Officer to assist.

Mr. Heller asked if the Commission wanted to have it in the pipeline, would we need recommendations by August or September? Mr. Kawafuchi agreed that it would be a good idea to start thinking about it and we could start preparing drafts based on the Commission's recommendations. The Senate President is also interested in hearing the Commission's recommendations as early as next session. Mr. Choy asked if it would be part of DOTAX's admin bill. Mr. Kawafuchi responded that it does not have to be part of our admin bill; however, in terms of allowing enough time for it to be drafted and circulated, three or four months would be appropriate, if possible.

Mr. Grandy asked if it was common for the Commission to propose legislative measures. Mr. Hirai responded that typically, the Commission makes recommendations, though the report does not have specific bill language, just general principles. Mr. Kawafuchi added that the Commission is not constrained from making specific recommendations. The last four Commissions have recommended increasing the standard deduction. The present Commission is not precluded from saying that it should be either equal to the federal, half, or left as vague.

Dr. Pham added that any administrative bill needs to be approved by the administration. DOTAX has internal deadlines and usually starts drafting by October. The bills are reviewed by the Attorney General's Office for legal and constitutional issues and Department of Budget and Finance would want to review it for any budget issues.

Mr. Choy asked to whom the Commission reports. Mr. Hirai responded that it goes through the governor to the legislature.

Ms. Teshima then discussed the procurement process. For the research study, the process available for the Commission to use will depend on the dollar amount. If a particular study will cost less than \$25,000, then this falls under the small purchase procurement. A written scope of services of what the Commission wants the study to cover must be prepared, and a minimum of three written price quotations must be solicited.

If the Commission felt that the study would cost \$25,000 or more, then we first need to get the governor's approval to expend the money on this type of service. Second, the professional service procurement process requires that instead of describing the study itself, we need to identify the professional service (economist, accountant, etc.) or expertise that the Commission is interested in purchasing. The notice will be posted on the State Procurement website and would request that individuals or companies submit a resume that identifies their qualifications or a past study that they may have done. All of this information would then be given to a review committee appointed by the Director of Taxation. The committee would comprise, at a minimum, three individuals, who would need training or experience to meet the credentials to evaluate that type of service. After the resumes are evaluated, depending on the study, a selection committee would then rank the individuals/companies from 1 – 3 and give the list to the Director of Taxation, who would be the one to negotiate the contract. Anyone who participates in the selection or review committee would also need to sign an affidavit stating that there is no conflict of interest as far as serving in that capacity.

If the Commission decides to go with another government agency (University of Hawaii, etc.), then we would be able to skip the whole procurement process because we could go directly to the agency and negotiate a contract.

Mr. Heller asked what the difference was between a review committee and a selection committee. Ms. Teshima responded that in the area of professional services, DAGS (for example) would need services for engineers, so they would solicit for this type of service, and as projects come up, they would put together the selection committee. However, in the Tax Review Commission's case, the review committee and selection committee can be one and the same.

Mr. Heller then asked how long the whole process usually takes. Ms. Teshima responded that it could take two weeks, but emphasized the fact that DOTAX be given adequate notice. Mr. Hirai mentioned that for a small purchase, from the time the Commission solicited the three quotes to the time the contract was signed, it took about two months. Ms. Teshima added that for a study that costs \$25,000 or more, it could take a couple of months because other items required for this type of contract from the individuals/companies are: 1) Tax Clearance certificate from the Department of Taxation, 2) Certificate of Good Standing from the Department of Commerce and Consumer Affairs, and 3) Certificate of Compliance from the Department of Labor (unemployment insurance, etc.).

Discussion ensued on the Tax Review Commission's proposed budget. Dr. Pham reviewed the list. Staff consists of two co-executive directors, a technical coordinator, clerical, and we may request for another research statistician. The Commission may want to propose that something be done in-house since DOTAX has the expertise, especially to price the tax expenditures in the general excise and income tax laws, using SAS programs. Approximately \$60,000 is projected; however, if we can hire from in-house, the fringe benefits might be paid for by the Department of Budget and Finance. Airfare will be provided to Mr. Roberts; office supplies may include a laptop computer; and postage and telephone are minimal. The big item is \$80,000 for the studies. In case we hire someone from the Research Corporation of the University of Hawaii

(RCUH), we need to pay them 6%; however, this is a much faster way to hire help. Also, the Tax Research and Planning Office and the Rules Office will donate a lot of time and resources.

Mr. Roberts asked for guidelines on what the blended or average rate would be if we use in-house resources. Mr. Kawafuchi asked Ms. Teshima to compute the rates. Mr. Kawafuchi asked what type of statistics were done for the last Commission. Mr. Hirai responded that three studies were done, however, nothing in-house.

Mr. Kawafuchi suggested the following as possible studies: 1) The income profile for the resident population (How many married people are making \$50,000 or greater, etc. According to DOTAX's latest 2002 study, almost 60% of the total population made \$40,000 or less in federal AGI.); and 2) The profile of those claiming credits (by marital status, demographics, etc.). The federal government gives DOTAX a database of those with Hawaii mailing addresses, and DOTAX would crosscheck it against their system filing to confirm that they are filing Hawaii resident returns to see the true resident population.

Dr. Pham mentioned that the latest DOTAX annual report is for fiscal year 2003-2004, and that his office is in the process of compiling the 2004-2005 report, which will be done by December. He also plans on updating the tax revenue data to be distributed at the next Commission meeting.

Ms. Liem suggested that the members receive copies of the latest available tax reports (Hawaii Income Patterns for Corporations and Individuals). Mr. Wilson mentioned that these statistics can be found on DOTAX's website, which he had emailed to all members, along with the links to the previous two Commission's reports. Mr. Smyth added that if anyone needed information from the Census Data Center which DBEDT manages, they constantly have new data coming in.

Mr. Choy asked if the administration had any specific or general areas they would like the Commission to look at. Mr. Kawafuchi responded that the Commission is supposed to be an independent group, though the administration is available for support. As a Commission, the members need to come up with their own recommendations. Dr. Pham mentioned Representative Glenn Wakai's request in which he expressed interest in the tax expenditure area. The House is interested in what they are getting for all the money they are spending on credits, exemptions, etc. Mr. Choy asked for the administration's standpoint. Mr. Kawafuchi responded that, in the past, DOTAX has tried to deal with abusive preparers/tax shelter promoters, and conformed to the federal laws.

#### REVIEW OF 2001-2003 COMMISSION RECOMMENDATIONS

Mr. Hirai reported that the previous Commission started out by discussing the principles of sound tax policy to get a sense of the overall philosophy of the Commission. It took several meetings to review the annual reports and familiarize everyone with the existing tax base. To try to establish the overall philosophy is what every Commission has to do for itself. You may or may not reach a consensus. Without an overall philosophy, it is hard to go to the next step,

which is the studies and recommendations of specific issues to be addressed. There are certain time and resource limits available. The prior Commission worked back from the actual due date of the report, which meant that the reports needed to be done by the end of summer, and the contracts needed to be signed in the spring, which meant that by fall, you needed to come up with an overall philosophy. A helpful hint would be that the group needs to budget backwards and keep to their timetables.

With respect to the specific recommendations and analysis, the first study was on the Streamlined Sales Tax Project (SSTP), which referred to H.B. 1224, and required DOTAX and an as yet to be appointed advisory council of six people (three appointed by the House Speaker and three appointed by the Senate President) who are supposed to come up with something by August 1. To date, the six people have not been appointed. The SSTP is an administrative program to collect use taxes at the source, and will have a lot of impact in the general excise and use tax area. The present Commission may want to get together with the coordinator of that group to familiarize everyone with the issues.

Mr. Choy asked about the principles of sound tax policies. This was what the previous Commission adopted; however, what was the dissenting opinion on this? Mr. Hirai responded that there wasn't necessarily a dissenting opinion; it referred to the statutory or constitutional charge of fairness and equity. Fairness and equity to one Commission may not be fairness and equity to another Commission. The prior Commission started with trying to understand the annual report and the existing tax base, the revenue needs of the State, and the fairest and most equitable way to raise money that was necessary. This Commission is not bound by what prior Commissions did.

Implementing is where the studies come in. How the Commission prioritizes the studies has a lot to do with the overall philosophy. The prior Commission looked into business incentive credits, the overall process, the accountability with respect to general excise tax by limiting exemptions and credits, reducing the tax on business-to-business transactions, rewriting the general excise/use tax law to achieve transparency and clarity, and taxation of non-profit corporations by lowering the administration compliance in that area. Every Commission looked at increasing the State's standard deduction to the federal amount, increasing the State's personal exemption amount, widening the marginal tax brackets, increasing federal conformity, and conforming to federal filing deadlines.

Mr. Hirai also mentioned that the previous Commission did a study on taxation of retirement income, concerned that the tax base would narrow as more and more people retired. The study looked at the types of retirement vehicles people used and the result was unexpected. A lot of the current retirement vehicles are subject to state tax, so the revenue base was not going to shrink that dramatically.

The State's transfer tax was reviewed which, as of this year, no longer exists.

Other items reviewed were the state Estate Tax Credit, conducting out-of-state tax audits, revenue sufficiency for future needs, enhancement of research modeling capabilities with the cooperation of DBEDT, overhaul and update the capital goods excise tax credit, and corporate income tax revenue trends which were steadily decreasing four years ago.

Mr. Heller was interested to see how much of the corporate income tax we actually received from local closely-held corporations versus multi-state taxpayers. He felt that we may be getting the real dollars from the multi-state taxpayers who have to apportion income to Hawaii.

Mr. Choy asked if the items discussed from the previous Commission were prioritized to a set amount due to lack of budget or time, or if they were inclusive of everything brought to the table. Mr. Hirai responded that for the income tax, the Commission agreed to follow the prior Commission recommendations. They commissioned the study on retirement income because they were interested in that issue.

Mr. Choy asked if the sources of these projects came from the public, practitioners, or government. Mr. Hirai responded that it mostly came from the Commission members.

At this point, Mr. Molay reported on the State's Sunshine Law and distributed handouts to the members. The law comes under Chapter 92, requires that all meetings be public, and precludes members from getting together outside of the public view, which includes one-on-one meetings where details are passed on from one member to another. Exceptions to this rule would be in the case of an executive meeting where personnel matters are discussed, if a board attorney is giving attorney-client advice to the members, etc. Mr. Molay encouraged the members to attend the Office of Information Practice's (OIP) board member training to be held sometime in September 2005. The law also requires that there be certain notices given to the Lieutenant Governor's office six calendar days prior to the scheduled meeting. The notices must be posted at the meeting place and agendas must be sent out to the public who request for it ahead of time. The minutes are available to the public when requested. Mr. Molay welcomed any questions the members may have on the subject.

Mr. Hirai mentioned that the prior Commission's meetings were not heavily attended and there were no executive sessions held.

Mr. Kawafuchi added that the Attorney General's Office has an Administrative Division which advises boards and commissions.

With respect to the definition of communicating about board business, Mr. Heller mentioned that he had circulated an email to members with an article that he found interesting. Does this constitute "communicating about board business"? Mr. Molay stated that this does not fall into the parameters of the Sunshine Law.

Mr. Smyth added that legislation passed this year clarified that two board members can at anytime talk about board issues as long as they are not soliciting a vote. Also, if the board goes

to the legislature to testify, going together as a group does not constitute a meeting which has to be noticed.

Mr. Grandy asked if the prior Commission met on a regular basis. Mr. Hirai responded that they met on a monthly basis, with a break in the spring or summer while the studies were being written. Another area which the prior Commission did not look into was addressing local county-level taxes (real property, fees, assessments).

Referring back to the Sunshine Law, Mr. Choy asked for clarification on sending emails. Mr. Molay responded that it depended on the nature and purpose behind sending the email. If it is just circulating an interesting article, then this is okay. However, it is not okay if someone is trying to solicit a vote or doing something that would normally be conducted at a meeting.

Mr. Choy asked what happens if a member wants something put on the agenda. Mr. Molay responded that you don't have to have a meeting to put something on the agenda as long as the item is discussed at the meeting.

Mr. Smyth mentioned that he has board members send items that they want to be distributed to staff and staff will send them out. This avoids the person-to-person contact. Members would send agenda items to the Chair, who will then make up the agenda. Mr. Kawafuchi mentioned that DOTAX is preparing a list of contact persons; however, Mr. Wilson or Ms. Farm would be the ones to send items to.

In responding a question, Mr. Smyth reported that investigative sub-groups would be designated through a resolution at a meeting, and the sub-groups can meet and report back to the group at a meeting to be accepted or not. Also, the sub-groups cannot constitute a quorum.

Mr. Roberts asked why more recommendations were not adopted and how the current Commission could do better. Mr. Hirai responded that historically, TRC recommendations are not adopted immediately. A lot of the de-pyramiding in the 1989 report was adopted ten years later. The TRC's priorities may not be the same as the legislature's priorities.

Ms. Ching asked what types of feedback were received from the various sectors after the report was published, and if there were any written letters and comments. Mr. Hirai responded that there was none that he could think of. The Commission submits the report to the legislature (House Finance Committee and Senate Ways and Means Committee) at a formal hearing and answers any questions the committees may have.

Mr. Heller asked if, prior to issuing the final report, there is a process of putting out an exposure draft for people to comment on. Mr. Hirai responded that as a practical matter, there is a time constraint. By the time the study is done, it takes one to two months to write the initial draft, at which point there is not much time to circulate it before it has to be finalized. It is hard to write the report while the studies are being done.



Mr. Kawafuchi asked Mr. Kamikawa to share his experience as to who actually read the TRC report when he was Director of Taxation. Mr. Kamikawa responded that not too many people read it. He recommended that the current members read all prior Commission reports and come up with their own ideas. Mr. Kawafuchi mentioned that the governor and he will definitely read it, and others will at least look at the recommendations. Mr. Hirai added that, at times, members of House Finance and Senate Ways and Means would sit in on the meetings.

Mr. Heller felt that the Commission may have a different political dynamic this time around with a Republican governor. It may make more of a difference if an “independent commission” recommends something when trying to make the administration and the legislature agree.

Mr. Smyth mentioned that people often cite the Commission’s recommendations in the bills that they present perhaps to add some weight. Mr. Wilson agreed and felt that even though there is sometimes a significant delay before you see any results from your recommendations, very frequently the recommendations are incorporated into bills. They may not get very far, however, frequently the recommendations do appear in acts.

#### CONSIDERATION OF CHAIR AND VICE-CHAIR CANDIDATES

Dr. Pham opened discussion for the election of a Commission Chair and Vice-Chair.

Mr. Roberts proceeded to nominate Mr. Choy for Commission Chair, with Mr. Grandy seconding. Mr. Roberts felt that Mr. Choy has the ears of some key policymakers at the capitol. If the current Commission just does half as good a work as the last one, they will provide a big contribution. He also felt that the Commission should not be concerned about creating such a polished product; it is more important to get people to act upon it. The motion passed.

Mr. Choy thanked everyone and stated that his whole objective was that because everyone’s time was valuable, he wanted to make sure that members’ suggestions were heard and duly reviewed. He requested input from the public and practitioners, so he wanted the members to communicate this to the different organizations which each member represents. He wanted to set up dialogue with people who may implement some of the Commission’s policies to make sure that we were not wasting our time. He admitted that he was probably the weakest tax person in the room, so he was willing to listen to what everyone had to say.

Mr. Choy proceeded to nominate Mr. Heller for Commission Vice-Chair, with Ms. Ching seconding. Mr. Choy felt that Mr. Heller is very valuable, his expertise is very needed, and he would be a great vice-chair. The motion carried.

### SCHEDULE NEXT MEETING

The next meeting was scheduled for Tuesday, August 16, 2005, at 10:00 a.m. It was agreed that all future meetings would be held on the third Tuesday of each month at 10:00 a.m., in the Director of Taxation's conference room. Ms. Ching mentioned that she was unable to make the next meeting.

Mr. Smyth reported on the President's Advisory Panel on Tax Reform, which has been meeting since February. DBEDT has compiled all meeting notes, Power Point presentations on the federal tax code, and the Impact on State and Local Taxes of changes to the federal tax law. They looked at fairness, equity and complexity. They made major changes, such as going to a consumption tax. If they make other changes, they may knock out deductions for municipal bonds, which would really affect states and local government. Things of this nature, piece by piece would have a big impact on states even if they don't change the structure of the system. He presented all this information to the Commission and DOTAX to review. He extracted the session on state and local impacts of federal changes, as well as verbatim transcripts of four of the meetings. He also extracted the last meeting of July 20, 2005, which summarized the various issues covered. All of the materials were also online. The final report is due on September 30, 2005.

Mr. Choy asked all members to read the Principles of Sound Tax Policy and prior Commission reports before the next meeting. He asked that everyone make lists of other new issues they want discussed.

Mr. Grandy mentioned that in view of the procurement issue, if anyone has any ideas on studies, the Commission should start getting those on the table as soon as possible.

Mr. Kawafuchi presented a list of contact persons, along with phone numbers and email addresses. For those who need parking, Ms. Teshima stated that we would need to get automobile information to create a parking placard.

### ADJOURNMENT

There being no further discussion, the meeting was adjourned at 11:30 a.m.