

TAX REVIEW COMMISSION

MINUTES FOR THE ELEVENTH MEETING OF THE
TAX REVIEW COMMISSION
HELD AT NO.1 CAPITOL DISTRICT BUILDING
250 S. HOTEL STREET
OFFICE OF AGING CONFERENCE ROOM 410
IN THE CITY AND COUNTY OF HONOLULU
STATE OF HAWAII, ON MONDAY, JUNE 5, 2017 AT 1:00 PM

The Commissioners of the Tax Review Commission (TRC) met at the Department of Health's Office of Aging Conference Room in the City and County of Honolulu, State of Hawaii, on Monday, June 5, 2017.

Members Present:

Colleen Takamura, Chair
Vaughn Cook, Vice-Chair
Nalani Kaina
John Knox

Members Absent:

William Pieper II, Raymond Blouin, Dawn Lippert

Staff:

Ted Shiraishi, Seth Colby, Titin Sakata and Noe Kaawa

Others:

Randall Nishiyama, Department of the Attorney General
Randy Bauer, PFM Group Consulting LLC
Donald Rousslang, Department of Taxation
Megan Johnson, State Auditor's Office
Ron Shiigi, State Auditor's Office
Dane Wicker, Senate Ways & Means
Alika Ke-Paloma, State Senate
Erin Conner, Senate Ways & Means
Albert Vargas, State House
Riley Fujisaki, State House
Tom Yamachika, Tax Foundation of Hawaii
Jana Moore, CAN
Katarina Ruiz, CAN
Peter Fritz

CALL TO ORDER:

Chair Takamura called the meeting to order at 1:00 pm with a quorum.

APPROVAL OF MINUTES:

Chair Takamura said the first order of business was the approval of the minutes from the April 24, 2017 meeting. She asked if there was any motion to amend or approve the minutes. Commissioner Knox moved the motion to approve the minutes with edits from April 24, 2017 and Commissioner Kaina seconded the motion. The motion carried unanimously.

UPDATE FROM PFM GROUP CONSULTING LLC ON PROGRESS ON REPORT ON STUDIES OF HAWAII'S TAX SYSTEM:

Mr. Bauer said PFM continued to make progress in accord with the project calendar. The next major milestone on that calendar would be to provide the TRC with high-level findings later this month and was on track to do that. They had a couple of complications which was normal with this type of project; the legislature made changes that had material impact on issues of tax burden and regressivity for some Hawaii taxpayers and had to refigure the models to take those into consideration.

He said as they start to look at key characteristics of the tax structure, it was not all that different from what one would expect. In general, the individual income tax was highly progressive, even more so with the changes made by the legislature. The GET was highly regressive. While the individual income tax had some characteristics that suggested it was less burdensome than most property tax systems in the country and was somewhat regressive. The balance between those components was what PFM was taking into consideration as they do the analysis.

At the same time, be mindful of what they were taking into consideration as well as the opportunities and options to reduce regressivity of the system. From their perspective it may be difficult to do much more in that area given the more highly progressive to add to the structure of the individual income tax that has had some significant changes in that respect legally in terms of restoring the highest marginal rates but would factor that in.

Other considerations they were looking at were a number of alternatives they analyzed back in 2012 as well as some additional ones. What were the opportunities to provide additional resources to the areas already targeted in the studies relating to the pension system and other post employment benefits primarily retiree healthcare. One challenge here from the way they were approaching it was it would be difficult to raise significant new revenue and also make the system less regressive unless you went back to the progressive source of revenue and that maybe difficult given changes were already made. What they were leaning towards was a least not make the system more regressive and believed those alternative could be explored.

As mentioned last time, they developed a model on the revenue side similar to the one that was used for the 2010-2012 TRC which has current revenue estimates, historical data and legislative changes. It would be used throughout the process and would be a resource. He believed the project was on schedule and they would meet the remaining project deadlines.

QUESTIONS AND ANSWERS FOR THE PFM GROUP CONSULTING LLC ON STUDIES OF HAWAII'S TAX SYSTEM:

Chair Takamura said in the June 1st report, it mentioned a compiled list of proposed initiatives and tax policy issues, and Mr. Bauer if he could share that with the TRC.

Mr. Bauer said with the caveat that they were still adding and subtracting from the list, they essentially started with the universe of recommendations that were made in 2012. Some were taken off the list. For example, at that time there was a projection of significant need for revenue over and above what was estimated in their charge right now. They suggested the GET rate be increased.

He said they were going to consider and analyze those primarily because that was considerably more regressive and goes against the charge provided them. As they go through each of the recommendations from the last report, some had been adopted. They were looking at the broad base excise taxes on cigarettes/tobacco, car rentals, alcohol to be increased as well as a different tax for sugary beverages; changes to the corporate income tax rates, some of the exemptions or credits that exist within the present system that were analyzed last time and still believe it was more progressive than regressive were the changes in exemptions that exist for pension income, changes to the legislative nexus as it relates to E-Commerce and online sales, collection of TAT on resort fees, imposing TOT on AirBnB rentals and similar kinds of rentals, the collection of excise tax on medical marijuana and shifting some expenses. K-12 (education) was the most logical one that if it were shifted to property taxes, it wouldn't require a change to the constitution to allow a state property tax but require local governments to raise additional property taxes. That would require significant statutory modifications and modification to the system and one they would certainly analyze what the repercussion of that would be as it relates to regressivity and the possibility of raising additional resources.

There were specific kinds of GET imposition like non-profits, schools, hospitals and other kinds of non-profit at some level were being taken into consideration. Last time, they looked at removing the deduction from real estate taxes and they were still trying to figure out exactly in terms of regressivity and could certainly raise the additional revenue but there might be a slight change to the middle income bracket that might make it slightly more regressive but was not sure if that was material. They were working through all of these in terms of what were the revenue possibilities, what does that do to the system in terms of regressivity, and ultimately what does it do to the system in terms of tax burden. The difference between burden and regressivity was, burden was what it took as an overall set share of personal income and regressivity was at different levels of income does it take a larger share of your income or not, so there was two different calculations but in many ways they were intertwined as well.

Commissioner Knox asked Mr. Bauer, in terms of those additional possible sources of revenue, were they looking at fees.

Mr. Bauer said they haven't focused much on fees. Generally it doesn't move the dial very much. When looking at the benchmarking, they would consider if there was something that jumped out at them where there was an area fee collection in other places that doesn't exist in Hawaii.

Commissioner Cook asked Mr. Bauer if they were looking at potential procedural changes to capture losses of revenue from the inability to collect, for example, out-of-state sales of real property.

Mr. Bauer said that was part of their scope. They were working with DoTAX to grasp a better understanding in terms of the implementation of their new collection system. As it relates to collection, it really gets into enforcement of taxes owed. It was an area that there was generally an agreement that there was uncollected revenue out there but effort was the issue not particularly in Hawaii but a number of states and was not a big expense associated with auditing and other factors that could be taken into consideration. They were going to look at that if they thought there were particular areas that were a focus with need to and significant additional revenue as well as an analysis of that.

Chair Takamura said another item was looking at other states to see if they had other revenue sources Hawaii could follow, and were they doing that.

Mr. Bauer said they had a database with different sources. When you get to states and the revenue talked about was in terms of making significant change in a structure and there was only a handful of places you could go to. You could change the structure of some of the taxes, the most common example for a lot of states was taxing services, but Hawaii's GET already captures that broad panoply of services that a lot of states were now starting to figure out how they were going to tax them. They were looking at the exemptions, credits and the various tax incentives as one way to add some fairly significant components, but in terms of a state having a tax that Hawaii doesn't that has a kind of major revenue source would only be states that controlled their liquor systems.

That was a monopoly of either the wholesale, retail or both components of that system which could be very lucrative for states. No state has ever gone from the system Hawaii and the majority of states had which was a licensed system to a controlled system. Few states had shifted from controlled to license but no one has unrung that bell and went back to a controlled system. That's a lot of revenue but there weren't those kinds of options or opportunities that exist.

Another that some states have filled in with and in a lot of instances had buyer's remorse and moved away from gross receipt taxes. Ohio is the only state with a significant revenue stream from gross receipt taxes while other state that did try this found it had too many negative features. Finding one of those kinds of big revenue streams that hasn't been tapped already doesn't really exist. One they had listed was at the local levels raising some significant revenues, again was for major urban cities was the sugary beverage tax that some states dabbled with, but that's still an excise tax and not a broad base tax like income tax, general sales tax and property tax or what could be a major component of a revenue structure.

Chair Takamura said Mr. Bauer spoke of a gross receipts tax was that different from the GET.

Mr. Bauer said it was a very small percentage of corporate receipts taxes and in that sense a little different from the GET, but had some similarities.

Chair Takamura said Mr. Bauer talked about state controlled liquor and that the state could get a lot more revenue if they did that and asked if he knew how much that would be?

Mr. Bauer said it depends on what parts of the system the state controlled. For example, Pennsylvania was the largest state that maintained a monopoly on wholesale and retail of their liquor system and generated about a couple hundred million dollars a year that was considered profit. They ran the retail system which PFM considered to be very fairly unprofitable. The states that probably do the best in terms of profitability were those that retained wholesale and a few states had sold the rights to their wholesale system. This was a monopoly and there was significant value. Ohio did a twenty or thirty year lease valued in the billions of dollars and Maine was in the hundreds of billions of dollars while states like Virginia, Oregon, Iowa and North Carolina that has maintained their wholesale systems. To change that system would be quite a significant undertaking and would get a lot of push back obviously from the current industry since in some ways you would be removing their ability to do what they do.

Chair Takamura said that would be a consideration, something the legislature could think about.

Mr. Bauer said to be truthful; their company has done studies on the privatization or the optimization of those controlled systems for seven of the seventeen states and none has ever taken a licensed system and turned it into a controlled system. Several states has gone in the opposite direction or gone back to a state run system.

Chair Colleen asked if in the next report, their ideas for the TRC could be summarized.

Mr. Bauer said that's what would basically be in their next update, what they had identified as high level findings. They would provide each of those kinds of alternatives, some broad base kind of high level ones and how it impacts on possibilities to raise additional revenues, regressivity and tax burden. It would be on a broad array of options and what they expect to present within the next two to three weeks.

PRESENTATION OF THE GENERAL EXCISE TAX BY THE DEPARTMENT OF TAXATION:

Hawaii Tax System: GET presented by Dr. Seth Colby, DoTAX TRP Officer

https://tax.hawaii.gov/stats/a9_2trc

QUESTIONS AND ANSWERS FOR THE DEPARTMENT OF TAXATION ON THE GENERAL EXCISE TAX PRESENTATION:

Commissioner Knox said for comparison purposes noticed Dr. Colby did not use as a percentage the gross domestic product (GDP) for state revenues.

Dr. Colby said the information was provided by The National Tax Foundation.

Chair Takamura asked if Hawaii was the only state that had a GET.

Dr. Colby said yes. There were other places with a gross receipts tax but there was no other state that has one as comprehensive and as large as Hawaii.

Commissioner Cook asked if there were any studies on what the rate would change to going from a GET to a value added tax (VAT).

Dr. Colby said he didn't know.

Dr. Rousslang said our system right now was close to a subtraction method of the VAT. Hawaii has gotten rid of a lot of the pyramiding in the tax and we've gotten a little bit better with the credit invoice back. Basically we had most of the advantages of VAT and were much easier to administer.

Mr. Bauer said a state that has done a fair amount of research of what they would have to do to get to a VAT and understanding that there was a non-income tax state was Washington. They had a study commissioned based on work to make their general sales tax into a VAT. They have not moved forward with that and felt it would be much easier for a state like Hawaii rather than Washington.

Commissioner Knox asked if it could be adjusted per capita to include the presence of visitors to get an estimate for the TRC but probably couldn't compare it to other places.

Dr. Colby said Hawaii was not the only state that exports taxes. Every state exports taxes and what Hawaii would need to do in order to provide those numbers would be to present those literature findings on how much we export our taxes and then would need to find it for every single state. It would be better to look at things from the beginning before thinking about exporting taxes.

Commissioner Knox said he realized it was just semantics but the bottom line suggested the GET was considered a consumption tax, but seemed to be more of a transaction tax.

Dr. Colby said even though we leverage the tax on businesses, who pays for it? Ultimately it was the consumers who pay for it and paid for it by consuming goods and services businesses provided, and that was why it should be thought of as a consumption tax. Whenever you look at tax incident or tax distribution, there were a lot of assumptions made about whose bearing the burden of the tax. One assumption was that consumers bear one hundred percent of the GET, which in reality was not true. If businesses increased prices, it affects supply as well as demand, and a business would sell less and not all of the tax was passed on to the consumer.

He said businesses would not lobby against tax increases on their services if it wasn't going to affect their bottom line, but it does. From the point of view of an economist, we always assume the GET was one hundred percent passed on to the consumer which in reality it was not, over ninety percent was and it was difficult to know that.

Commissioner Knox said there have been arguments that it had gone down recently. He thought the nature of tourism has changed with more lodging made online, more tourist dollars was going to lodging and less towards purchases made while here.

Dr. Colby said Commissioner Knox hit on two important points. One was the argument that people were into spending less and experiencing more free things like hikes while on vacation. If lodging was the issue, it shouldn't matter since there was the GET on lodging. If what

Commissioner Knox talked about was AirBnB that was something the legislature has yet to address.

Commissioner Knox said the total tourist per person per day spending has gone up in the last few years but not as much as it fell in the early 2000's. There was a precipitous drop until the recession where it bottomed out and has been inching back up since.

Chair Takamura asked Dr. Colby if he thought about adjusting the income of the low wage earners to include the free items they got so their income would be higher.

Dr. Colby said it would be difficult to do that but was trying by using estimations and different things and includes a lot of assumptions. DoTAX would not have those numbers ready for the TRC.

He said the idea was so the TRC think and it may involve trade-offs in what you may recommend and decide, but the point was now the TRC had a better idea of what were the advantages or disadvantages of every tax type, and all they do. That way the TRC could make a more educated opinion going forward.

Commissioner Knox said he had a comment, Dr. Colby noted if we wanted to move the dial and increased the GET and Mr. Bauer mentioned they had removed increasing the GET recommendation for this report. He recalled with the previous TRC, PFM had it in their list of possibilities which was not endorsed by the TRC and because it was simply in the report, there was quite a lot of push back and hand-wringing at the legislature and the business community as well.

Mr. Bauer said the nature of what PFM did was broader and more focused on the resource needs. They suggested there likely was a real possibility that that was a need. At the same time recommend some changes that would ameliorate some of the regressivity, suggested a significant increase in the refundable credits that existed for low income residents, and also suggested a lower rate increase for the wholesale portion of the GET. PFM didn't say Hawaii should raise it but suggested it as a viable alternative.

He said some of what has been discussed in terms of how regressive the GET could be. He wanted to look at Dr. Fox's data set because what they seen as a concern across the country right now was a dearth of savings amongst households and that was significant and different from what existed ten or twenty years ago. He would suggest that for a lot of households that curve were still going to be significant with the GET.

Commissioner Cook said he appreciated the presentation that showed a lot of the good and important parts of the GET. He recalled reading past TRC reports and studies that were done on what would be the effect of removing the individual income tax and replacing it with the GET, and what would the GE rate increase be. He recalled the range of six to eight percent.

Dr. Colby said another principle of taxation was diversity of revenue sources. It was one thing to raise the tax rate and another to totally eliminate the second largest income stream. There should be as much revenue streams as possible to help decrease volatility levels.

Commissioner Cook said the concern of doing that was the regressivity. Part of how regressivity was addressed was we had the GET that was efficient, at a low rate and broad-based and income tax for mitigating some of the regressivity.

Dr. Colby said again, that was completely true, but you need to remember that tax systems were relatively blunt instruments and to solve the inequality question exclusively through the tax system was overly ambitious. What is found typically in other countries was a much better chance of addressing inequality and income gaps by providing needed services to low income individuals; and addressing those things without worrying about the tax system as much as what was provided, that really high level quality services then that's a good way of doing it.

Another way of doing it was by providing tax credits. With the income tax credits (ITC), the consensus was that it was an efficient way of providing assistance to low income people as long as you don't have what a lot of states worry about, tax fraud. This was something that was addressed several times when Hawaii tried to adopt it. Tax credits generally meant you wait and had to ask for it later whereas with food stamps, you immediately got the tax credit. There was a lot of different ways to address inequality and only thinking about it through the tax system was like using blinders or you could be just good at taking care of your population through an extended tax base whether its regressive or not.

PROGRESS REPORT FROM THE DEPARTMENT OF TAXATION ON THE ANALYSIS OF THE COSTS AND BENEFITS OF ELIMINATING THE CORPORATE INCOME TAX:

Dr. Rousslang said the corporate income tax liabilities were about \$120-\$130 million annually from 2013-2015. He said the collection reports TRP publishes on the DoTAX website may include other things besides corporate income tax collections. The liabilities figures he had were from the N-30 returns and were different from what was in the collection reports. A couple of differences, first the liabilities were by tax year instead of when the tax is actually collected and second, the collection reports include collections from Forms N-3, N-4, N-20 and N-35.

Chair Takamura asked Dr. Rousslang what was the difference between what's filed versus what's on the website.

Dr. Rousslang said it varies a lot by year. He said the data on tax liabilities were by tax year and the collection reports recoded the corporate taxes when the cash came in. He said the difference shouldn't be that great, because estimated payments were made quarterly by corporations, but he said there were big differences in the liabilities as reported on Form N-30s, Corporate Income Tax Returns, and what was reported as corporate income tax collections on the DoTAX website for the same calendar year. He said part of the difference could be HARPTA withholding for partnerships went into the corporation basket when collected, but was not be removed from the corporate basket when the withholding was refunded. He said the differences were big for some years.

Chair Takamura said Dr. Colby mentioned the individual income tax collections should be higher.

Dr. Rousslang said the corporate income tax was small compared to the individual income tax. He said the corporate income tax liabilities run about \$120-\$130 million per year, but that most of the tax, about sixty percent of it, was offset by tax credits and the bulk of those were refundable tax credits. For the study, he said it was assumed that the refundable tax credits were going to continue even if the corporate income tax was eliminated, because corporations could establish single member entities to claim the refundable credits, like the renewable energy credit or the film credit.

He said the figures on tax liabilities and tax credits, the annual averages from 2013-2015, were \$94 million in tax credits and \$120-\$130 million in gross liabilities. He said that only about \$10 million of the tax credits were nonrefundable and \$84 million were refundable. He said the bulk of the refundable tax credits would continue even if the tax was eliminated. The effect of eliminating the tax would be a lot bigger than one would think by just looking at the net tax liabilities. He said that Hawaii's corporate income tax was deducted from the federal income tax and the federal corporate statutory rate was thirty-five percent, and that the amount deducted has been estimated to be between twenty-three to thirty-five percent, so a substantial amount of Hawaii's tax was exported as a federal tax offset. He said that gave the corporation income tax a pretty big advantage. For example, its tax exporting was higher than that for the individual income tax. He said that also part of the corporate income tax was exported in higher prices to nonresident consumers.

He said the goal of the study was to estimate what would happen if the corporate income tax was replaced with either an increase in GET or the individual income tax. If you just got rid of the corporate income tax, there would be a lot of things to consider, like what would happen to government spending. He said those things were taken off the table with the assumption that the revenue would be replaced by a GET increase or an individual income tax increase.

He said the first part of the cost-benefit calculation was the amount of the tax exported from the corporate income tax and a big part of that was the federal offset. He said the cost-benefit analysis considered only the costs and benefits to residents, and that meant people eligible to vote in the state elections and their dependants.

He said the tax exported from the GET was substantial. He said both the corporate income tax and GET probably had a bigger portion of the tax exported than the individual income tax. He said the better option for replacing the corporate income tax revenue was to use the GET as the replacement tax, rather than the individual income tax. He said that in an open economy, one with cross border investment flows, the corporate income tax was paid mostly by local residents, either workers' got lower wages or people paid higher prices for consumption. He said the tax was not paid by corporate shareholders. He said empirical studies found that across states, the loss in wages was something like two hundred fifty percent to three hundred fifty percent of the amount of corporate revenue collected. He said he was not going to try to explain how it could be that the burden of the tax was bigger than revenues collected by so much, but Harberger had explained how that could happen and it was partly because consumers and other factor owners were getting some of that back.

He said the conclusions, based on the preliminary calculations for the cost-benefits, were that the biggest factor in the cost-benefit calculations was the amount of tax exported for each tax and the amount of wealth transferred to non-resident shareholders when the corporate income tax is eliminated. He said that even though in the long term the tax was paid by local factors, in the

immediate short term, if the corporate income tax was eliminated, there would be a big windfall to the shareholders of existing corporate investments. He said it would take time for the greater investment to transform that windfall from the shareholders into income gains for residents. He said that basically, what would happen is that in the long run there would be more investments here, wages would be higher, consumer prices would be lower, and there would be more jobs, but that in the short run, there would be a wealth transfer to non-resident shareholders.

He said that at the national level, when they discuss whether the corporate income tax was a good idea or not, the transfer to shareholder doesn't matter, because it goes to "us" but for Hawaii (or any other state), since shares were traded on national exchanges like the New York Stock Exchange or Nasdaq, the bulk of the corporate income generated in the state was going to nonresidents. He said that since the state is a small open economy, the standard economic story was they should be the first to get rid of the corporate income tax because the local population was bearing the full burden of the tax. But he said it turns out that there was a lot more to that story, because for any individual state the bulk of the corporate investment was going to be owned by non-resident shareholders.

He said getting rid of the corporate income tax was an investment in the future, that there would be a big transfer to shareholders now for gains that would come in the long run and continue on forever. He said the question was whether it was a good investment. He said the answer depends on the discount rate used and on the size of the permanent gains compared to the short run costs. He said the calculations so far indicate that it would probably not be a good deal, at least not if you suddenly eliminated the tax. There were various ways to change that. First, if you could convince investors that the corporate income tax would be eliminated in the future they would make investment plans based on that. He said that announcing he tax change in advance would be one way of reducing the immediate wealth transfer to non-resident shareholders. He said a second way would be by expensing current new investments. He said for equity financed investments that would make the effective rate of tax on new investment income zero.

He said the final thing to think about was federal tax reform. He said if the federal deductions for state and local taxes were eliminated, then the big advantages in tax exporting of the corporate tax would be gone. He said that then it would pay to get rid of the tax for sure, even if it is done abruptly. He also said that if they cut the federal corporate tax rate in half, or to something like fifteen percent, that would shrink the federal offset and reduce the tax exporting advantage of the corporate income tax, making it more likely that it would be a good idea to replace the tax with the GET. He said it probably wouldn't be a good idea to replace the corporate income tax with the individual income tax if they do either of those things, because if they also cut the individual income tax rate or get rid of state and local deductions that would reduce or eliminate the tax exported from the individual income tax.

He said the calculations were still being developed and that they were turning out to be trickier than he thought. He said he hasn't seen any models for this, and especially for the big transfer to non-resident shareholders. He said the international studies he looked at had assumed shareholders were residents and the general equilibrium calculations for the U.S. economy, like those made by Larry Kotlikoff also assumed the shareholders were residents.

Mr. Bauer said part of what Dr. Rousslang talked about was that a lot of states in the last twenty to thirty years have moved from the classic model of three factor apportioning method and were now doing a double weighting on sales or using a single factor on sales. There was a recognition that some kinds of businesses and industries like retail chains would locate to Hawaii because that's where their customers were there. So apportioning their sales in Hawaii wasn't going to change their decisions made about investments.

He said as Dr. Colby pointed out, the state was generally a service economy and he thought the state at the least would change the corporate income tax. The furthest he suggested be done would be to use a single factor in terms of apportioning the income.

Dr. Rousslang said one reason states do that was for example, you had a manufacturing plant in Michigan and sell products all over the country and would want to attract that type of operation. If the tax was based only on sales in Michigan, the state would be taxing a small part of that operations income. States has moved to using the sales factor to attract investments in the production of tangible personal property like cars or anything in manufacturing. Also used were tax breaks in the way of grants, tax holidays, credits for wages and credits for property taxes. For Hawaii, if we changed to a sales factor, he didn't think it would do very much nor would it reduce the tax burden because the sales were here.

Mr. Bauer said that was the point since Hawaii was a sales based economy and eliminating the corporate income tax was not going to change that but if you were trying to target investments to companies that would put significant payroll and property in the state then that would do it which was better than giving the Targets and Wal-Marts of the world the corporate income tax breaks.

Dr. Rousslang asked if Hawaii moved to a sales factor since we were a service economy and basically producing for consumption here, it won't change their tax rate and it was not going to attract investments, why would we do that.

Mr. Bauer said it would attract investments for manufacturing if that made sense in Hawaii or research and development. What were we trying to do by eliminating the corporate income tax, giving Target and Wal-Mart a tax break? They located to Hawaii not because of the corporate income tax.

Dr. Rousslang said retailing was a service and the amount here was not fixed, and the bulk of the benefit that we get from eliminating the corporate income tax when they invest more here went to consumers. It was not to wages like the standard story. Retailing had a lot of dimensions like how many models to carry, how much inventory was in stock, where to locate stores, how much to spend on each store, should we provide parking to make in convenient for customers, or to cut order times how much service time do you give.

He said we're talking about expanding investments here by his estimates of two point three to four percent, relatively a small change. The premise of Mr. Bauer's argument was the supply of corporate capital here was fixed and wasn't going to change much if you cut the rate. That's one economist would argue against.

Mr. Bauer was pointing out that within the last twenty-five years with every state that had the corporate income tax used the classic three-factor allocation to a situation where Hawaii was now in the vast minority and believed there were only seven states that still used the classic allocation method for income. Let's keep in mind we're talking about C-Corporations which were not the primary driver of employment and no longer in the economy. It was a significantly smaller factor if you're just talking about trying to induce increased employment and that was not where one should focus their time and attention, its S-Corporations and sole proprietors not C-Corporations.

Dr. Rousslang said the primary purpose in secular tax policy was never look at employment. One should look at wages, consumer benefits, but employment was something the economy tends to in the long run, full employment. Like in 2005, we had people with nose rings working in the food service industry and had a secular tax policy that applied in 2005 when you're at full employment, then what happens if you did something like that in a recession in 2005? If one tried to use tax policy to create jobs by moving jobs from one sector to another and if you're distorting the economy to do that was usually a bad idea.

Dr. Colby asked Dr. Rousslang if Hawaii eliminated the corporate income tax that the service providers, retailers would pass on those savings on to the consumers.

Dr. Rousslang said yes.

Commissioner Knox said there were a handful of states that had no corporate income tax and asked Dr. Rousslang if he looked if they gained any particular advantage by not having the corporate income tax?

Dr. Rousslang said he would provide what was in the empirical studies, and they said that if you had a corporate income tax the wage rate would be lower by two hundred fifty to three hundred fifty percent of the corporate income tax collected.

Commissioner Knox said tax policy ultimately at the legislature would become the combination of economics and political-optics. The political-optics in Hawaii were to say that we were going to end the corporate tax and increase what was already considered a regressive tax, would be difficult.

Dr. Rousslang said that was an excellent point, one that would be covered in his study. One advantage of the corporate income tax was its hidden and for Hawaii, it was believed that the bulk of that tax was being paid by consumers just like the GET, only we don't see it and it was not as even as GET so it distorts prices across the economy more than the GET does. If we replaced the corporate income tax with GET, the only problem was people won't see their paying that corporate income tax in the prices paid but they would see it if the GET was raised.

Commissioner Knox asked Dr. Rousslang if he would be able to tell the legislators it was to their advantage to do that.

Dr. Rousslang said you could only tell them what's right and we had a lot of things that were there for political reasons.

Commissioner Kaina asked Dr. Rousslang when looking at the tables provided in his preliminary report, he indicated the information industry included the film industry, were there other industries involved?

Dr. Rousslang said yes. There were pieces of that industry that were paying tax and then there were film producers basically paying no net tax and getting hug tax credits. He would have to research to see what the other industries were.

Commissioner Kaina said if that could be expanded that would be helpful.

DISCUSSION ON DEPARTMENT OF TAXATION ASSISTANCE ON STUDIES FOR THE COMMISSION:

Chair Takamura said from the DoTAX response to the TRC's letter of requests, when could the TRC expect the information on HARPTA and pension taxes.

Mr. Colby said the TRC would receive that information by the end of August.

DISCUSSION AND ACTION ON A PROPOSAL FOR A REPORT WRITER AND TO FORM A COMMITTEE TO DRAFT REPORT FOR THE TAX REVIEW COMMISSION:

Chair Takamura said she wanted to appoint a committee to investigate hiring a writer for the TRC report and to start drafting that report so that committee could come back to the full TRC with a recommendation for the writer and a start for the TRC report to the legislature.

In thinking of who should be on the committee and Mr. Nishiyama said there could only be three members due to the Sunshine Law, felt the committee should be made up of herself, Commissioner Cook as vice-chair and Commissioner Knox since he wrote the last TRC report and his experience could greatly help the TRC in getting the report together.

Commissioner Kaina said her concern was what Chair Takamura was trying to accomplish by the drafting of a report before the TRC had any information from PFM and was trying to figure out her aim was in forming a drafting committee.

Chair Takamura said there were two things she wanted the committee to do. One reason was to recommend a writer to the TRC and second was draft an outline for the report to follow, maybe come up with ideas on what should be in the report and how the report should flow. She felt a need to something about it now instead of waiting for the PFM report. By the time the TRC got the PFM report, hopefully the committee would have some idea of what the report could look like to show the entire TRC. She said the TRC couldn't rely on the writer to write everything and the TRC should provide an outline of what needs to be there.

Commissioner Knox said he was able and willing to help with drafting. He understood Commissioner Kaina's concern about scoping out first what the various pieces were that was coming and he was vague at the moment. For example, what the TRC was getting in August in

terms of updates. He said he may be able to contribute because he was on Oahu and he could just have lunch with Dr. Colby and get a clear understanding of what's coming when.

Commissioner Kaina said she was blindsided by Chair Takamura's decision on who she appointed to the committee and the fact that three TRC members absent. She felt it was an uncomfortable situation that the three members proposed were the three members here. She was not quite sure how to respond at that point since Chair Takamura also indicated coming up with recommendations which made her feel really uncomfortable with respect to the TRC.

Chair Takamura said the first recommendation was for the writer. Second was the TRC should start thinking about what was good tax policy for the state. She thought the TRC should start thinking about what should or should not be in the report. That was why she wanted to start looking at previous recommendations and prior reports to see how it was formatted and how it was written to see if the TRC should follow or were there better ways to do the report. That was her reasoning for setting up a committee within the TRC.

Commissioner Knox said he didn't understand that the committee was going to make the recommendations.

Chair Takamura said not make the recommendations but starting a list of what the TRC should think about or what maybe good policy and then discussing that.

Commissioner Kaina said that was going into the policy decision and thought if Chair Takamura set up a committee to only draft an outline that would include essential features and what it could look like and that was one thing; but she kept bringing up over and over in the conversation about policy and what it should be, and that should be a discussion taking place with the entire TRC after the TRC received all the information and reports from DoTAX, PFM and Dr. Rousslang. It sounded like Chair Takamura wanted to put out ideas she has personally related to the TRC report which has already happened prior by both the chair and vice-chair in separate letters sent to DoTAX without utilizing the entire TRC.

She said she has hesitation with such broad expanse of what Chair Takamura seemed to be describing. So, if it's just a draft of the five sections of the report and the recommendation for a procurement of a writer within that contained scope, she was fine with that, but as she talked about other things, it made her really nervous as to a report that maybe getting drafted without the input of TRC.

Chair Takamura said her first thought was to draft the outline and felt the TRC should start that already, and it could be limited to that, and should get a recommendation started for the writer. That's what the committee function would be.

Commissioner Knox asked if Commissioner Kaina was comfortable with that, just fearful of it going beyond that.

Commissioner Kaina said her concern especially under the Sunshine Law and given how the conversations has been, could go into more about I want this or I want that, formulating a report and policy has been talked about several times and recommendations a number of times.

Commissioner Knox said that was not his understanding. He asked Commissioner Kaina if she could also see that it benefits anybody to discuss specific proposals rather than just having a blank sheet. He could see a list of possible proposals without any specific recommendations.

Commissioner Kaina said again, we need to get the PFM report that has the recommendations. If it was just an outline of what was going to be the major categories of the report, fine. Anything more was beyond the scope.

Commissioner Cook said that was more from an efficiency point of view to get the ball rolling.

Commissioner Kaina said if you start listing policy ideas and putting in your own policy ideas that was not presented was her problem.

Commissioner Knox said the part about "your own policy" thing, he doesn't see that happening.

Chair Takamura said the committee would start the outline and when the reports from PFM, DoTAX and Dr. Rousslang were received the TRC could review all the recommendations as a whole and do a recommendation for a writer.

Mr. Shiraishi said sounds like the TRC wanted to stick to the form and don't get into too much of the substance. The outline could be the different requests, different studies and topics assigned that could be major headings and the positions taken from those reports would be the decision of the TRC.

He said those major headings were determined by the requests the TRC made and trying to ask specific questions that relate to those topics without seeing the reports would get into policy. Right now, there wasn't too much to do in creating the outline except to compile that information.

Commissioner Kaina said she wanted the motions separated out, one for procurement and one to form the committee.

Commissioner Knox motioned to form a committee to create the procurement to find a writer and Commissioner Cook second the motion. The motion carried unanimously.

Commissioner Cook motioned to form a committee to draft an outline for the TRC report to be provided to the TRC for review and Commissioner Knox seconded the motion. The motion carried unanimously.

WRITTEN COMMENTS ON HAWAII'S TAX STRUCTURE OR ITEMS LISTED ON THE AGENDA:

Chair Takamura said the TRC received a letter from Mr. Fritz requesting to inspect the forecasting model developed by The PFM Group for the 2010-2013 TRC. She asked if he could be provided that.

Mr. Nishiyama said it was a public record and should be made available to him.

Mr. Shiraishi said he thought the model was proprietary and was unsure if it could be made available to the public.

Mr. Nishiyama asked if the proprietary information could be removed from the model.

Chair Takamura said she was referring the request letter to legal counsel for response.

Commissioner Knox asked Mr. Fritz, he wasn't asking for a description, not for anything written, but if he wanted to sit at a computer and see what's inside?

Mr. Fritz said he had no idea and that he had never seen it. He made four requests for it to four different tax directors and tax people every year. It has been mentioned in the committee reports and TRC meetings several times previously. Furthermore, there was a statement that said the new model would be based on the old model. With proprietary information, there were a number of issues dealing with that and this was the first time he made the request in writing.

Mr. Shiraishi said to Mr. Bauer that Mr. Fritz has requested the model his company prepared for the previous TRC.

Mr. Bauer said PFM entered into a licensing agreement with the state which was done with the prior director of DoTAX. That licensing agreement allowed them to use but not publically distribute or provide it outside of those whom were licensed to use it. Yes it had proprietary information and the work that went into it was not something PFM would share with the general public.

Mr. Nishiyama asked Mr. Bauer if he could put that in writing and send it to him.

Mr. Bauer said he would get their attorneys to respond in writing, but needed the letter for which the request was being made. He knew for a fact that there was a licensing agreement entered into. He knew what the history was of their models and that requests were made in other states but models were never forwarded nor considered to be public information in any of those states where a model was done.

Mr. Shiraishi was a copy of the request letter would be sent to him.

Mr. Fritz said to Mr. Nishiyama that he would like to see the licensing agreement.

Mr. Nishiyama said that was fine.

Mr. Fritz said he would like to see the licensing agreement talked about to see how it interfaces with what's a public document and what portions of the model would be available.

Mr. Nishiyama said DoTAX would respond accordingly with necessary documents.

Mr. Bauer said PFM would respond to the state and there was no standing with Mr. Fritz to compel PFM to provide him anything as a private citizen.

Chair Takamura said to Mr. Fritz that DoTAX would provide a legal response.

PUBLIC COMMENTS ON HAWAII'S TAX STRUCTURE OR ITEMS LISTED ON THE AGENDA:

Mr. Fritz said draft minutes was not posted 30 days after the April 24th meeting; PFM documents problematic because not tabbed or tagged, alternate text missing from graphics and images, rows and tables not set up properly for people using screen readers and was not compliant with Comptroller Memorandum 2010-28.

He also wanted a copy of Mr. Colby's presentation.

NEXT MEETING:

The next meeting was scheduled for Thursday, July 6, 2017 at 1:30 PM.

ADJOURNMENT:

The meeting was adjourned at 3:10 PM.