

TAX REVIEW COMMISSION

MINUTES OF THE SIXTH MEETING OF THE
TAX REVIEW COMMISSION
HELD AT 830 PUNCHBOWL STREET, ROOM 221
IN THE CITY AND COUNTY OF HONOLULU
STATE OF HAWAII, ON TUESDAY, NOVEMBER 29, 2005

The Commissioners of the Tax Review Commission met at the Department of Taxation, Director Conference Room, in the City and County of Honolulu, State of Hawaii, on Tuesday, November 29, 2005.

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

Absent: Carolyn Ching, Carolyn L. Ching CPA

Staff: Tu Duc Pham, Donald Rousslang, Josephine Malama

Other: Tom Smyth, DBEDT
Diane Erickson, Department of Attorney General
Peter Fritz, Chun Kerr Dodd Beaman & Wong
Lowell Kalapa, Tax Foundation of Hawaii
Marilyn Niwao, Hawaii Association of Public Accountants
Titin Liem, DOTAX

CALL TO ORDER

Chair Isaac Choy called the meeting to order at 10:00 a.m.

It was moved by Mr. Heller and seconded by Dr. Grandy to amend the agenda and move the item under New Business to Old Business following Study 4. The motion was carried unanimously.

APPROVAL OF OCTOBER 25, 2005 MEETING MINUTES

It was moved by Mr. Roberts and seconded by Mr. Okada to approve the minutes of October 25, 2005. The motion was carried unanimously.

Dr. Donald Rousslang was introduced as Barney Wilson's replacement. He worked for the U. S. Treasury, Office of Tax Analysis, for ten years prior to coming to the Department of Taxation.

He worked in the Rules Office, Technical Section, before transferring to the Research and Planning Office to work as liaison to the Tax Review Commission. Dr. Rousslang will be writing the Tax Review Commission report for the 2007 Legislature. Chair Choy announced that Mr. Wilson left for personal reasons. He expressed appreciation working with him and wished him well in his future endeavors.

Ms. Marilyn Niwao was acknowledged and introduced as a member of the past Tax Review Commission.

COMMUNICATION TO THE COMMISSION

Mr. Heller reported that the 2005 Report on State Revenues and Expenditures by the Tax Foundation of Hawaii is available for free download from the website. He offered his copy for review.

Chair Choy asked if the annual State tax report is available. Dr. Pham responded that the report is in draft and should be final within a month or two. Mr. Smyth reported that he has two copies of the Presidential Report, 350 pages, one for the Tax Department and one for the Commission.

OLD BUSINESS

Status of RFP for External Studies

Study I: Economic, Revenue and Distribution Impacts of General Excise and Use Taxes

Mr. Heller stated that he was not exactly sure how it happened but the latest draft seems to be the reverse of what the committee previously discussed. The group talked about a study that would analyze the effects of changing the general excise tax from 4 to 4 1/2 percent, and then as an add-on to that, look at what the equivalent sales tax rate would be if we went to a typical sales tax model. It has now been turned around so that the main thrust is looking at a sales tax equivalent rate, and then with resources permitting, addressing the effects of the Honolulu county surcharge. He does not remember any discussion by the group that would make such a big shift in emphasis. He stated that he is not necessarily opposed to the way it is restructured but felt it is a major decision that the Commission should make.

Dr. Grandy stated the spirit of this was as an additional suggestion from the staff for the Commission to consider. We can accept it or reverse it. Piggy backing on what Mr. Heller said, Dr. Grandy would like the Commission to think about the suggestion at the end of the first paragraph regarding scenarios that would involve estimating the effects on various types of businesses in Hawaii including the effects of competitiveness with producers outside the State. This may be an interesting thing to do, but it will likely be time consuming and expensive. Dr. Grandy's main interest in portions of this is to think about the excise tax system as a whole as

opposed to investigating particular industries. If people are interested in looking at particular types of businesses, he would prefer the Commission talk about it.

The Chair stated that a lot of these issues are a function of dollars and having researchers available to do them. It is easy to add issues, however, it doesn't look like we have enough money or people to submit proposals to do them. What we would have to do is change the emphasis and narrow things down to accommodate the budget.

In following up on the viewpoints expressed, Mr. Heller agreed that talking about estimates of the effects on various types of businesses in Hawaii is pretty wide open and can cover a lot of ground. If we are going to ask for something more specific that's fine. Leaving it this broad will invite a lot of debate down the road and we will not know exactly what we are going to get. It will also make it difficult to get someone to offer a bid. If we are going to focus on the probable cost of the study, we need to look at that first.

The Chair asked Dr. Pham if we have enough money to do the studies. He agreed that this portion of Study 1 was too broad and we should narrow it. Mr. Smyth commented that another approach might be to provide an opportunity for representatives of different industries or associations to comment on this issue. He was not sure if we had enough time to do it, but it would help shift the resources.

The Chair asked how could we lessen the scope of the study? It was suggested and agreed that the following portion of the first paragraph be eliminated: "For both scenarios, the study should also provide estimates for the effects on the various businesses in Hawaii, including the effects on competitiveness with producers outside the State, and for the effects on economic efficiency of the tax system". Also, eliminate the words "Resources permitting" from the second paragraph.

The Chair inquired about the negotiation process, if people go line by line with a price per line. Dr. Grandy was not sure how to answer because he does not have that level of experience. But, his understanding is people do go line by line and if we give them an indication of priority, it would be helpful for them to respond. Mr. Smyth added that we should put down the main thing we want, itemize the other things we might like to have, and have the bidder price them separately. This will allow the Commission to decide what portions of the study to complete after we get prices.

Mr. Heller was asked for his concerns over the changes. He responded that the way it is written now is opposite from what we previously discussed. Dr. Grandy felt comfortable with the revision stating that the first paragraph would be more of interest to the policymakers and the second paragraph easier, more straightforward, and less interesting than the first. The Chair asked if everyone was comfortable with the changes and if the RFP was ready to go? There was no opposition. Mr. Heller stated that the Committee already went through the procedural parts of the RFP and we should hurry and get it out.

Ms. Niwao asked how different is this study from the one conducted by William F. Fox? Dr. Pham responded he would have staff look into it and work with the subcommittee. Mr. Kalapa commented that the typical sales tax is not the same as general excise tax. The GE tax applies to transactions that are not subject to sales tax and that needs to be clarified. Mr. Heller responded that's why we have the study in two parts, with one part preserving basically the existing GE tax base but taking out inter-business transactions. In that part, we would still be applying the GE tax to services and rent. Discussion followed. Mr. Heller added that we are basically asking for two numbers: (1) what would the rate be if we just take out business to business transactions, leaving in rent, services, and everything else, and (2) what if we take out services, rent and other activities that are not typically covered by state sales taxes, in addition to taking out business to business transactions, what would the rate be? Dr. Pham reiterated that staff would provide the numbers for the person who is awarded the contract. The Chair reminded everyone that the subcommittees have the final say on the RFPs.

Study 2: Cost and Benefit Analysis of Selected Recent Tax Credits

Dr. Grandy stated that the third paragraph is consistent with what we've talked about. The fourth paragraph on cost of capital came from Dr. Rousslang, who explained that whenever you give a tax credit to someone, you are changing the cost of capital for the project. He was concerned that the way it was phrased, the focus would be on the direct beneficiaries of the credit. Part of the concern about the economic effects of such credits is that they skew investment incentives. Dr. Pham stated that data collected on the selected tax credits is limited or in some instances is not yet available, mentioning as examples Ko Olina Resort, Marina Attractions and Educational Facilities, and Motion Picture and Film Production. What we are trying to do is get some cost/benefit analysis on tax credits by using Ko Olina as an example. If we don't have the data, we want more transparency when enacting these credits. If the report comes out that they have all the data and can estimate the economic impact, then it's fine. The proposal should include a proposed price for studying each type of tax credit. It was suggested that the fourth paragraph be eliminated. The Chair reiterated that the revision would be up to the subcommittee.

Study 3: Economic Effects of Eliminating the General Excise Tax Exemption of Nonprofit Organizations

Mr. Heller reported that the draft incorporated some of his suggestions on how to handle the study on nonprofits. The bigger question is whether we decided to focus only on nonprofit and exclude all others. He doesn't recall the Commission making that decision. Chair Choy reported that there were too many exemptions, a total of 65. We are not restricting only to nonprofits. We used nonprofits as a generic example. Cost-wise, how many can we do of the 65? Dr. Pham reported that staff is able to give the dollar impact for all 65. Mr. Kalapa suggested that we find out the rationale for each of the exemption and see if the rationale is appropriate today. It was also suggested that we put the list by size, after we cross off the ones we clearly don't want to study, and let the bidder give us separate prices for each part of the

study. It was agreed that we should not limit the study to nonprofits, and the subcommittee will go back and work out how to expand the list.

Study 4: Effects of Eliminating Corporate, Insurance and Personal Income Taxes, and of Adjusting the Franchise Tax

Mr. Heller commented that the study was originally split in two topics – elimination of corporate tax and elimination of personal income tax, with corporate tax given the higher priority. The way it's rewritten, the two topics are combined. The Chair commented they were put together so the vendor would have it as one study, but the results will be sectionalized. Ms. Niwao questioned the need to collect revenue data for corporate and personal income taxes because that information is available. She asked, "Are you asking the contractor what kind of tax increase we need to make up for that?" Mr. Heller stated we are going beyond revenue replacement. We're talking about economic modeling and the effect on overall output, jobs, new business formation, and other factors. In essence, the study should address the overall effect on the State's economy.

STATUS OF INTERNAL STUDY/RESEARCH

Dr. Grandy reported that he and Dr. Pham met with Pearl Imada Iboshi of DBEDT to ask if they would be available, with approval from the Commission, to assist in calculating economic impacts or assist in coordinating with a vendor to do some of the studies. They said they would but some cost would be involved. How we would do this and what would be specifically entailed are things we are unable to address at this time until we see what kinds of responses we get from the RFPs and what actual studies will be framed.

Dr. Pham reported that external Study 2 would be done with input from the Tax Department and DBEDT because they both have interest in this issue. He went on to say that if we cannot get contractors for the other external studies, we may have to ask DBEDT and, together with the Tax Department, get the studies done. Pricewise, Dr. Pham reported that Study 1 would be the cheapest. Mr. Smyth suggested that the RFP itemize the different areas of work to be done so people can bid separately on each part.

The Chair had a question about quality of the report. What would be a quality report versus one that lacks substance? Dr. Grandy stated that for economic analysis, contractors might have to rely on DBEDT for information on input/output models, estimates and multipliers. The issue of quality should be a consideration of the Commission for selection and implementation. Mr. Heller added that various mechanical questions are included in the RFP – each bidder is asked to tell the Commission what data they plan to use and what their basic methodology will be.

A status report of the internal studies was distributed. Due to time, the Chair suggested the Commission members review the report and be ready to discuss it at the next meeting. He also asked that they come prepared to give their comments so staff can finalize the studies. This is in case we forgot to include something.

Ms. Niwao questioned the retirees' distribution from defined benefit plans and defined contribution plans being exempt from State taxes. She was asked to email her concern and that it would be included with the list of other suggestions. Chair Choy reiterated that the topics for external and internal study/research and our list of potential changes to the tax law reflected input from the public.

ANNOUNCE NEXT MEETING

There will be no meeting in December. To make up for it, we will have a meeting on Tuesday, January 10, 2006. Our regular meeting will be on Tuesday, January 31.

A tour of the Tax Department was offered to the Tax Review Commission. It was suggested it be included with the January 10th meeting. Mr. Heller stated that since he frequently visited the Department, he is more interested in seeing an organization chart and budget of the Tax Department. He would like to know the number of personnel and the cost involved in performing each of the Department's major functions. Mr. Smyth stated that the public cannot be included in the tour. Jo Malama will arrange for a date and time in early January, 2006.

The deadline for the RFPs going out will be the morning of January 10th. Mr. Smyth stated that we need to list the RFPs and publicly announce when they go out.

Items for the next meeting should be listed on the agenda. There have been times, due to time constraints, when items listed were not covered. Per Ms. Erickson, those items can be tabled to the next meeting.

Chair Choy thanked everyone for their hard work and wished them a happy holiday.

ADJOURNMENT

It was moved by Mr. Heller and seconded by Mr. Roberts to adjourn the meeting at 11:50 a.m. The motion was carried unanimously.