

TAX REVIEW COMMISSION

MINUTES OF THE TWENTY-SECOND 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, OCTOBER 31, 2006

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, October 31, 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

Other: Jeffrey Au, PacifiCap Group
Hayley Callahan, DOTAX
Diane Erickson, Dept. of Attorney General
Lowell Kalapa, Tax Foundation of Hawaii
Johnnel Nakamura, DOTAX
Tom Smyth, DBEDT

CALL TO ORDER

Chairman Isaac Choy called the meeting to order at 9:05 a.m. with a quorum present.

He stated that it was his intention to post the draft report onto the website on November 19, 2006, and the final report approved at the next meeting. The report needs to be at the printers by December 1, 2006. Therefore, their work must be completed by the end of the meeting.

APPROVE MINUTES OF MEETINGS OF SEPTEMBER 22 AND 26, AND OF OCTOBER 6, 17, AND 25

The October 25, 2006, meeting minutes were not completed in time for the meeting. The Chairman called for any corrections or additions to the minutes for the meetings on September 22, 2006, September 26, 2006, October 6, 2006, and October 17, 2006, including the minutes for the executive session; there were none. Releasing the minutes of the Executive Sessions held, the first on March 7, 2006, and the second on October 17, 2006, was also discussed.

It was moved by Mr. Heller and seconded by Mr. Okada to approve the minutes of September 22, 2006, September 26, 2006, October 6, 2006, and October 17, 2006, and also to make public the minutes of the March 7, 2006, Executive Session and the October 17, 2006, Executive Session. The motion carried without opposition.

ANNOUNCEMENTS

Correspondence Received. The Chairman noted the receipt of correspondence regarding the streamlined sales tax project that had been received from Rachel Chang and Susan Sunderland, and correspondence regarding the qualified high technology business (QHTB) investment tax credit received from Henry Ting, Jeanne Unemori Skog, David Fisher, and Scott Weeker.

He also acknowledged the receipt of correspondence from The Honorable Georgina Kawamura, Director of Finance, transmitting the study on *Hawaii's State Budget Process and Budget Stabilization Funds*.

Also received and distributed to the Commissioners was supplemental information from Ann Chung of the Hawaii Science and Technology Council on data collected by the Department of Taxation on the QHTB investment tax credit and the release thereof, and e-mail from Dr. Bruce Bird regarding changes made to the draft report.

The Chairman then noted that the Commissioners had received a copy of the Washington State Department of Revenue's report entitled, *Descriptive Statistics for Tax Incentive Programs – 2006 Report Covering Activity During Calendar Year 2005*.

The Chairman thanked all who submitted testimony and provided information to the Commission to help them in their deliberations.

WORK ON PROPOSED RECOMMENDATIONS TO COMPLETE REPORT

Dr. Rousslang had prepared a list of deferred and new recommendations. However, Mr. Roberts and his high technology subcommittee had not completed work on the recommendation on the disclosure of information for purposes of evaluating the QHTB investment tax credit.

The Commission recessed at 9:18 a.m., to allow the high technology subcommittee to meet and come up with a recommendation to present to the full Commission. The income tax subcommittee also met during the recess.

The Commission meeting reconvened at 11:30 a.m.

CONSIDER ADDITIONAL RECOMMENDATIONS ON THE STREAMLINED SALES TAX PROJECT, ON THE HIGH TECHNOLOGY BUSINESS INVESTMENT TAX CREDIT, ON EXEMPTIONS FROM THE GENERAL EXCISE TAX, AND OTHER TOPICS THAT COMMISSIONERS MAY WANT TO ADDRESS.

Dr. Rousslang prepared a handout of deferred and additional recommendations to assist in the discussions. The commission first addressed the recommendation that had been discussed by the income tax subcommittee during the recess. That was followed by a consideration of the recommendation the high technology subcommittee put together during the recess. The remaining items listed were covered after that.

Recommendation 14. Hawaii's individual and corporate income taxes should be eliminated, and the revenue replaced with in-tandem increases in the general excise tax (GET) and the Public Service Company Tax (PSC).

The Chairman stated that his idea in recommending this for a study was the complexity of the system and the amount of administrative overhead for Hawaii. He felt that eliminating the income tax leaving only the GET would greatly simplify things and reduce the amount of resources that have to go towards things like administering the QHTB investment tax credit.

The study, done by Dr. Rousslang, has been posted on the Commission's website for a month. The executive summary lists a number of advantages and disadvantages. He specifically cited as advantages the shifting of more of the tax burden to nonresidents, the transparency of the GET, and improved stability of government revenue in addition to a number of others. The main disadvantage is the regressivity of the GET, which the offset through low-income tax credits and other means by the income tax. Although not in the report, the Chairman noted that the income tax is also used as a political tool to grant favors. Eliminating the entire income tax, however, was believed to be too extreme.

Mr. Heller stated that their revised recommendation was to (A) continue to study and evaluate the option of eliminating the Hawaii personal income tax; and (B) eliminate the Hawaii corporate income tax.

Their explanation read as follows:

The Commission received a suggestion that all Hawaii income taxes (corporate and personal) be eliminated, with the revenue to be replaced by increases in the general excise tax and public service company tax. The Commission is not ready

to make that recommendation at this time, but believes that the idea deserves further consideration.

Elimination of the corporate income tax would not have a substantial effect on overall state tax collections, and would not require an increase in the general excise and public service company taxes. Eliminating the tax, however, would eliminate substantial amounts of work for both taxpayers and the Department of Taxation. As it is now, the corporate income tax requires expenditures of time, effort and energy that are disproportionate to the benefits derived from the tax. If this recommendation is implemented, the Legislature may also wish to look at the rate of the franchise tax.

With respect to the personal income tax, the Commission notes that it offsets, to some extent, the regressive impact of the general excise tax. If the personal income tax were eliminated, replacement of the revenue would require an increase in the general excise tax, thus worsening the regressive impact. While unwilling to recommend elimination of this tax, however, the Commission does suggest increasing the standard deduction and the personal exemption, and raising the threshold at which filing of a Hawaii income tax return is required. All of these steps would reduce the burden on taxpayers, especially lower-income taxpayers.

Mr. Roberts asked if they addressed the issue of reducing the number of exemptions from the GET. Mr. Heller and the Chairman replied that they didn't address that and noted that there had been general recommendations to reduce the proliferation of exemptions and that they were focusing on just the income tax.

Mr. Heller noted that a substantial increase in the GET to about 6.8% would be required if they eliminated the personal income tax. The corporate income tax is a tiny percentage of the overall state budget.

Mr. Okada asked if the bank franchise tax would be reduced as well, because that tax is paid in lieu of both the GET and income tax. The Chairman stated that, in their discussions, the franchise tax and insurance premiums tax would remain unchanged, although Mr. Heller stated that it would be open to discussion as they had not discussed that specific topic; perhaps the franchise tax would need to be reduced somewhat. Dr. Pham stated that the franchise tax is very small, about \$16 million, and would not be impacted very much.

Ms. Ching expressed concern about businesses switching from LLC and other pass-through organizations to corporations. Mr. Heller stated that they had assumed that state tax considerations would not drive behavior because federal tax considerations are far more important. In addition, corporate income tax is complicated and takes a lot of taxpayer and Department time, and what the State gets out of it is not that much in the big picture.

Mr. Heller asked if, for purposes of writing a recommendation, they should say anything about the franchise tax and insurance premiums tax.

The Chairman stated that eliminating both the individual and corporate income taxes would eliminate about 60% of the current State tax forms, and asked how many forms would be eliminated if just the corporate income tax was eliminated. That number was not known, but Ms. Tokishi noted that many of the income tax forms, such as many credit forms, were used for both individual and corporate income taxes such that the number may not be that significant.

Mr. Heller reiterated that the complexity of the corporate returns made eliminating it worthwhile.

It was moved by Mr. Okada and seconded by Ms. King, that the State (A) continue to study and evaluate the option of eliminating the Hawaii personal income tax; and (B) eliminate the Hawaii corporate income tax. The motion 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

Recommendation of the high technology subcommittee regarding the high technology business investment tax credit.

Mr. Roberts distributed the text of the subcommittee's recommendation to the Commission and to the public, which read as follows:

This Commission shares the view of the 2001 – 2003 Tax Review Commission,

"A tax incentive program is a potential 'black hole', because it is a future benefit of unknown proportions, which is determined by the favored taxpayer's interpretation of what the tax credit should be, and is claimed on a tax return which is confidential."

We believe Act 221/215 is such a potential black hole. We recommend that the Legislature avoid using these types of tax credits as an economic development tool.

As for Act 221/215, at a minimum, this Commission suggests the following changes be adopted:

Increase transparency and timely disclosure so that the credit can be evaluated effectively. Towards this end, we believe the data

collected should be mandatory and expanded to include sales; employment by compensation ranges and status, including full-time, part-time, and seasonal; and number of trademarks, patents, and copyrights obtained during the year. These data should be collected by NAICS codes and distributed to the public periodically, but not less frequently than annually. To gather these data, a tax confidentiality waiver should be required so that aggregated data can be released to the public.

Mr. Roberts stated that the subcommittee believed that the policy of tax incentives is flawed, so they wanted to make a general statement and then transition to the credit. If the credit was to be maintained, then, at a minimum, address certain information and disclosure issues.

They had discussed whether the credit should be capped and a whole host of issues that were listed in the "Possible Framework for Discussions Regarding High Tech Credit" handout that was distributed both to the Commission and to the public (copy attached to the minutes).

Mr. Roberts noted that the handout reflected a continuum that ranged from do nothing on the left to repeal the credit on the right, and that their recommendation fell to the left of that continuum.

Mr. Roberts stated that Washington State served as the model for transparency even though their taxation structure is different.

In response to a question from the Chairman, he explained that their initial methodology had been to immediately eliminate the Status Quo and Kill options, but that proved difficult as they were inclined to recommend the repeal of the credit as a matter of policy with respect to tax incentive programs. However, this credit already exists, it has political support, and they have incomplete data available such that it is not practical to evaluate the costs and benefits of the credit to get a definitive answer at the present time. However, they saw a potential for abuse and therefore felt that they needed to have more information in order to do it right if the credit is to be continued.

The Washington State model goes into issues such as employment and intellectual property that is generated. Employment is broken down by compensation range and part-time, full-time, or seasonal, and those factors were important to policymakers evaluating the credit and were therefore included in the subcommittee's recommendation.

Mr. Roberts noted that there appeared to be some hesitancy on the part of the taxpayers to provide information even though the data to be released was aggregate data. Therefore, they felt that some sort of tax waiver was needed. If taxpayers wanted the credit, then they needed to give up something with that something being whatever it is that would make the Department comfortable with releasing aggregate data that did not identify the specific business. This could facilitate the releasing of timely data, in addition to staffing issues being addressed.

The subcommittee also discussed how businesses should be categorized, and whether in addition to the NAICS codes the Department should have the flexibility to develop other criteria, something that was dropped although it remains an issue.

Ms. King stated that it seemed that the subcommittee's position contradicts what their position as a policy issue was, which was to kill the credit. Mr. Roberts agreed, but Dr. Grandy stated that he preferred to see it as a layering in order of preference rather than a contradiction.

The Chairman asked if the subcommittee had addressed performing arts and drop down subsidiaries. Mr. Roberts said that they had. Dr. Grandy said that they had decided not to mention these in their proposed language, and that he had argued against trying to refine and restructure the credit as the Legislature would do whatever it wanted and should be given maximum flexibility to do what it felt was sensible. However, the Commission should suggest parameters to promote accountability and transparency and remind the Legislature that the Commission would prefer to not have economic incentive tax credits like this at all.

The Chairman stated that he is troubled when person after person says that the fictitious example he had discussed with various people would qualify for the QHTB investment tax credit, and the fairness issue as well. Since there had been some people who had questioned the study of this one credit to the exclusion of the other credits, he asked if any other tax credit had the same effect.

Mr. Roberts stated that the subcommittee had spent one-third of its time discussing the generic issue of whether they should be considering just this credit or tax incentives and credits in general. They decided to touch on tax incentives and credits in general and also provide guidance on the QHTB investment tax credit.

Dr. Grandy was reminded that they had discussed adding an additional sentence at the end of the text that was read that said, "These considerations may well apply in general to other tax credits."

Ms. King thought that data reporting, rather than data collection, should be mandatory. The others agreed to the change.

Mr. Okada asked if this was a legislative matter or whether the Tax Department could require certain data. Mr. Au stated that the Department already did, and Ms. King added that it was already on the forms.

Mr. Heller agreed, but stated that they were recommending specific legislation to require different kinds of data like the NAICS codes. Mr. Au objected to the NAICS codes, because the data provided must relate to the credit. The NAICS codes involve some activities unrelated to the QHTB investment tax credit. The only relevant data are the data for sectors that are covered by the credit.

Mr. Roberts noted that the entire company benefits from the credit even if only part of the company does credit-related work. However, Mr. Au stated that what mattered was what the

classification of the company was. For example, Mr. Au cited recent press reports that stated that technology jobs had dropped, but the drop was in sectors that were not covered by the QHTB investment tax credit but were included in the NAICS codes; call centers for example.

Dr. Grandy noted, however, that it would be the company itself that would be reporting their NAICS code classification for those activities rather than taking information about the company and determining which category to put it into. Mr. Roberts reiterated that they had considered developing additional activity classifications and had decided not to do that.

The Chairman mentioned that, under the Washington State model, there are statistical reports that lead up to a mandated effectiveness report, and asked if the Commission should mandate an effectiveness report in addition to the data capture. The had discussed that, but decided to limit their recommendation to just creating the data and making readily available to the public, the academic community, and the business community and let them interpret and analyze it as they see fit.

Mr. Heller also noted that, in their general recommendations, they had already approved one that recommended that credits be enacted with an automatic sunset date and reviewed prior to any renewal or extension.

The Chairman stated that his concern is that they do something to avoid the problem they had this year with the study conducted with Dr. Marcia Sakai when prior, to the expiration of the credit in 2010, someone orders a study of the credit. He would like to ensure that the Commission's recommendation helps so that when the ultimate report is done, it is not a surprise to everyone, and there are no assertions that the researcher is wrong, the data is wrong, the data is old, etc.

Dr. Grandy stated that he didn't think that would happen because what was envisaged was the timely reporting of data that is made public such that any fight would be about what study would be done with that data. The problem now is that they don't have timely access to publicly available data such that anyone doing a study would have to cobble together data from disparate sources.

Mr. Au asked if, to the extent that Form N-317 data currently exists within the Department of Taxation, the recommendation really should be to ask the Tax Department to release that data in aggregate form that preserves confidentiality. Maybe they could change the data collection for the future, but everyone wants to see the existing data in aggregate form.

However, the Chairman noted, and other commissioners agreed, that the Form N-317 is inadequate and is not a good attempt. Mr. Au again argued that the focus should be on requiring the release of data already collected. The Chairman responded by saying that their recommendation is for additional data collection going forward, and that they will have to rely on existing information provided on the Form N-317 anyway. The Chairman also noted that the added line suggested that such standards be applied to other credits as well.

The Chairman observed that the Washington State law has an accountability statute provision in addition to the credit provision, with different accountability standards for each of the credits.

Mr. Smyth asked if they intended to have an accountability provision for each credit. Mr. Roberts reiterated that they had economic development credits in mind. Mr. Smyth, however, stated that a number of credits, including the low income housing tax credit could be viewed as economic development credits. However, the Chairman reiterated that there are different requirements for different credits and some credits may not have such a requirement at all. Dr. Grandy stated that they were not going to set the requirements for all credits, and while they did specify certain data for the QHTB investment tax credit, the requirements could be different for other credits.

Mr. Au objected to the additional requirements, which he felt placed an unreasonable burden on the technology companies. He was particularly concerned about small companies as opposed to large corporation, noting that most of the firms have five to ten employees and that the largest such firm in Hawaii had 5,000 employees. However, it was pointed out that the Washington statistical report listed the size of the firms, and the Chairman observed that the report listed three firms with a total of four employees.

Mr. Au also questioned whether the Commission's conclusions and recommendations were based on empirical research or simply the preconceived ideas and notions of the Commissioners, because he felt that the methodology should be disclosed to the public. The Chairman stated that it was irrelevant. Mr. Roberts asked if Mr. Au really wanted to go there because the input stage had passed, and Mr. Au insisted that he did.

The Chairman stated that the reason that the Commission made those recommendations was because they were all residents of Hawaii, they love the community, they love the people, and they were trying to do their best to serve the people. That was the reason and their basis for making their recommendations.

Mr. Au continued to object to the language of the recommendation, particularly the repeating of the last Tax Review Commission's characterization of tax incentive programs as a "black hole," which he considered inflammatory and a statement of opinion that has no place in an objective study. Mr. Au also questioned the credibility of the Commission should it choose to use the term, "black hole" and ignore the costs of complying with the credit. The Chairman thanked Mr. Au for his input.

Mr. Heller noted that the language could be seen as inflammatory, and suggested that they delete the sentence that read, "We believe Act 221/215 is such a potential black hole," and revise the next sentence to read, "We recommend that the Legislature avoid using tax credits as an economic development tool," since they go on to make the specific recommendations anyway.

Following a general discussion on the wording, the Commissioners declined to change "shares" to "notes" in the first sentence, but agreed to (1) change the first sentence following the quotation to: "We believe Act 221/215 raises similar concerns"; (2) delete from the following sentence

"these types of"; (3) change the word, "collected," in the changes to be adopted section to "reporting"; (4) add a sentence at the end that read, "These considerations may well apply to other tax credits"; and (5) change all "Act 221/215" to "the high technology business investment tax credit."

It was moved by Dr. Grandy and seconded by Ms. Ching, that the following recommendation be adopted:

This Commission shares the view of the 2001 – 2003 Tax Review Commission,

"A tax incentive program is a potential 'black hole', because it is a future benefit of unknown proportions, which is determined by the favored taxpayer's interpretation of what the tax credit should be, and is claimed on a tax return which is confidential."

We believe the high technology business investment tax credit raises similar concerns. We recommend that the Legislature avoid using tax credits as an economic development tool.

As for the high technology business investment tax credit, at a minimum, this Commission suggests the following changes be adopted:

Increase transparency and timely disclosure so that the credit can be evaluated effectively. Towards this end, we believe the data reporting should be mandatory and expanded to include sales; employment by compensation ranges and status, including full-time, part-time, and seasonal; and number of trademarks, patents, and copyrights obtained during the year. These data should be collected by NAICS codes and distributed to the public periodically, but not less frequently than annually. To gather these data, a tax confidentiality waiver should be required so that aggregated data can be released to the public.

These considerations may well apply to other tax credits.

The motion passed with the following votes: 4-Yes 2-No 1-Abstain.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	Abstain
Carolyn Ching	Yes
Christopher Grandy	Yes
Melanie King	No
Lon Okada	No

John Roberts Yes

A short recess was taken at 12:45 p.m., as it was thought that the Commission had to relocate to another room. However, that was not necessary, and the meeting resumed at 12:53 p.m.

Deferred Item 1: The Department of Taxation should review the certification process for the high-technology credit.

This was covered to some extent in another recommendation addressing the problem with the March deadline for filing the Form N-318A that falls during the income tax filing season. Discussion was held regarding the purpose of certification, and it was noted that the Department had earlier opposed certification, and Ms. Nakamura acknowledged the high administrative burden imposed on her office.

Mr. Heller suggested that the Department review the need for certification in light of their earlier recommendation to collect more data. Mr. Au suggested simply modifying the information required for certification; eliminating the certification requirement, even if it would save the companies the certification fee, concerned the industry because opening the statute to a legislative change could result in unwanted changes such that nobody would invest during the session and companies could run out of money.

It was moved by Ms. King and seconded by Mr. Okada, that in light of the recommendation to require the collection of more data for claims of the high technology business investment tax credit, the Department should review the continued need for certification. The motion 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

Deferred Item 2: Hawaii should maintain the structure of the General Excise Tax.

This was covered in recommendation 7 on page 14 of the draft report, which recommended rewriting the statute for clarity and transparency, so no action was taken.

Deferred Item 3: Hawaii should consider replacing the General Excise Tax with a sales tax.

This was addressed in the section of the draft report, beginning on page 11, although that text was a discussion and not a recommendation. No motion was proposed.

Deferred Item 4: The General Excise Tax exemption for nonprofit organizations should be clarified to improve taxpayer compliance.

The Commission had already adopted a recommendation to require nonprofits to obtain a GET license. However, it was recognized that many nonprofit organizations did not realize that they were required to apply for tax exemption and to understand, that not all their income was tax exempt, and that there was a difference between what was exempt from income tax as opposed to what was exempt from the GET. Mr. Heller, however, felt that a lack of education was the problem and that additional legislation was not required. No motion was proposed.

Deferred Item 5: Counties should make better use of existing taxing authority: a) property taxes; b) user fees and charges; and c) development fees and exactions.

This Commission had taken up this issue early on, and the decision had been to not review county taxes. Dr. Grandy asked if counties could be considered creatures of the State. Mr. Heller added that counties only had the ability to levy taxes to the extent granted by the State, this Commission did not have time to conduct a comprehensive review of county taxation, and they should therefore leave it to a future Commission to consider.

This item had been deferred from the September meeting pending further information on the status of the Senate Concurrent Resolution No. 191. That resolution had been introduced during the 2006 Legislative Session to recommend that a task force be established to conduct a holistic review of State and county taxation. The original resolution included the Tax Review Commission as a participant, but that provision was subsequently deleted. The resolution did not pass.

Both Dr. Grandy and Mr. Heller expressed uncertainty on what this recommendation actually meant.

Mr. Heller suggested that they might consider a recommendation to amend the law to specify that the Tax Review Commission look at both State and county taxes. The Chairman expressed concern about a lack of time, money, and people to conduct such a study. Ms. Tokishi noted that the counties might want to have a say in who was appointed to the Commission.

Ms. Ching also expressed a reluctance to act on this. No motion was proposed.

Recommendation 1a: The Commission believes that the goal of coordinating the collection of taxes on interstate, sales such as via the Internet, is desirable. However, the costs of transitioning to coordination are significant. We believe that Hawaii should remain involved in these discussions, and we support the work of the Hawaii commission on the Streamlined Sales Tax Project.

Recommendation 1b: The Commission believes that it is not necessary or advisable to join the Streamlined Sales Tax Project at this time. We believe that the Legislature should wait until the

major states have joined the project and implemented it for several years. We therefore recommend that the matter be examined again in the future, after more information is available on the operation of the project and on the costs and benefits of joining.

Recommendation 1b is the recommendation proposed by the Chairman and that had not been voted on but that had been included on page 9 of the draft report for drafting purposes. Recommendation 1a was proposed by Dr. Grandy as an alternative and is a qualified support of the Streamlined Sales Tax Project (SSTP).

The Chairman stated that the first sentence of Recommendation 1a was okay but not the second. Cost was not the issue; whether the big five states join or not is the issue since it would die without them. If all five states join, then the SSTP would continue. The purpose of the SSTP is to show that all the states can have a uniform law. If uniformity can be achieved, then federal preemption would occur and we would have no choice but to be subject to those federal rules. To put forth the effort now would be a waste of resources.

Dr. Grandy's concern was that the first sentence of Recommendation 1b sounded as if they were stepping back from the conversation. The Chairman suggested substituting Dr. Grandy's first sentence for the first sentence of Recommendation 1b. Ms. King stated that she liked first sentence of Recommendation 1b, and suggested adding Dr. Grandy's first sentence to that recommendation.

Further discussion was held with respect to changes and proposed changes to the original SSTP agreement, such that anything Hawaii adopted now would be subject to subsequent change. Mr. Roberts asked how the SSTP was currently monitored. Ms. Nakamura stated that the Department currently monitors the SSTP; it could send a representative to the meetings but doesn't due to budget considerations.

Mr. Heller thought that the Commission should take a position if they could agree on one, and didn't think that Craig Hirai's commission would come up with anything in the near future. He suggested taking Dr. Grandy's proposal and adding to it a statement that the Commission doesn't think that Hawaii should make a final commitment to the SSTP right now. Dr. Grandy stated that he would be fine with that, and that perhaps they could delete the second sentence regarding the transition costs. The Chairman asked if they would consider adding that they wait until after the major states have joined and it be implemented for several years. They didn't think that should be added.

Dr. Grandy and Mr. Heller suggested that Recommendation 1a be rewritten as follows:

The Commission believes that the goal of coordinating the collection of taxes on interstate sales, such as via the Internet, is desirable. Hawaii should remain involved in these discussions, and we support the work of the Hawaii State commission on the streamlined sales tax project. However, we do not feel that the state of Hawaii should make a final decision on this issue yet.

Additional discussion was held regarding the potential influence Hawaii would have should it join now. However, it was felt that Hawaii was too small a state compared to the major five states that have yet to join. Also, Hawaii's tax system is not as complex as those in other states and any participation would therefore be a waste of resources. Dr. Pham also noted that joining the SSTP now would place a severe burden on the Department's employees who already are taxed with implementing the county surcharge. It would be best to wait for a few years after the implementation of the county surcharge.

Ms. Nakamura asked if anyone was concerned about home rule issue should Hawaii join, since the GET would have to be changed whenever a change is made to the SSTP agreement based on what 15 other states wanted.

Mr. Heller stated that it was of concern and was one of the reasons why he did not want to join now, but he also did not want to preclude Hawaii's participation.

Both the Chairman and Ms. King agreed that they would prefer to put Dr. Grandy's sentence first, but then keep the rest of the original recommendation.

There were two revised recommendations, and the decision was to vote on one recommendation, and then vote on the other if the first did not pass.

It was moved by Mr. Heller and seconded by Dr. Grandy, that the following recommendation be adopted:

The Commission believes that the goal of coordinating the collection of taxes on interstate sales, such as via the Internet, is desirable. Hawaii should remain involved in these discussions, and we support the work of the Hawaii commission on the Streamlined Sales Tax Project. However, we do not feel that the state of Hawaii should make a final decision on this issue yet.

The motion passed with the following votes: 4-Yes 3-No.

The Chairman called for the vote:

Isaac Choy	No
Ronald Heller	Yes
Carolyn Ching	Yes
Christopher Grandy	Yes
Melanie King	No
Lon Okada	Yes
John Roberts	No

Recommendation 2: Because the GET is essentially a tax on consumption rather than profits, the Commission urges that consideration be given to eliminating the GET exemption for

not-for-profit organizations to insure that they are treated in the same manner as for-profit entities.

Dr. Grandy suggested this and the next recommendation based on the study by Dr. William Fox, and his contention that it is a sales tax on consumption. Mr. Heller stated that this would mean that such things as private school tuition, hospitals, and the like. This change would not apply to straight donations. Ms. Tokishi explained that there is a provision exempting gifts under section 237-24(4), Hawaii Revised Statutes (HRS), that is not part of the section dealing with tax-exempt organizations.

To address concerns that this recommendation does not apply to donations, Ms. Tokishi suggested adding, "This is not meant to eliminate the exemption afforded to donations and other gifts under section 237-24(4), HRS," at the end of the recommendation.

Discussion was held regarding combining recommendations 2 and 3, but the decision was to leave them as separate recommendations.

It was moved by Dr. Grandy and seconded by Mr. Roberts, that the following recommendation be adopted:

Because the GET is essentially a tax on consumption rather than profits, the Commission urges that consideration be given to eliminating the GET exemption for not-for-profit organizations to insure that they are treated in the same manner as for-profit entities. This is not meant to eliminate the exemption afforded to donations and other gifts under section 237-24(4), HRS.

The motion passed with the following votes: 4-Yes 3-No.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	No
Carolyn Ching	No
Christopher Grandy	Yes
Melanie King	No
Lon Okada	Yes
John Roberts	Yes

Recommendation 3: In the absence of eliminating GET exemptions for nonprofits, the Commission recommends that the Legislature consider establishing maximum exemption amounts for nonprofit organizations.

It was moved by Dr. Grandy and seconded by Mr. Heller, that the following recommendation be adopted:

In the absence of eliminating GET exemptions for nonprofits, the Commission recommends that the Legislature consider establishing maximum exemption amounts for nonprofit organizations.

The motion 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

Recommendation 4: The Commission recommends that the Legislature avoid applying the GET to business-to-business transactions. Exemptions of business-to-business transactions are appropriate, although the Commission endorses the expenditure of some audit resources to ensure that business GET exemptions are not used to avoid taxes on personal consumption items.

This position is in agreement with Dr. Fox's assertion that the GET is a sales tax, a position with which Dr. Rousslang agrees. There was discussion on what was meant by business-to-business; it could be just transactions currently taxed at the 0.5% rate or all transactions. There was concern about people creating business entities to avoid taxation on what are non-business transactions. Dr. Rousslang noted that Dr. Fox had stated that the State had already gone as far as it could to exempt or tax at a lower rate such transactions, and what was left was the hard stuff.

Dr. Grandy moved to adopt this recommendation, but there was no second.

Recommendation 5a: Proposals to exempt transactions from the GE should be weighed carefully. In general, exemption of transactions primarily affecting consumers is undesirable. The Commission therefore cautions against approving proposals to exempt health care services, food, apparel, or shelter, for example. The Commission suggests that if the Legislature finds it desirable to grant such exemptions on equity grounds, that the Legislature pursues those goals either through low-income credits against income taxes or through expenditure policy.

Recommendation 5b: Proposals to exempt transactions from the GE should be weighed carefully. In general, exemption of transactions primarily affecting consumers is undesirable. The Commission therefore cautions against approving proposals to exempt health care services, food, apparel, or shelter, for example. The Commission suggests that if the Legislature finds it desirable to grant such tax relief on equity grounds, that the Legislature pursues those goals

either through low-income credits against income taxes or through the appropriation and expenditure process, which enhances transparency and accountability.

Recommendations 5a and 5b are the same with slightly different wording. This would be in addition to the general recommendation on page 10 of the draft report regarding limiting exemptions.

There was general consensus that they preferred recommendation 5b

It was moved by Ms. King and seconded by Mr. Okada, that the following recommendation be adopted:

Proposals to exempt transactions from the GE should be weighed carefully. In general, exemption of transactions primarily affecting consumers is undesirable. The Commission therefore cautions against approving proposals to exempt health care services, food, apparel, or shelter, for example. The Commission suggests that if the Legislature finds it desirable to grant such tax relief on equity grounds, that the Legislature pursues those goals either through low-income credits against income taxes or through the appropriation and expenditure process, which enhances transparency and accountability.

The motion 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

Recommendation 6: The county surcharge should be applied across the State, on all islands. The revenue should be distributed to the counties and each county can then adjust its expenditures or its other taxes to obtain the balance it wants. It is simply not worth the cost, both to the State and to taxpayers, to administer the tax as it applies to a single county.

The Chairman stated that this does not have anything to do with the county surcharge per se. It is just that it is difficult to administer a tax when the rates are different in each of the counties. Mr. Roberts suggested saying that it was not practical to implement a county surcharge, to which the Chairman suggested that "county surcharge" not be used. Mr. Heller noted the difficulty in administering the county surcharge, including, for example, the allocation issues currently being addressed in the proposed rules. Ms. King stated that they should say "county surcharge" since that is what they mean.

Mr. Roberts indicated that he would have to vote against the recommendation as it implies that the county surcharge should be implemented in all counties and write a dissent. He expressed an understanding as to why it needed to be written in that way for purposes of Oahu's concern, so he suggested leaving the language as is, and he would write a dissenting paragraph or footnote.

Ms. Ching asked if they wouldn't still have the same problem since they wouldn't otherwise know which county to allocate the transaction to. However, Mr. Heller stated that it could be an agreed upon percentage similar to how the transient accommodations tax collections are distributed to the various counties.

Mr. Heller suggested that they recommend repealing the county surcharge. The Chairman, however, noted that funding for the proposed Oahu rail system would then be jeopardized.

Mr. Heller and Mr. Okada indicated that they also would vote against the recommendation, but that their reason was that they didn't like the county surcharge. Various changes to the wording were proposed, including having a single state rate with a portion of the revenue allocated amongst the counties, however none of the changes were agreed to.

It was moved by Ms. Ching and seconded by Ms. King, that the following recommendation be adopted:

The county surcharge should be applied across the State, on all islands. The revenue should be distributed to the counties and each county can then adjust its expenditures or its other taxes to obtain the balance it wants. It is simply not worth the cost, both to the State and to taxpayers, to administer the tax as it applies to a single county.

The motion failed with the following votes: 3-Yes 4-No.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	No
Carolyn Ching	Yes
Christopher Grandy	No
Melanie King	Yes
Lon Okada	No
John Roberts	No

Recommendation 7: The cost of the high technology business investment tax credit is high and it is subject to no practical limit. To prevent the credit from compromising the tax structure, it should be subject to an annual limit, as is the ethanol facility tax credit.

Ms. Ching stated that the subcommittee had discussed capping this credit but had decided against making such a recommendation. There was no interest in this recommendation and no motion was proposed.

Recommendation 8: The cost of the high technology business investment tax credit has proven hard to determine in a timely manner. From anecdotes it has heard, the Commission also believes that the credit is subject to substantial abuse. In order to get more control of the program and to curb abuses, the Legislature should change it from a tax credit to a program of grants administered by a State agency.

The Chairman suggested deleting the second sentence and adding “potential” to the following sentence such that it read, “In order to get more control of the program and to curb potential abuses, the Legislature should change it from a tax credit to a program of grants administered by a State agency.”

It was moved by Dr. Grandy and seconded by Mr. Roberts, that the following recommendation be adopted:

The cost of the high technology business investment tax credit has proven hard to determine in a timely manner. In order to get more control of the program and to curb potential abuses, the Legislature should change it from a tax credit to a program of grants administered by a State agency.

The motion passed with the following votes: 4-Yes 2-No 1-Abstain.

The Chairman called for the vote:

Isaac Choy	Yes
Ronald Heller	Abstain
Carolyn Ching	No
Christopher Grandy	Yes
Melanie King	No
Lon Okada	Yes
John Roberts	Yes

Ms. King noted that she is unsure about changing it to a grant program.

The Chairman asked the Commissioners if they wanted to add this recommendation to the QHTB investment tax credit provision enacted earlier, and they did.

Recommendation 9: The rate of the high technology business investment tax credit is overly generous, allowing investors to recoup the entire amount of their investment from the State over a five-year period. The rate of reimbursement should be reduced from 100% to 50%. Such a reduction would curb abuses and it would reduce waste by discouraging projects that are likely to return less than half of the original investment.

Dr. Grandy stated that it appeared to be a cap on the credit although Dr. Pham disagreed. The Chairman suggested deleting the entire last sentence. Mr. Roberts stated that the subcommittee could not agree on a cap either as a fixed dollar amount or as a percentage as he could not justify one number over another. Dr. Grandy stated that he would vote against this recommendation on the grounds that it encouraged the idea of a credit at all. Ms. Ching agreed. Mr. Heller indicated that he would have to abstain on this vote as well.

There was no interest in this recommendation, and no motion was proposed.

Recommendation 10: Now that Legislation has provided a refundable tax credit of from 15% to 20% for the performing arts, this activity should be removed from among those eligible for the high technology business investment tax credit.

Ms. Ching stated that the subcommittee had discussed it but had decided to not propose anything, as it appeared that there was a choice of credits that had to be made. The Chairman noted that Jeff Au, in an earlier conversation, had mentioned that his group had thought that this would apply to computer animation for movies and that its application to other endeavors was an unintended consequence.

There was no interest in this recommendation, however, and no motion was proposed.

Recommendation 11: The financial operations of the qualified high technology business or other entity in which investment qualifies for the high technology business investment tax credit should be fully disclosed and made available to the public, including tax records.

This was covered in the earlier recommendation regarding disclosure, so no motion was proposed.

Recommendation 12: The high technology investment tax credit is not directly tied to expenditures by business on activities that the credit is meant to encourage. Consequently, the credit is subject to abuse and does not fulfill its purpose in an efficient manner. It should be restructured so that the credit to investors is directly tied to expenditures by business on desired activities.

The Chairman noted that it is true that the credit is not directly tied to expenditures, but that is not the purpose of this credit. If it were, it would be a research and development credit.

Dr. Grandy stated that the subcommittee did not want to say how the credit should be restructured. His particular concern was that he didn't want to tell businesses how to spend their money. The Chairman stated that the research credit does tell businesses what to spend their money on. Dr. Grandy acknowledged that, but stated that his concern with both that credit and this credit was that the Legislature had said that businesses should spend in particular ways and that was what they would get the credit for, and it may not make economic sense, but they would be spending in that way to get the credit.

There was no interest in this recommendation, and no motion was proposed.

Recommendation 13: The Commission has been unable to determine to its satisfaction whether the high technology business investment tax credit has achieved its goals, but we have determined that the credit imposes a substantial drain on the resources of the State. Consequently, we believe an independent task force should be established, effective July 1, 2007, and continuing to the last day of the 2009 Legislature, to further evaluate the credit. Members of the task force should be appointed by the Governor and by the Legislature, in the same manner as the Council on Revenues. The Department of Taxation should be directed to provide technical and administrative support to the task force. The Department should be provided with additional adequate funding to perform these tasks. The task force will report its findings to the 2009 Legislature.

The Chairman noted that this is similar to the Washington State provisions mandating a report on the effectiveness of a credit in 2010 or 2015.

Ms. King proposed changing “we have determined that the credit...” to, “we are concerned that the credit...”

The Chairman was concerned about a task force being mandated. Mr. Roberts stated that the subcommittee felt that just getting the data disseminated to the public, as well as to the journalism, academic, and trade associations would allow the truth to percolate to the surface in the end. The Chairman noted that he had read the Philadelphia Tax Review Commission report, which stated that they only have academic economists review tax policy.

Dr. Grandy is concerned that they are suggesting a commission to evaluate just one tax credit, which raises the possibility of having separate commissions to evaluate other credits. The Chairman stated that he doesn't need to have a commission; he just wants to see a report or evaluation at the end of 2009. Mr. Roberts speculated on what the next Tax Review Commission would do with this credit, but Ms. Ching pointed out that it would be too late as that Commission's report would be published after the 2010 sunset date of this credit.

The consensus was to change the second sentence to read, “Consequently, an independent evaluation should be performed prior to any extension of the credit,” and to delete the subsequent sentences. They also agreed to attach this to the end of the earlier recommendation regarding QHTB investment tax credit.

It was moved by Mr. Roberts and seconded by Dr. Grandy, that the following recommendation be adopted:

The Commission has been unable to determine to its satisfaction whether the high technology business investment tax credit has achieved its goals, but we are concerned that the credit imposes a substantial drain on the resources of the State.

Consequently, an independent evaluation should be performed prior to any extension of the credit

The motion passed with the following votes: 6-Yes 1-Abstain.

The Chairman called for the vote:

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

Recommendation 15: The Legislature should not enact measures that do not have a predictable revenue impact, such as was done with the high technology business investment tax credit established with Act 221.

This was covered earlier, so no motion was proposed.

DECIDE WHETHER TO ACCEPT THE FINAL REPORTS FROM THE EXTERNAL STUDIES.

Report by Dr. Marcia Sakai and Dr. Bruce Bird. The Chairman distributed copies of an e-mail from Dr. Bruce Bird that noted the changes made to the draft presented at the meeting on October 6, 2006. The Chairman added the page references that were written in the margins.

There was discussion on whether the Department appeared better or worse in this revision, but there was general agreement with Mr. Heller's assertion that it was not for the Commission to say what should be in the report as long as it met the terms of the contract.

Dr. Grandy stated that he was unable to follow the rate of return computation in the appendix. He also noted that the references in many places are incomplete. Instead of a full citation, there are occasions in which there may be a name and/or a title, but the publication in which it was printed was not provided. He'd like the references cleaned up before it is accepted because it will be a public document.

Dr. Rousslang also noted that there were sentences that clearly don't say what the authors meant to say.

Mr. Heller noted that there was no urgency to accept the report and that it could be left for the next meeting. Acceptance of this report was deferred. Dr. Rousslang would send his comments to Dr. Grandy who was tasked with immediately contacting Dr. Sakai to resolve the issues.

Report by Dr. William Fox. There were no concerns expressed regarding the report on the study by Dr. Fox.

It was moved by Mr. Heller and seconded by Dr. Grandy, that the report on the study by Dr. Fox be accepted as final. The motion 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

Report by the State of Hawaii Department of Budget and Finance. There were no concerns expressed regarding the report by the Department of Budget and Finance entitled, " Hawaii's State Budget Process and Budget Stabilization Funds."

It was moved by Ms. Ching and seconded by Mr. Heller, that the report by the Department of Budget and Finance entitled, " Hawaii's State Budget Process and Budget Stabilization Funds," be accepted as final. The motion 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

New agenda item regarding the PowerPoint handout prepared by Dr. Marcia Sakai and Dr. Bruce Bird for the October 6, 2006, Commission Meeting. Dr. Rousslang brought to the Chairman's attention Dr. Sakai's request to have a disclaimer put on the PowerPoint handout that is included with the minutes of the Commission's October 6, 2006, meeting.

It was moved by Mr. Heller and seconded by Dr. Grandy, that the agenda be amended to add the consideration of Dr. Sakai's request to have a disclaimer on the PowerPoint handout included with the minutes of the Commission's October 6, 2006, meeting. The motion 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

It was moved by Mr. Heller and seconded by Dr. Grandy, that the agenda be amended to add the consideration of Dr. Sakai's request to have a disclaimer on the PowerPoint handout to be included with the minutes of the Commission's October 6, 2006, meeting. The motion 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

It was moved by Mr. Heller and seconded by Ms. Ching, that the Commission approve Dr. Sakai's request to have a disclaimer on the PowerPoint handout to be included with the minutes of the Commission's October 6, 2006, meeting. The motion 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

RE-EVALUATE THE TAX ADEQUACY INTERNAL STUDY.

The Chairman expressed the concern that, although the report concludes that the tax structure is adequate, uncapped tax credits could affect that conclusion. Dr. Rousslang agreed, and added that caveat, with a reminder that adequacy in the past is no guarantee of adequacy in the future.

Dr. Pham disagreed with the change, noting that another 9/11 could also affect tax adequacy. The Chairman, however, pointed out that 9/11 was unpredictable and external to the tax structure itself.

Mr. Heller thought it appropriate to say that if credits claimed in the future are more than expected, then that could affect the conclusion regarding tax adequacy. He added that it could be redundant, but it wouldn't hurt to say it.

It was moved by Ms. Ching and seconded by Mr. Roberts, that the Commission approve the revised report entitled, "Study on the Question, 'Is Hawaii's Tax Structure Adequate?'" The motion 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

MISCELLANEOUS ADMINISTRATIVE MATTERS RELATING TO THE STUDIES

The Chairman stated that he was troubled by the comment made by a participant at the previous meeting questioning why more bids were not received, which implied that Dr. Sakai was somehow favored when the truth was that her proposal was the only one received on that topic. He asked if that should be mentioned in the report.

Dr. Pham pointed out, however, that the Commission had just that morning voted to release the minutes of that Executive Session and post them on the website. Mr. Heller added that he didn't think it necessary to state in the report that they picked her because they had no other bids even if true.

The Chairman informed the Commission that the paragraph in the cover letter that stated that the tax structure was adequate was removed. The Chairman also asked that any additions to the acknowledgements be e-mailed to Dr. Rousslang.

The Chairman asked if the chart of Tax Review Commission Recommendations was final. Ms. Tokishi stated that it was not, in part because the current Commission's recommendations were to be included, and they had not concluded their discussions prior to the meeting.

Mr. Roberts asked if there was to be an executive summary. There will not be an executive summary, because there are too many recommendations.

SCHEDULE NEXT MEETING AND LIST AGENDA ITEMS

The next Tax Review Commission meeting will be on December 1, 2006, at 4:00 p.m. The agenda will include the final acceptance of the study by Dr. Marcia Sakai and Dr. Bruce Bird and approval of the Final Report.

Dr. Rousslang will be e-mailing the completed draft report to the Commissioners. Any changes should be given to him by Thursday, November 16, 2006. The compiled draft (including the appendices) should be posted on the website on Monday, November 20, 2006, for public comment.

The Chairman thanked everyone for the time and effort they put into this project.

ADJOURNMENT

It was moved by Ms. King and seconded by Dr. Grandy to adjourn the meeting at 3:35 p.m. The motion was carried unanimously.




"Radiant Software Support"
<info@radiant.com>
08/28/2006 04:11 PM

To <Tax.Research@hawaii.gov>
cc
bcc

Subject Testimony: I strongly oppose Internet sales taxation 8/28/06

History:

 This message has been forwarded.

August 28, 2006

2005-2007 Tax Review Commission
c/o Tax Research and Planning Office
State Department of Taxation
P.O. Box 259
Honolulu, HI 96809-0259
Tax.Research@hawaii.gov

Re: Streamlined Sales and Use Tax Agreement
Dear Tax Review Commission:

I strongly oppose collecting taxes on goods sold to out-of-state consumers, or paying taxes on goods bought from out-of-state businesses.

I am a co-owner of two small businesses in Hawaii. We sell our products almost exclusively via the Internet. The collection of out-of-state sales tax would be a heavy burden in terms of time, effort, and expense. It would prevent us from being competitive with other software vendors. It would reduce the amount of sales that we could generate, as we pass along an additional tax to our customers.

Please do not support the Streamlined Sales and Use Tax Agreement.

Sincerely,

Rachelle Chang
Hawaii resident and small business owner
778-7846

SUSAN K. SUNDERLAND
55 S. Judd Street #1709
Honolulu, Hawaii 96817

August 28, 2006

TAX REVIEW COMMISSION
P.O. Box 259
Honolulu, Hawaii 96809-0259

RE: Taxing Ecommerce Purchases

I would like to express my dissension about the proposed taxation on ecommerce purchases by Hawaii residents. Please do not recommend adoption of this tax.

Hawaii is an isolated market with limited choices for purchases, as much as one might believe that the presence of big-box discounters and other retailers serve that need. Don't penalize consumers and our freedom to purchase items across trade zones.

Although it is a source of revenue, please consider carefully the added expense of administering, collecting, and policing this tax. Also, where would the funds go? Just going into the General Fund doesn't seem strategic.

I'm one voice. Only one voice. But I value the privilege to make that voice heard. And what I'm saying is "No, please don't do this."

Sincerely,


Susan K. Sunderland

AUG 30 2006

isaac w choy

From: Bruce Bird [bbird@westga.edu]
Sent: Tuesday, October 24, 2006 10:54 AM
To: iwc@hawaii.rr.com
Cc: marcias@hawaii.edu; bbird
Subject: Final Report (Friday, October 20,2006)

Isaac Choy
 Tax Review Commission for the State of Hawaii

Dear Isaac:

I certainly enjoyed having the opportunity to meet you prior to our Draft Report presentation before your Commission.

Dr. Sakai has finished the Final Report dated Friday, October 20,2006. She will be e-mailing you a copy of it by the end of your business day.

I wanted to give you a "heads up" on a few matters. Please note that we met with members of the Department of Taxation --including the Director of Taxation-- by teleconference on Thursday October 12, 2006. We learned a number of interesting bits of information.

In the "Administration and Enforcement Issues" section, Kurt Kawafuchi states for the record that he was misquoted in several newspapers. This section is somewhere pages 40 and 43 of the Final Report. (Dr. Sakai is still moving things around in the Final Report). pg 42

The body of the Final Report contains Audit Information. The Act 221 audit rate is quite low (especially given the potential amounts of tax credits involved).

✓ In the "Other Act 215 Administration Information Relating to the Department of Taxation" Section (somewhere between pages 40 and 43) the Director of Taxation indicated that he did not know how many QHTBs existed in the "universe of QHTBs". pg 43

✓ In addition, the body of our Final Report contains new information relating to 1) the number of comfort rulings issued 2) the use of "drop down" subsidiaries after Act 215 --it's been reduced but not eliminated-- and 3) the amount of non-Hawaii investor investment in Hawaii as a result of Act 215-- in Kurt Kawafuchi's view, it's quite significant. pg 43

Please also note that a business does not have to get a comfort ruling in order to qualify for the Act 221 credit.

We also addressed certain comments from several members of the technology industry in Hawaii. We have made several changes to the Special Allocations section (around pages 9-11). We put in some information about Hawaii and non-Hawaii investors in this section. pg 11

If you get the chance, please read the Credit Recapture section. Because the Department of Taxation does not audit many Act 221 transactions, the possibility exists that an investor in a business that ceases to be a QHTB may improperly continue to claim the Act 221 credit. Or it is possible for a "barely" operating QHTB to continue to operate in order for the investors to continue claiming the Act 221 credit. While the credit recapture is fairly tame, the possibility of losing the credit in current and later years can be quite severe. Please see the examples in this section (they are quite illustrative). pg 10

We could not find out whether --or the extent to which-- Department of Taxation is examining QHTBs each year to determine whether they have ceased to qualify as QHTBs (so as to result in loss of current and future Act 221 credits and credit recapture).

10/24/2006

The Technology Job Creation and QHTB Investment Tax Credit section has been "beefed up". Please note that many in the technology industry count "gross jobs" (as in Department of Taxation data) when they should be counting "net" jobs (as in DBEDT technology jobs data over time). pg 36

Also the technology industry often counts non-technology jobs --as determined by the widely-used NAICS codes-- as "technology jobs under Act 221/215". For example, a number of "performing arts products" jobs are Act 221 jobs. However, most of these "performing arts products" jobs are not technology jobs (as determined by the NAICS codes). pg 37

Please note that the Final Report has several Appendices. One appendix refers to a request by Commissioner Grandy to Dr. Sakai. pg 47

Another Appendix represents a "hot off the press" report from DBEDT entitled "Hawaii's Technology Sector: 2001-2005. Please note that our report was based upon DBEDT data from 2001-2004 (preliminary). pg 5

DBEDT issued a 2001-2005 report after the date of our Final Report. Here are the highlights. "R&D" jobs are up. This is quite understandable given that a business can get a refundable Hawaii R&D credit based upon a portion of R&D expenditures. If the business is a QHTB, its investors can also qualify for a nonrefundable ACT 221 credit based upon the amount invested in a QHTB. (Under Act 215, the business has to be a QHTB in order to get the refundable "R&D" credit).

(By the way, I've been told that the DBEDT actually moved some job classifications from the "R&D sector" to the "technology services sector". Since the "moved jobs" did not show much job growth, the remaining jobs in the "R&D sector" showed a greater rate of growth than they otherwise would have shown).

In any event, the body of our report looked at DBEDT 2001-2004 preliminary data. This showed a decrease in "technology jobs" using NAICS codes. The Appendix indicates that, based upon new data, the technology jobs showed a mild increase.

Specifically, the new DBEDT data shows a 2.6% increase in "all private technology" jobs in Hawaii from 2001-2005. (Please note that the new data includes 2005). Please also note that the growth in "all private sector jobs" in Hawaii is 9.2% for this period. Stated alternatively, the rate of growth in "all private technology" jobs in Hawaii is about 28% of the growth in "all private sector jobs".

I hope that all of this information helps. If I can be of further help, I can be reached tonight after 10:00 E.S.T. (4:00 Hawaii time) at (770) 998-2631.

Very Truly Yours,

Bruce M. Bird
University of West Georgia

10/24/2006