TAX REVIEW COMMISSION

MINUTES OF THE SIXTEENTH MEETING OF THE
TAX REVIEW COMMISSION
HELD AT STATE CAPITOL, ROOM 211
IN THE CITY AND COUNTY OF HONOLULU
STATE OF HAWAII, ON TUESDAY, AUGUST 29, 2006

The Commissioners of the Tax Review Commission met at the State Capitol, Room 211, in the City and County of Honolulu, State of Hawaii, on Tuesday, August 25, 2006.

Members Present:
Chairman Isaac Choy, Manoa Consulting Group, LLC CPA's
Vice-Chairman Ronald Heller, Torkildson Katz Fonseca Moore & Hetherington, AAL, ALC
Carolyn Ching, Carolyn L. Ching CPA
Christopher Grandy, UH Manoa, Public Administration Program
Melanie King, Bank of Hawaii
Lon Okada, Hawaiian Electric Industries, Inc.
John Roberts, Niwao & Roberts, CPA's

Staff: Tu Duc Pham, Donald Rousslang, Cathleen Tokishi, Dana Remigio

Other:
Kris Arakaki, DOTAX
Stephanie Beran, DOTAX
Suzanne Efhan, DOTAX
Diane Erickson, Dept. of Attorney General
Peter Fritz
Craig Hirai, Bowen Hunsaker Hirai
Lawrence J. Holbrook, CCH Inc.
Lowell Kalapa, Tax Foundation of Hawaii
Ray Kamikawa, Chun Kerr Dodd Beaman & Wong
Kurt Kawafuchi, DOTAX
Ross Kawano, Erwin Cabrinha & Au, LLP
Roger Kim, House Majority Staff Office
Johnnell Nakamura, DOTAX
Marilyn Niwao, Niwao & Roberts, CPAs
Ronald Randall, DOTAX
Curtis Saiki, Cades Schutte & Hawaii State Bar Association Tax Section
Brian Taniguchi, State Senate
Nicki Thompson, Governor's Policy Office
Russell Yamashita

CALL TO ORDER

Chairman Isaac Choy called the meeting to order at 9:00 a.m. with a quorum present. The Chairman thanked all the attendees for their presence and asked for their indulgence while the Commission dealt with other matters before discussing the Streamlined Sales and Use Tax Agreement that most attendees were there to hear.

APPROVE MINUTES OF JULY 25, 2006, MEETING

The Chairman called for any corrections or additions to the minutes; there were none.

<u>It was moved by Mr. Roberts and seconded by Ms. Ching to approve the minutes of July 25, 2006. The motion carried without opposition.</u>

ANNOUNCEMENTS

<u>External studies and special meetings.</u> As noted on the agenda, Dr. William Fox will present the findings of external studies 1 and 3 on Friday, September 22, 2006, at 1:30 p.m. in the Director's Conference Room, Room 221 of the Princess Ruth Keelikolani Building, and Dr. Marcia Sakai and Dr. Bruce Bird will present the findings of external study 2 on Friday, October 6, 2006, at 1:30 p.m. in the Director's Conference Room. The results of the external studies will be evaluated at the September meeting after the preliminary reports are due, and again at the October meeting after the final reports are due.

<u>September meeting.</u> The Commission will provide the results of its work on the internal study on recommendations made by past Commissions, and will also review a preliminary draft of the Commission's report.

CONSIDER WHETHER HAWAII SHOULD ADOPT THE STREAMLINED SALES AND USE TAX AGREEMENT

The Chairman first asked if any of the attendees wanted to testify; only Mr. Kawafuchi, Director of Taxation, asked to testify. The Chairman stated that testimony time limits were unnecessary. He added that the other attendees may freely comment, but asked that they state their name, the organization or firm that they represented, if applicable, and their position in that organization or firm before offering their comments.

The Chairman invited Director Kawafuchi to testify and asked that he also provide a brief introduction to the Streamlined Sales Tax Agreement. Ms. Nakamura, the Department of Taxation's Rules Officer, and Ms. Efhan, the Department of Taxation's Administrative Services Officer, joined Director Kawafuchi at the table.

Director Kawafuchi stated that he recognized that this is a hot topic amongst the states, and explained that the Streamlined Sales Tax Project was an effort on the part of states and businesses to address use tax collections on Internet sales and sales by remote sellers.

The collection of use tax is a challenge for states because states can't tax businesses unless the businesses have sufficient presence to acquire nexus in the state. The landmark case is *Quill Corp. v. North Dakota*,[1] which involved catalogue sales. The result is that many remote sellers are not required to pay sales/use taxes to the states. There is one Hawaii case: *Baker & Taylor, Inc. v. Kawafuchi*.[2]

The Streamlined Sales Tax Project is a voluntary program in which remote sellers collect from consumers the use taxes owed to the states. Currently, there are 13 member states in full compliance with the Streamlined Sales Tax Agreement. Several others are poised to obtain full compliance; Tennessee is scheduled to be in full compliance by mid-2007 and Ohio by 2008.

The retail industry has supported the Streamlined Sales Tax Project in the past because it would level the playing field between local and remote sellers. A recent study by Dr. William Fox cited a Washington State study that estimated that states should expect 20% of the uncollected use tax to be remitted, but that left 80% uncollected, at least in the short term.

The Department has found that there is substantial compliance with the use tax by businesses, but low compliance on the household side. This is consistent with the experience of other states across the country, so participation should result in an additional, though limited, revenue source for member states.

To entice businesses to voluntarily collect state taxes, amnesty is offered. That is, states must offer participating companies amnesty from the assessment of taxes that may have been due in past years. This would be especially important to companies that operate in the gray zone in which states claim that the company has nexus while the company says that it doesn't. Examples include some big record stores and bookstores that have affiliates that sell over the Internet and may have nexus here. The California Board of Equalization litigated and prevailed in a couple of cases in which the store handled exchanges and advertising for affiliates.

Companies would also be compensated for collecting the tax under 3 of the 4 choices.

Hawaii's compliance with the Streamlined Sales Tax Agreement is problematic because Hawaii's general excise tax is unique. The general excise tax is not the same as sales taxes, which in most cases only apply to retail sales and which traditionally only apply to tangible personal property, though some states have changed. Sales taxes also don't pyramid whereas the general excise tax does.

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[1] Recorder's Note: 504 U.S. 298

[2] Recorder's Note: 103 Haw 359

The Streamlined Sales Tax Agreement also requires states to have only one rate, but Hawaii also has the 0.5% wholesale rate and the 0.15% rate on insurance commissions. Therefore, legislation is needed to carve out the 4% rate from the rest, and separate forms for the 4% rate will also be required, because forms must be uniform.

The legislation will also need to resolve differences in sourcing transactions. For example, the Streamlined Sales Tax Agreement taxes services at the place of first use. If a client visits Mr. Heller's office on Oahu for a Maui case, the transaction will be taxed on Oahu. This is contrary to existing Hawaii rules that source the gross income to where the services are rendered. The place of first use rule has been the subject of much discussion by the mainland states where it is easy to cross state lines. It would, for example, make more sense for a truck to start in a low-tax state and end in high tax state. If a mortuary picks up a body in one state for a funeral in another state, is the transaction sourced to the state where they picked up the body?

By complying with the Streamlined Sales Tax Agreement, the State gives up complete autonomy with respect to the imposition of the general excise tax.

The Department has been carefully following these discussions and is interested in what the bigger states do, though many of them have not yet joined. The Department has also been waiting to see if Congress will enact legislation to require remote sellers to collect the tax, which it seems unlikely to do in 2006, or if the Supreme Court will overturn *Quill*.

Director Kawafuchi concluded his initial comments by stating that he did not think that the costs of conforming to the Streamlined Sales Tax Agreement are justified by the potential $10.3 million in revenue that Dr. Fox estimated.

Ms. Nakamura added that, regardless of the number of businesses that choose to participate, the State would be required to maintain a GIS zip code database and provide a checklist to the Streamlined Sales Tax Governing Board to certify compliance.

Director Kawafuchi noted that participation by businesses is voluntary and that Amazon and eBay, two of the largest Internet sellers, don't plan to join.

Ms. Nakamura stated that the organizers had initially thought that the number of participating states would be higher, but the anticipated groundswell didn't happen. Participating states are mostly in the Mid-western region.

Ms. Efhan was called upon to present preliminary cost estimates. Her preliminary estimates to implement the Streamlined Sales Tax Agreement (based on implementing both the Streamlined Sales Tax Agreement and the county surcharge at the same time) were that the initial first year start-up costs would be $15.4 million, of which $8.2 million is for vendor payments for computer system upgrades and $7.2 million is for Department costs for postage, printing, equipment, GIS zip code database, outreach, and other operational costs. In subsequent years, the recurring annual costs to the Department would be $4.2 million.

Mr. Roberts commented that, as a CPA, he understands the impact of the general excise and use taxes on business-to-business transactions. He then asked if, given that Hawaii's taxes are exported to tourists to some extent, the Department had an opinion on the impact of the streamlined sales tax on the exporting of those taxes. Director Kawafuchi stated that he thought that about 20% was exported, but Dr. Pham and Dr. Rousslang stated that their recent work indicated that a relatively high 37% is exported, though the 37% includes amounts “exported” to military personnel who pay it here when businesses pass it on, and not just to tourists. However, Dr. Rousslang stated that the Streamlined Sales and Use Tax Agreement wouldn't have much actual impact.

Mr. Roberts also asked about the cost of implementing the Streamlined Sales and Use Tax Agreement given recent discussions about whether the State's current system costs too much to administer. He asked if the costs, given our size, would be too much; the general consensus was that it would be.

Ms. Ching asked how the general excise tax on services would be affected. Director Kawafuchi stated that the tax on services provision would remain in the same chapter, but that the rules would have to be changed to tax it according to the place of first use.

Mr. Heller noted that the issue is whether to source transactions based on destination or origin, and that there is some disagreement amongst the states. Mr. Kawafuchi added that Texas and Ohio wanted to control in-state sales differently than intrastate sales, and had asked the Governing Board if the Streamlined Sales and Use Tax Agreement could be amended to do this but they were denied. This is one reason why Ohio's implementation was delayed until 2008. He also noted that states that generate a lot of commerce, such as California, would like tax collections to be origin based.

Mr. Kalapa stated that his biggest concern was that many of the proponents of the Streamlined Sales and Use Tax Agreement fail to appreciate the differences between the general excise tax and sales taxes. If the State is to completely rewrite the law, he fears that the administrative and compliance costs for both the State and businesses will be higher than currently thought. If the State wants to implement the Streamlined Sales and Use Tax Agreement, perhaps they should also consider exempting business-to-business transactions. Noting that Dr. Fox's study addresses these issues, Mr. Kalapa stated that he is most concerned about the tax treatment of services, and offered as an example the current situation regarding the sourcing of commission income for purposes of the county surcharge tax citing problems and differences in the taxation of travel agent and real estate commissions.

Mr. Roberts observed that Department estimates $15.4 million in start-up costs and $4.2 million annually in subsequent years, while Dr. Fox’s estimate of what could be collected was only $10.3 million. Therefore, even if the State collects the full $51.7 million of uncollected Hawaii tax on e-commerce that Dr. Fox estimates, it doesn’t make sense to go through all this trouble for that relatively small amount of potential revenue.

Director Kawafuchi confirmed that, at present, the sourcing rules for services are different under the Streamlined Sales and Use Tax Agreement (place of first use) and the draft county surcharge rules (where services are used or consumed).

Mr. Heller noted that there were four possible scenarios if he were to write a will for a client located in Hilo:

- Mr. Heller could meet the client in Hilo and then return to Honolulu to write the will.
- Mr. Heller could meet the client in Hilo and write the will there.
- Client could call Mr. Heller and Mr. Heller could write the will in Honolulu.
- Client could visit Mr. Heller in Honolulu and Mr. Heller could write the will in Honolulu.

While the draft county surcharge rules would source this transaction according to where the services are provided, a similar series of transactions involving a remote service provider may differ depending on what the Streamlined Sales and Use Tax Agreement says.

The Chairman asked Mr. Randall, the Department's Compliance Division Chief, if the Streamlined Sales and Use Tax Agreement could be enforced. Mr. Randall stated that his staff would have to, but that it would be difficult.

Ms. Nakamura pointed out that these audits would be done nationally. However, Mr. Randall noted that the added complexity would result in higher audit times and costs.

Dr. Grandy noted that states would have to adopt a uniform rate though not the same rate as that in other states, but questioned whether states would be able to maintain their own internal definitions. Ms. Nakamura stated that the State's current definitions would have to be changed to conform to the definitions in the Streamlined Sales and Use Tax Agreement. Director Kawafuchi added that, while some definitions could be more restrictive, other definitions would expand the State's current definitions. The Streamlined Sales and Use Tax Agreement definition of a prosthetic device, for example, would expand the current Hawaii definition.

Dr. Grandy clarified that, what he intended to ask was whether certain gross definitions could be retained, for example whether services could remain as part of the tax base.

Director Kawafuchi and Ms. Nakamura stated that the State could determine what types of income were taxable, but that the State would have to adopt the Streamlined Sales and Use Tax Agreement definitions.

Mr. Holbrook added that, when defining services or tangible personal property, the Streamlined Sales and Use Tax Agreement identifies individual items and transactions. There is a taxability matrix and the tax base doesn't change although the definitions do. As a result, Hawaii could go forward with the Streamlined Sales and Use Tax Agreement and keep its tax base but there would eventually be common rules such that someone would get the tax.

The Chairman asked who would do all the work collecting and administering the tax.
Mr. Holbrook stated that the states would provide the zip code matrix, but that there currently are 3 companies that offer software to companies to use for purposes of the Streamlined Sales and Use Tax Agreement. The Governing Board compensates the software companies; these fees and the fees for businesses to collect the tax have not yet been determined.

The Chairman asked who is to be compensated. Mr. Kalapa noted that software companies are compensated out of the states' revenue stream. According to Ms. Efhan, this expense is unknown and therefore not included in the Department's cost estimates.

Dr. Grandy asked Director Kawafuchi if the amnesty provision would prevent the State from actively pursuing a business for taxes that should have been paid and the amount of revenue that may be forgiven due to amnesty.

Director Kawafuchi pointed out that amnesty doesn't cover companies that have already been notified of an audit.

Dr. Grandy asked how much revenue Hawaii collects in these kinds of situations. Director Kawafuchi's guess was $10-$30 million; Mr. Randall didn't know.

Mr. Heller asked how much use tax was collected in these types of audits. That was unknown, but Director Kawafuchi stated that it was not just the use tax, but the general excise tax too, and pointed out that the Department had one walk-in last year that resulted in a $10 million payment.

Mr. Roberts asked if the Streamlined Sales and Use Tax Agreement applied to transactions external to the United States. Director Kawafuchi stated that it did not apply to remote sellers outside the United States. Mr. Roberts then asked if this agreement theoretically encouraged businesses to relocate outside the country.

Dr. Grandy stated that much of what he had been hearing was about the difficulty of transitioning to something we're not sure of, especially transition cost issues. He asked whether it would be more desirable to have a multi-state compact for these kinds of transactions than not if the State could find a way to resolve the transition issues.

Director Kawafuchi stated that, if Congress mandates the collection of tax or if 40 states adopt the Streamlined Sales and Use Tax Agreement, then it would be worth it, but not now.

Mr. Kalapa noted that it would be easier to let the federal government take over the sales tax and then distribute the funds, and that there had been discussion in Congress as to whether they should be involved or not.

Director Kawafuchi stated that it would be easier if Hawaii had a sales tax. Mr. Kalapa commented that this supported his point regarding the general excise tax not being a sales tax and the difference not being appreciated.

Mr. Roberts stated that the real rate of the general excise tax should be debated. There is a lack of transparency in our political system as to how much tax the customer is actually paying. One advantage of the Streamlined Sales and Use Tax Agreement is that it may make it more transparent.

Mr. Heller noted that Internet sales are currently growing, but that it must at some point reach a peak and level out. In addition, some things, such as eggs and milk, will not be bought over the Internet. With that in mind, he asked what the potential tax base is. Dr. Pham didn't have a figure but thinks Dr. Fox did.

Mr. Okada asked how the businesses are to be compensated. Mr. Kalapa stated that it would not be based on actual costs, but pennies per dollar or a percentage. He also noted that this would hurt small businesses that have higher fixed costs.

However, Director Kawafuchi noted that the participation by businesses was voluntary.

Ms. Ching asked if each state represented on the Governing Board had only one vote.
Ms. Nakamura affirmed that it was one state, one vote, but noted that California, as a large state, would like this changed. She added that there also was an advisory committee of associate members. Utah was a founding state and they withdrew last spring. Tennessee also has delayed their entry due to local sourcing issues. Director Kawafuchi stated that there were about 20 participating states.

Mr. Kalapa stated that there was a question about what a business' liability would be, and that 1099 forms may be a possibility.

The Chairman asked what Hawaii's status was with respect to the Streamlined Sales and Use Tax Project. Ms. Nakamura stated that Hawaii is a participating state. Director Kawafuchi added that Hawaii is allowed to participate in the discussions but has no vote. Senator Taniguchi stated that it appeared to be a case of close but no cigar. However, Ms. Niwao asserted that Hawaii is a participating state, although the Chairman stated that if Hawaii has no vote, as stated by Director Kawafuchi, it would appear that Hawaii is merely an observer state and has no standing.[3]

The Chairman asked those present if there was general agreement that the amount of revenue lost by not fully participating in the Streamlined Sales and Use Tax Agreement was not an earlier $200 million projection by Dr. Fox. There was general agreement.

Mr. Holbrook reiterated that it is the consumer use tax that is being missed. For participating vendors, it would be a business use tax.

The Chairman stated that Dr. Fox said that businesses have a high compliance rate.

[3] Recorder's Note: Information on the Streamlines Sales Tax Project website lists Hawaii as a participating state, rather than an observer state. However, Hawaii is not listed as either a full or associate member state of the Streamlined Sales Tax Governing Board.

Mr. Randall pointed out that the cost to audit individuals was high given the difficulty of tracking their purchases.

The Chairman asked those present if there was general agreement that the amount of revenue lost by not fully participating in the Streamlined Sales and Use Tax Agreement was not $100 million, noting that Dr. Fox's study said that there was roughly $50 million in unpaid tax with the probability of collecting $10 million under the Streamlined Sales and Use Tax Agreement.

Mr. Heller reiterated that the $50 million is the entire amount and that it is totally different from what the State would get under the Streamlined Sales and Use Tax Agreement.

Ms. Niwao pointed out that, unlike the past when few, if any, out-of-State sellers would charge Hawaii's tax on purchases shipped to Hawaii, many more of them now have nexus in Hawaii and are therefore charging Hawaii's 4% tax. An example is Macy's. Currently, it is only some of the more "fringe" sellers that are not already paying Hawaii's tax.

Mr. Roberts added that Hawaii's population is only about 1.25 million people, such that the figure of $10.3 million of additional revenues still appears high when you think about it on a per capita basis.

The Chairman asked if the State was in fact chasing negative revenue given that the cost of compensating the businesses is not included. Ms. Ching stated that only the initial costs were high, with the annual cost dropping to $4.2 million later. However, Director Kawafuchi noted that there are other costs to the Department as well, and Mr. Kalapa pointed out the compliance costs for businesses, both transitional and ongoing costs to handle allocation and other issues.

The Chairman asked if the State would break even in the future, and if there were any alternative ideas. Director Kawafuchi pointed out that the Department already has a number of use tax compliance projects. Participating in the Streamlined Sales and Use Tax Agreement has potential. However, it is not clear that the State should jump in at this time although it remains a future possibility.

Mr. Kalapa stated that any alternatives could include requiring 1099 reporting. That would cost remote vendors something, but would put the collection onus on the states. He would have more faith in compensation being offered if the Legislature enacted compensation for the businesses for the county surcharge currently being implemented.

As another alternative, Director Kawafuchi pointed out that Mr. Kamikawa, a former Director of Taxation, had suggested adding a line on income tax returns for individuals to report and pay the use tax back when he had been the Director.

The Chairman asked if there were any representatives of the retail industry present, as he wanted to ask them about leveling the playing field; however, a representative was not present. He did note that he only buys via the Internet things that he can't get here, and also noted Mr. Heller's previous point about how some things, such as eggs and milk, would not be purchased through

the Internet. Ms. Niwao added that many small Internet businesses don't ship to Hawaii. The Chairman summed this up by noting that the cost and added revenue figures were only guesses and estimates.

The Chairman then asked if there were penalties for not signing up. Director Kawafuchi stated that there were no penalties because the businesses presumably have no nexus. Mr. Kalapa noted that that is how it always is.

The Chairman then asked about the cost to Hawaii businesses that do participate. Mr. Kalapa stated that a larger company like Hawaiian Host should probably be paying something to California because they probably have nexus there. The Chairman asked about the cost to small businesses, and Mr. Kalapa said that small businesses might not have nexus in other states, citing the small Two Ladies business in Hilo as an example.

Mr. Roberts asked if joining the Streamlined Sales and Use Tax Agreement would tie our politicians' hands with respect to providing exemptions and credits. Mr. Kalapa stated that the states have a right to provide exemptions, but Mr. Heller pointed out that the legislators must use the Streamlined Sales and Use Tax Agreement categories.

Mr. Roberts asked if income tax credits would be affected. Director Kawafuchi said that it wouldn't, although Mr. Kalapa mentioned the Ko Olina credit, which may be used as a credit against the income tax as well as the general excise and use taxes, amongst others.
Ms. Nakamura reiterated that there cannot be multiple rates and that all exemptions and such must comply with the Streamlined Sales and Use Tax Agreement.

Ms. Niwao asked how a remote vendor would know if the tax to be collected is at the 0.5% or 4% rate. Director Kawafuchi stated that resale certificates would be used by businesses to exempt the transaction from the collection of tax under the Streamlined Sales and Use Tax Agreement, and that the business would pay the 0.5% use tax directly to the Department.

The Chairman asked Director Kawafuchi what the Tax Department's official position on this matter was. Director Kawafuchi stated that it was to continue to watch and monitor this matter, as they are not sure if the benefits outweigh the costs.

The Chairman asked Mr. Kalapa what the Tax Foundation's position on this matter was.
Mr. Kalapa stated that it was to watch how things proceed, but that he didn't think that the State should expend its resources on this at this time.

The Chairman also asked Mr. Holbrook what CCH's position was. Mr. Holbrook stated that he couldn't answer for CCH, only for himself. He thinks Hawaii already has a lot in place and that the uniformity of definitions would help Hawaii internationally as well. The Chairman noted that CCH publishes a book on the Streamlined Sales Tax and asked how popular it was;
Mr. Holbrook didn't know.

The Chairman asked those present for a straw poll on whether the Commission should recommend that the Legislature enact conforming legislation, but there was no response.

The Chairman asked Mr. Hirai about the status of the work by his committee. Mr. Hirai stated that nothing was currently happening.

Finally, the Chairman informed those present that Dr. Fox would be presenting the results of his study (not on the Streamlined Sales and Use Tax issue) at a special meeting on September 22, 2006, and that Dr. Fox had agreed to answer any questions they may have about his other work on the Streamlined Sales and Use Tax issue.

REVIEW OF PAST TRC RECOMMENDATIONS

This continues the discussion begun at the July meeting on the previously distributed list of past Tax Review Commission recommendations, supplemented by the additional information regarding the specific acts implementing the adopted recommendations.

RECOMMENDATIONS OF THE 2003 TAX REVIEW COMMISSION (CONT.)

These recommendations had been assigned to Mr. Heller.

Income Tax Recommendations:

30d. Require beneficiaries of tax credits to file truth and disclosure reports in addition to income tax returns.

Further discussion on this issue had been deferred at the end of the last meeting pending a review of the Washington provisions by Mr. Roberts. That review was not completed, so this item was again deferred.

31. Conform to federal estate tax repeal but retain state death tax.

The issue was whether to decouple from the phase-out of the federal estate tax. The suggestion had been to have a separate estate tax that would continue even if the federal repeal became permanent. The question was whether it was worth it, in terms of State revenue, to enact a separate state estate tax. The last Commission was leaning towards a separate estate tax that didn't have to be that complicated.

The Chairman asked about the difference between the estate tax and an inheritance tax. Ms. King said that it was a transfer tax both on estates and gifts rather than an inheritance tax. Mr. Heller added that one could either tax the estate on the transfer or the beneficiary on their inheritance, but in this case they are referring to the tax on the estate.

Dr. Rousslang stated that the current law is a "pick-up" provision that has resulted in no State estate tax after December 31, 2004, due to the phase-out of the federal state death tax credit.

Mr. Heller clarified that there actually are two questions: 1) should Hawaii have a pick-up tax where there is no net cost to the taxpayer because it is limited to the federal credit allowed; and 2) should there be an independent Hawaii estate tax that applies even if there is no federal tax and no federal state death tax credit.

Mr. Heller's personal opinion is that it doesn't make sense for Hawaii to have a law tied to the federal law because nobody knows what Congress is going to do and when. If the State wants an estate tax, then it should have one that is independent.

The Chairman asked if having a State estate tax would result in a credit or deduction. Mr. Heller and Ms. King stated that it may or may not result in a federal credit or deduction, depending on what Congress does, and is a separate matter.

Mr. Okada asked how much revenue the State received from this tax in the past. Mr. Heller stated that it was about 0.5% of revenues. Dr. Pham added that the estate tax was very small, only accounting for about $10-12 million in revenue per year. Ms. Ching asked if it was worth having a whole set of laws, enforcement mechanism, and such for that amount of revenue.

Mr. Heller noted that the State is not getting any of this tax now so it won't impact the budget. His opinion is that they should not recommend a State estate tax.

No further action was taken on this item.

30e. Embed tax incentives in strategic planning context.

No discussion on this item.

30f. Encourage public participation in process.

No discussion on this item.

30g. Require sunset provision before granting extensions.

This had been discussed before so no further discussion on this item was held.

Miscellaneous Recommendations:

19. Give DOTAX resources to monitor business incentive tax credits; 20. Give DOTAX resources to conduct out-of-State audits; 21. Provide adequate resources for Tax Research & Planning Office to update or improve economic forecasting and modeling capabilities with regards to: (a) tax incentives (exemptions and credits), (b) auditing activities, (c) nonprofit organizations, (d) conformity with federal tax laws, (e) equity concerns, (f) bracket creep,

(g) administrative costs, and (h) state corporate tax revenue trend analysis; and 22. Provide adequate resources for Tax Research & Planning Office to analyze specific tax credits such as: (a) ethanol production facility credit, (b) high technology credit, and (c) energy conservation credit.

Mr. Heller noted that all of the above items fell into the same category of providing adequate resources to the Department to analyze, monitor, and report on various things and didn't think there was a need to discuss each item separately. However, he stated that he did think it important to include a general recommendation that the Department be given appropriate and adequate resources. By this he doesn't include only direct, revenue-producing positions like auditors, but other positions for writing rules that taxpayers can understand and follow, revising forms in a timely manner, and the like. He feels that money invested in a better functioning Department is money well invested.

Mr. Roberts concurred and surmised that their upcoming tour may allow them to be more specific in their recommendations.

The Chairman asked if there were national standards for the staffing of tax departments in terms of revenue per employee or something to that effect. Dr. Pham stated that the annual report includes a figure comparing the Department's budget to the total tax collections. While this figure is not compared with other tax departments in the country, the cost trend for Hawaii is declining. At one time it was $0.50 per $100 of taxes collected; this year it is $0.36 per $100 of taxes collected. Dr. Grandy noted that this trend indicates that the Department is getting more efficient.

Dr. Pham added that the Legislature added 32 auditor and collector positions last year. Ms. Nakamura pointed out, however, that part of the problem was finding qualified people to fill those positions for the pay that is offered. Mr. Heller agreed that pay is a problem. Dr. Pham stated that support was given to the back end auditors and collectors, but not to the front end Tax Services and Processing area.

The Chairman asked if there was a way to get rid of workers hired now when revenues are high should revenues fall. Dr. Pham noted that the number of employees has been cut in the past, in part because of the efficiencies due to technology. Ms. Tokishi recalled the Department undergoing a downsizing during the Cayetano Administration due to the budget situation at that time.

The Chairman asked if there was anything that identified the minimal staffing level, or whether the number to be cut depended on whatever the governor said. Dr. Pham stated that there is one study of the Tax Services and Processing Division conducted by CGI-AMS, the company contracted for the Department's computer system project, which concluded that the Division's staffing levels much lower than it should be.

Mr. Heller agreed that some things just don't get done or don't get done in a timely way because there are not enough people, noting that he's had audits going on for more than a year simply because the auditor is spread too thin over a number of different projects.

Dr. Pham stated that he recently went to a Federation of Tax Administrators meeting, and even a small place like Washington D.C. had a research staff of about 10 to 12 people, while his office has only 4 or 5 people despite the added complexity of Hawaii's tax system.

The Chairman asked which state would be comparable in size to Hawaii. Mr. Heller said that, population-wise, perhaps Wyoming, but that their economic base is totally different. Dr. Grandy stated that Wyoming only has a state population of 0.5 million people.

The Chairman called for a motion from Mr. Heller, who stated that he would like to make a general recommendation combining items 19 through 22, that the Legislature consider the needs of the entire Department of Taxation, not just audit but all divisions, and that, in general, they recommend adequate funding to the Department as a good investment for the State to make.

The Chairman called for further discussion. Dr. Pham stated that his office has some staff just because of the Tax Review Commission, and would very much like to keep them. He was particularly concerned that a policy analyst position did not exist in his office. He pointing out that Dr. Rousslang was merely borrowed from the Rules Office and Ms. Tokishi from the External Training and Outreach Office. Even when the Tax Review Commission is not seated, the studies that have been done for the Commission should be regularly updated; this is something that will benefit future Commissions as well. He asked that they support having those positions permanently placed within his office.

The Chairman asked if Dr. Pham thought that the outside studies were worth it. Dr. Pham did not comment directly, but said that he thought that the studies done by Dr. Rousslang and Ms. Tokishi were just as good, if not better, than what could have been done externally, and that his office had provided much of the data needed by Dr. Marcia Sakai. The important thing is that the studies be done regularly, and that his office does not have the staff to do the policy analysis, which is what the Tax Review Commission did, and that is aside from the Council on Revenue work for which they also are understaffed. They should be able to do the policy analysis work for the Director of Taxation and the Legislature as well as the Tax Review Commissions, and that would entail making these positions permanent.

Dr. Rousslang added that, aside from the revenue collection functions, the Department has a duty to inform the public on how the tax system is working, what they are collecting, and what the various programs are doing. This function is currently very tight.

The Chairman asked if he was referring to the outreach and education part. Dr. Rousslang stated that outreach and education was a whole separate thing. The Chairman referred to Ms. Tokishi's prior work with External Training and Outreach, but Ms. Tokishi explained that Department priorities had changed and that no permanent employees were currently working in that office.

Mr. Heller stated that, this is his whole point. All these other things are being lost. It is helpful to taxpayers to get communications from the Department explaining the law. He also observed that there were more policy memos in the form of tax information releases, Tax Facts, announcements, and the like, than in recent years. If the State wants people to comply with the law, it would be helpful to tell them how.

As an example, Ms. Tokishi noted that, until she left the position in early 2005, she did 3 to 4 small business classes a month plus a lot of other outreach. However, priorities and needs changed and she was assigned to Dr. Pham's office in 2006. She found that he had good statisticians who needed her to explain the tax implications and history of bill provisions that the staff was preparing revenue impact statements for. The lack of tax knowledge also was reflected in various reports, assumptions made for their statistical analyses, and the like. Dr. Pham currently doesn't have anyone with Dr. Rousslang's economics expertise and her tax knowledge in his office, but they are needed now and will be even more essential if some of the things that the Commission recommends, such as regularly reviewing certain tax credits and benefits before renewing then, are implemented. Dr. Pham would like to request a specific request for the policy analyst position.

Rather than making specific recommendations, the Commission decided to keep the general motion, but to elaborate on the needs of the Tax Research and Planning Office for a policy analyst and tax specialist in the report itself.

It was moved by Mr. Heller and seconded by Ms. Ching that the Commission recommend that the Legislature consider the needs of the entire Department of Taxation, not just direct revenue-producing positions such as auditors but all the divisions within the Department, and that they provide adequate funding to the Department as a good investment for the State to make. The motion was passed with the following votes: 7-Yes.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	Yes
Carolyn Ching	Yes
Christopher Grandy	Yes
Melanie King	Yes
Lon Okada	Yes
John Roberts	Yes

RECOMMENDATIONS OF THE 1997 TAX REVIEW COMMISSION

These recommendations had been assigned to Ms. Ching.

Overall Tax Recommendations:

3. Minimize all tax exemptions and credits.

Ms. Ching noted that the Commission had already discussed exemptions and credits at some length already and that the Legislature had been going the other way. Therefore, she doesn't think that it is worthwhile bringing it up again.

The Chairman noted that virtually every Tax Review Commission had recommended this and that the legislators enacted yet more exemptions and credits. He then asked Mr. Kalapa, given Mr. Kalapa's long experience, how he would reconcile this disconnect between the Tax Review Commissions' recommendations and the legislators' actions.

Mr. Kalapa attributes this to those in policy-making roles not understanding the larger picture and focusing instead on their special interests. The purpose of taxation is to collect money to run the government, not as a tool to get people to act in a certain way to solve society's problems, as that is better achieved through the appropriations process. The result has been tax credits such as digital media, high technology, ethanol, and the like, for which the true costs and benefits are unknown. The result is that the rest of the economy labors under an unduly high burden of taxes because they are not favored. This skews the economy's development as not everyone has the same opportunity. Favored businesses, such as high technology businesses, may have a false sense of security, because without the government subsidy, they would fail. Perhaps everyone should get a subsidy.

Mr. Kalapa cited one example of the reverse when a lawyer stated that hotels should pay something more, and he replied that the hotels were paying the same 4% that lawyers pay, but perhaps lawyers should also pay something more because they are clogging up the legal system with the additional amount going to the judiciary. Another example was that of the unfixed potholes, which perhaps could not be funded in part because 3/10 of 1% of fuel tax collections goes to the Dept. of Land and Natural Resources for trails and access rather than to the roadways.

The State's tax system is so skewed that everyone feels that they have a right to ask for a tax benefit for their sector without recognizing that they are creating an unequal environment for everyone else.

The Chairman asked whether it would help to have a set of rules for those proposing that the Legislature enact an exemption or credit since it seems to be a losing battle to prevent special interests from asking for the tax benefits and to prevent the Legislature from granting them for tax policy reasons. Perhaps require more information about the economic effect of their proposal and why it is good.

Mr. Kalapa suggested a list of criteria that advocates for a tax preference would have to meet for reporting on and justifying such back door expenditures of State funds. For example, the

proponent claiming that a specific number of jobs would result from a credit would be required to prove that claim and not be allowed to make unsubstantiated job creation claims.

The Chairman asked whether, in addition to something at the front end, something verifiable be required at some point, perhaps two years later, to validate or repudiate the initial justification.

Mr. Heller noted that this issue refers back to the discussion that was deferred at the last meeting on income tax recommendation 30(d) on the mechanics of the reporting requirements, though they all agreed at that time that the State should get information needed to verify the effect of a credit in exchange for giving the credit.

Mr. Kalapa commented that, while the Legislature and Administration scrutinize expenditures, they do not question such credits and exemptions although they should be asking whether the State is getting "the most bang for the buck." The only time it happens is when a tax preference is offered to taxpayers erecting a costly structure or providing a service to prevent the taxpayer from being penalized by the tax imposed under existing law. An example that he thinks is justified was the exemption for gross income received by hotel operators, orchards, and telecommunications as a reimbursement of certain payroll costs.

Mr. Roberts asked if Mr. Kalapa was suggesting that the Commission chair and vice chair do more before the public media to draw more attention to their recommendations. Mr. Kalapa stated that whether they do or don't is a call for the Commission. Some have not done much more than present their report while others have done more. However, if they are committed and feel that the educational process is important, they need to go public and explain why they decided as they did.

The Chairman asked whether it would be appropriate to entertain a motion to require an applicant for a credit or exemption to provide information about the benefits to the State and also provide verifiable information within two years of obtaining the credit or exemption.

Mr. Heller stated that it is pretty close to the deferred recommendation. Therefore, this recommendation will also be deferred to allow Mr. Roberts time to work with Dr. Pham and Dr. Rousslang on a motion to require information at the front end and verifiable information at the back end.

Dr. Grandy stated that he would like captured in their report, rather than as part of a specific motion, that they endorse minimizing exemptions and credits, but also state that if they enact a new exemption or credit that they require certain information. However, he doesn’t want to lose sight of the general principle that there may be hidden costs that result from the skewing of investment decisions. Minimize the number of credits and exemptions, but impose informational requirements for any enacted.

Dr. Grandy also wanted to emphasize in both the report and report presentations the commonality of the recommendations made by past Commissions that have not been recommended. He suggested including a tally of the number of recommendations that have been

implemented and the number not implemented at the end of the table that will be included in the report.

Dr. Rousslang commented that verifying credit benefits could be difficult. For example, if a proponent claims that a certain number of jobs would be created and then comes back two years later showing that the company did create a certain number of jobs within the company, it does not mean that employment in Hawaii has increased. The number of jobs created is a "counter-factual question" because the company itself can never establish the number of jobs created for the economy. The number of jobs they created for themselves may be completely misleading.

Mr. Roberts stated that, based on their clients, it seems that the number of jobs created by a technology company goes beyond just the company's jobs. The Chairman also noted that certain businesses, such as the Hawaiian Water Park, might also generate a lot of tourist dollars that in turn translates into other jobs.

Mr. Kalapa added that, when the authors of the digital media credit wrote the law, they didn't realize that they had created a measurable element in that the qualifying costs must be subject to the general excise tax, and it can therefore be determined how much gross revenue subject to the general excise tax the credit created – how much was purchased from a Hawaii business. However, not all "costs" are subject to the general excise tax, such as wages. That is one measure, though whether the Department actually follows up on that is another matter.

Dr. Pham, adding to what Dr. Rousslang had said about job creation, stated that the movie company could come in and hire one person for one week and say that they created one job. He then asked what one job was; is it one job for one week or one job for the whole year. How much was paid in wages may be better.

The Chairman stated that he had the Washington state package discussed at the last meeting at his office and will distribute copies to the Commission members for their review. He noted that Dr. Grandy had suggested re-recommending this provision. Ms. Ching stated that this is all part of the same general topic regarding the verification reporting of credit benefits, and should be a substantial section in their report.

It was moved by Dr. Grandy and seconded by Mr. Heller that the Commission re-recommend minimizing all tax exemptions and credits. The motion was passed with the following votes: 7-Yes.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	Yes
Carolyn Ching	Yes
Christopher Grandy	Yes
Melanie King	Yes

Lon Okada	Yes
John Roberts	Yes

7. Lower the overall level of state taxes.

Ms. Ching noted that personal income tax rates had recently been lowered, but general excise tax rates have remained the same.

The Chairman asked whether this was referring to all taxes, including county taxes such as the real property tax, or just State taxes. Dr. Rousslang pointed out that there is a difference between State taxes and all taxes in the State. Mr. Heller stated that, since the Commission is making recommendations to the Legislature, it should just be State taxes. However, Mr. Kalapa said that one could have an impact on the other, and offered the example of the State transient accommodations tax, which the 1989 Commission recommended distributing to the counties; a change that was subsequently made.

In response to a question from the Chairman regarding the tax burden, Mr. Kalapa stated that this goes back to the whole issue of tax benefits. Offering more targeted tax credits erodes the tax base, thereby shifting the tax burden to taxpayers who are not favored by the tax preferences, which therefore means that higher tax rates have to be maintained. The general excise tax rate is able to remain relatively low because of the broad tax base, but the more income tax credits that are offered, the higher the rates must be to maintain income tax collections.

Mr. Heller noted that tax burden can be measured in various ways, but whether expressed in terms of dollars per capita or as a percentage of income or some other measure, Hawaii is still among the top five high tax states. He points out that one of the principles of sound tax policy is to not have a tax burden that discourages people from living or doing business in Hawaii. If Hawaii is in the top five, then the question of whether Hawaii's taxes are too high must be considered. He added that the spending level also must be considered, as the tax revenues must be high enough to cover State spending; the question is whether taxes are too high given what the people are getting out of State government.

Dr. Pham noted that the State tax burden is high in part because, in Hawaii, many expenditures often covered by county taxes in other states, such as education, are paid for at the State level. However, Mr. Kalapa asserted that Hawaii is a high tax state even when combined state and local taxes are considered.

Dr. Rousslang asked what the Commissioners think the State is spending too much money on. Mr. Heller stated that the 2006 Legislature could have given more of the surplus back to taxpayers, but instead found other things to spend it on. The Chairman noted that 2006 was a "catch-up" year in which appropriations were made for deferred costs, but that he would be concerned if the same occurred next year.

Mr. Kalapa suggested looking at the 1989 Commission report with respect to special funds, because government is expanding at a faster rate than what had been hoped for through the use

of special funds; the Department of Commerce and Consumer Affairs, which was fully funded by general funds but now has a $33 million budget fully funded by special funds, is a good example. The tax burden has been increased rather than decreased over the years, and not much has been done to reduce that tax burden.

Mr. Roberts noted that, anecdotally, their practice had two fledgling software companies that left the State in part because of Hawaii's high tax burden and the lack of trained personnel, and clients routinely ask them to evaluate potential sites for relocation based on the relative tax burdens.

Ms. Niwao, however, pointed out that certain taxpayers, such as high technology and movie businesses, have a really low tax burden due to the tax preferences, and that makes the tax burden on the rest of Hawaii taxpayers higher.

Mr. Roberts says that he isn't sure how to determine if the State's tax burden is too high, but he feels that it is too high based on anecdotal evidence.

The Chairman asked if, from a tax policy viewpoint, Hawaii should structure its tax policies to attract certain kinds of businesses. Dr. Grandy doesn't think so, because you don't know which industry to target. Mr. Kalapa referred to it as the "Cabbage Patch Doll" phenomenon, because nobody knows what the next big thing will be and the State could potentially drive away what could become a cutting-edge industry.

Mr. Kalapa suggested having the Tax Research and Planning Office do a study on what all the tax breaks have cost over the last 10 years to determine how much additional tax burden has been shifted to all the non-preferred taxpayers.

Dr. Grandy said that one way to address the issue is to first determine what the Legislature wants to spend and then structure the tax system to achieve that level of funding while being mindful of the level of public spending. Instead of lowering tax amounts, from an economist's perspective perhaps they should focus on the tax rates; improving economic activity by keeping the rates low since the rates drive behavior. If so, you look at which taxes, such as the income tax, have particularly high rates.

<u>It was moved by Dr. Grandy and seconded by Mr. Heller that the Commission recommend lowering the overall level of taxes by focusing on lowering tax rates by broadening the tax base and fiscal discipline. The motion was passed with the following votes: 7-Yes</u>.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	Yes
Carolyn Ching	Yes
Christopher Grandy	Yes
Melanie King	Yes

Lon Okada	Yes
John Roberts	Yes

Recommendations for the General Excise Tax:

4. Eliminate or limit exemptions for intended social policy such as the exemption for those who are blind, deaf, or disabled and those with Hansen's disease, and the 0.5% rate allowed those who are blind, deaf, or disabled.[4]

This was not discussed further because it was covered in the discussion of overall recommendation 3, which was to minimize all tax exemptions and credits. No recommendation made.

7. Eliminate or limit gross receipts splitting.

This was not discussed further because it was covered in earlier discussions regarding tourism-related businesses. No recommendation made.

10. Eliminate blanket exemptions in favor or specific exemptions.

This was not discussed further because it was covered in earlier discussions regarding insurance companies and the like. No recommendation made.

11. Eliminate or limit specific exemptions or special rates for (a) scientific contracts with the U.S., (b) petroleum products refined in Hawaii, (c) loading, transporting, and unloading agricultural products, (d) sugarcane producers, (e) certain contractors to the federal government, (f) labor organizations, (g) food products produced in Hawaii sold to common carriers, (h) air pollution control facilities, and (i) solid waste processors (waste-to-energy).

This is similar to the discussion regarding the general recommendation that exemptions and credits be limited.

The Chairman asked if any of these exemptions required a special form to claim them. The answer was no, although it was noted that there was a now repealed provision requiring those claiming the scientific contracts exemption to first obtain departmental approval although many still write in for an opinion because it is a tricky exemption in application and many vendors will not give this benefit unless the contractor provides proof. One exemption that was not listed and that does require a special form is the low-income housing exemption for which the amount to be exempted is certified by the appropriate housing authority.

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[4] Recorder's Note: The original table indicated that the 0.5% rate was limited to gross receipts under $30,000. However, the actual provision is that the tax rate is limited to no more than 0.5% on all gross income received by those who are certified blind deaf or totally disabled. Section 18-235-1.14, Hawaii Administrative Rules, provides a $30,000 earned income limit with respect to determining if a person totally disabled is able to engage in a substantial gainful business or occupation and is not directly applicable to the amount of gross income eligible for the 0.5% general excise tax rate.

The Chairman asked if anyone would object to eliminating these exemptions. However, Mr. Heller noted that the Commission has already recommended that such exemptions should be limited in favor or a broader tax base, and questioned the need to address specific exemptions.

The decision was to keep their recommendations general and no action was taken on this recommendation.

12. Eliminate or minimize all general excise tax exemptions.

The decision was to keep their recommendations general and no action was taken on this recommendation.

13c. Automatically sunset "new industry" development exemptions such as the exemption for a stock exchange.

This was not discussed further because it was covered in the discussion of overall recommendation 2, which was to eliminate or sunset tax exemptions and credits. No recommendation made.

Income Tax Recommendations:

2. Provide income tax credits, not exemptions, to offset regressive effects of excise taxes on foods and drugs.

This had been adopted, but has since been repealed in favor of a general low-income refundable income tax credit. No recommendation made.

3. Adjust general excise tax credit for inflation.

This credit was repealed in favor of a general low-income refundable income tax credit. No recommendation made.

6. Increase the standard deduction.

This was not discussed further because the Commission had previously voted to recommend indexing the standard deduction to inflation at the July 25, 2006, meeting.

9. Increase the personal exemption.

This was not discussed further because the Commission had previously voted to recommend indexing the personal exemption to inflation at the July 25, 2006, meeting.

11. Exempt additional types of pension income.

This was not discussed further because it had been previously discussed at the June 27, 2006, Tax Review Commission meeting and a recommendation made at that time.

12. Phase-in taxation of all pension income.

This was not discussed further because it had been previously discussed at the June 27, 2006, Tax Review Commission meeting and a recommendation made at that time.

15. Limit like-kind exchange tax deferrals to situations where the replacement property is in Hawaii.

This was not discussed further because it had been previously discussed at the June 27, 2006, Tax Review Commission meeting and a decision to not re-recommend this recommendation made at that time.

16. Limit involuntary conversion tax deferrals to situations where the replacement property is in Hawaii.

This was similar to the like-kind exchange situation just addressed and would not be re-recommended.

18. Eliminate 90% prerequisite for automatic filing extension.

This assertion is incorrect; there is no 90% prerequisite for the automatic extension, though there is a 90% of current year liability for the second extension. There also was a 90% requirement for purposes of the underpayment of estimated tax penalty, but that was changed to 60%. No further discussion was held on this matter.

19. Conform to federal filing deadlines.

The April 15 versus the April 20 deadline is not an issue for practitioners. They are more concerned with conforming to the federal extension provision, which for individuals is now a full 6-month extension until October 15. However, Ms. Nakamura stated that her office is working on administrative rules that would conform to that provision using the October 20 date for State returns.

30. Overhaul business incentives tax credit process.

This was not discussed further because it had previously been discussed in a more general context with respect to credits and exemptions.

Miscellaneous Recommendations:

12. Impose the 4% general excise tax on insurance commissions, not 0.15%, and review the general excise tax on insurance policy premiums.

Mr. Kalapa explained that the Lester Machado report from 1975 outlines three kinds of commission agents that are prohibited by law from passing on the general excise tax: (1) taxi cab drivers, (2) travel agents on airline commissions, and (3) insurance agents. Only insurance agents are prohibited from doing so by state law; taxi cab drivers are prohibited from doing so by county ordinance and travel agents by federal law. Since it is State law that prohibits insurance agents from visibly passing on the general excise tax, Lester Machado recommended the 0.15% rate, which is comparable to the 0.166% on the mark-up. Mr. Hirai noted that the committee reports said that insurance premiums are taxed at more than 4% to make up for the revenue loss.

No further action was taken on this measure.

RECOMMENDATIONS OF THE 1989 TAX REVIEW COMMISSION

These recommendations had been assigned to Mr. Okada.

Recommendations for the General Excise Tax:

2. Limit exemptions to those needed for horizontal equity.

This was covered in more general discussions on tax equity. No further action was taken on this recommendation.

9. Exempt residential rental income.

This was an equity issue for renters as opposed to homeowners. The Chairman noted that this would shrink the tax base, which, as noted by Mr. Okada, is contrary to their general recommendation to maintain a broad tax base. No further action was taken on this recommendation.

Income Tax Recommendations:

1. Maintain existing corporate tax burden.

The Chairman noted that an internal study is being conducted on eliminating the corporate income tax, so this will be covered later.

4. Add back capital gains, dividends, interest, retirement contributions, unemployment and workers compensation payments, public assistance benefits and individual housing account payments to Adjusted Gross Income (AGI) base.

Mr. Okada was unsure as to why this had been recommended. Mr. Kalapa suggested that it had to do with the qualification thresholds for certain low-income tax credits such as the food tax credit and the general excise tax credit.

This is still relevant with respect to current credits such as the low-income refundable tax credit and the low-income household renter's credit. Ms. Tokishi noted that this was also one of the reasons why the $100 food, medical services, and nonprescription drug income tax credit that the Governor had proposed to the 2006 Legislature used the federal adjusted gross income rather than the Hawaii adjusted gross income to determine eligibility.

Discussion on this was deferred until the report could be re-checked.

Miscellaneous Recommendations:

4. Reconcile TAT tax base with DBEDT and HVC estimates.

Dr. Pham stated that this is a moot issue. No further action was taken on this recommendation.

Due to time constraints, further discussion of the 1989 recommendations was deferred.
Mr. Okada noted that he would be unable to attend the next meeting.

LIST AGENDA ITEMS FOR THE NEXT MEETING

The next regular Tax Review Commission meeting will be on September 26, 2006, at 9:00 a.m. As announced at the beginning of the meeting, however, the special meeting to question Dr. Fox about his study will be held on September 22, 2006, at 1:30 p.m.

ADJOURNMENT

It was moved by Dr. Grandy and seconded by Ms. Ching to adjourn the meeting at 12:05 p.m. The motion was carried unanimously.