

## **TAX REVIEW COMMISSION**

MINUTES OF THE EIGHTH MEETING OF  
THE TAX REVIEW COMMISSION  
HELD AT 830 PUNCHBOWL STREET  
DEPARTMENT OF LABOR & INDUSTRIAL RELATIONS ROOMS 310-313  
IN THE CITY & COUNTY OF HONOLULU  
STATE OF HAWAII, ON MONDAY, MARCH 12, 2012 AT 9:00 A.M.

The members of the Tax Review Commission (TRC) met at the Department of Labor & Industrial Relations Conference Rooms, in the City and County of Honolulu, State of Hawaii, on Monday, March 12, 2012.

**Members Present:** Randall Y. Iwase, Chair  
Mitchell A. Imanaka, Vice-Chair  
Roy K. Amemiya, Jr.  
Peter S. Ho  
Michael T. McEnerney  
Darryl K. Nitta  
Gregg M. Taketa

**Staff:** Donald Rousslang, Titin Sakata and Sondra Kaawa

**Others:** Randall Nishiyama, Department of the Attorney General  
Frederick Pablo, Department of Taxation  
Suzanne Efhan, Department of Taxation  
Hamid Jahanmir, Department of Taxation  
John Cape, PFM  
Heidi Patterson, PFM  
Phyllis Resnick, PFM  
Lowell Kalapa, Tax Foundation  
Anthony Valdez, WAM  
Nandana Kalupahana, House Finance  
Peter Fritz

### **CALL TO ORDER**

TRC Chair Iwase called the meeting to order at 9:00 a.m.

### **APPROVE MINUTES FROM PREVIOUS MEETING**

Chair Iwase asked if there were any changes, comments or requests for amendments to the minutes of the December 22, 2011 and January 12, 2012 meetings, other than corrections sent by

email. He then asked for a motion to approve the minutes of the meetings. The motion was made by Mr. Ho and seconded by Mr. Nitta. The motion carried unanimously.

## **COMMUNICATION TO THE COMMISSION**

None.

## **DISCUSSION WITH PUBLIC FINANCIAL MANAGEMENT, INC. (PFM)**

Chair Iwase informed the TRC members that Dr. William Fox of the University of Tennessee was retained to perform the E-Commerce and GET updates, the two studies that were approved for updates at the December 22, 2011 meeting.

Chair Iwase said forty-five minutes was set aside for the discussion with PFM. He said they will meet with key stakeholders while they are in town for the week. He introduced the team of John Cape, Managing Director; Heidi Patterson, Senior Managing Consultant; and Dr. Phyllis Resnick, economist.

Chair Iwase asked the TRC members to introduce themselves. He then asked Mr. Cape to proceed.

Mr. Cape referred to the handout that was provided to the Commissioners.

Mr. Cape said PFM was excited to be undertaking the project and was thrilled to be on this beautiful island. He said the PFM could not wait to get started and that he planned to go over the presentation very quickly. They asked the TRC members to interrupt at anytime with questions. He said the discussion was for the TRC's benefit and that the PFM would like the members to share what they expected from the study.

Mr. Cape introduced the PFM's team. Mr. Cape is the Engagement Manager for the project and a partner with PFM. He is the former State Budget Director and long-time employee of the state of New York. He said he has worked with Georgina Kawamura, former Hawaii Budget Director. Mr. Cape is also a senior fellow at the Rockefeller Institute, which is a non-profit institute that focuses on state government finance.

Mr. Cape said that he and his partner Randy Bauer (who would arrive later in the day and would also be in Hawaii for the rest of the week) had knowledge of state government practices.

Mr. Cape said he is expert on the spending side, whereas Mr. Bauer is expert on the tax side, and that they both have a wealth of experience on both spending and revenue sides.

Mr. Cape introduced Heidi Patterson as the Senior Managing Consultant at PFM. Ms. Patterson said she works primarily in the Des Moines office with Mr. Bauer, that she supports most of their

state projects and has spent nearly ten years in state government prior to coming to PFM. She said she was the Executive Director for the Iowa Accountancy Board where she was responsible for the licensing and regulation of the State's 10,000 CPAs and LPAs.

Mr. Cape introduced Dr. Phyllis Resnick as an independent consultant who has collaborated with PFM in the past on studies in Colorado. Dr. Resnick said she is excited to be on the team for this study and that Colorado just finished a study very similar to the one PFM is about to start here in Hawaii, where they looked at the fiscal sustainability for the state for the next 15 years. She said Colorado is moving through a very difficult political process with respect to changing tax revenue because of some constitutional amendments limiting tax policy changes. She said she is happy to share lessons learned from Colorado, and to learn about how to find fiscal sustainability for Hawaii.

Mr. Cape noted that in his opening remarks, Chair Iwase mentioned retaining Dr. Fox. Mr. Cape said that the PFM has worked with Dr. Fox and is willing to work closely with Dr. Fox. If directed, the PFM would work with Dr. Fox to make sure he is aware of what the PFM is doing and vice versa. He said sharing information might lead to maximum benefit for Hawaii.

Mr. Cape provided a short introduction of PFM, a forty year old company that provides objective, independent financial advice to governments. The advice is provided by seasoned government professionals. The PFM began as a firm with ten people in Philadelphia and now has over thirty offices all over the United States with almost five hundred professionals. He said the expertise of all PFM professionals is available for the present study.

He said the team of four people in Hawaii is backed by a team of five or six other people, but that all PFM expertise is available to them.

He said the PFM has three main lines of business. First, it provides independent bond advice to governments in the United States. They are in the market approximately a thousand times a year, more than any of the major capital and investment banks in the United States. They also provided advice to the State of Hawaii on some of their capital financing projects.

Second, the PFM is also a money manager for state and local governments. They have about \$48 billion under management and another \$18 billion under advisement that ranges from pension funds to short term cash pools, and everything in between. They maintain their own trading floor; and they trade approximately \$50 billion worth of securities on a daily basis.

Third, the PFM is a strategic consultant that provides management and fiscal advice to state and local governments. Mr. Cape said he is one of the three partners that run that part of the organization.

Ms. Patterson provided the project organizational chart to the TRC so they could have a better understanding of who is in charge of various aspects of the project. She said Mr. Cape is the Engagement Director, in charge of the overall project. The Project Managers are herself and Mr. Bauer, and they will be the day-to-day contacts.

She said PFM has divided the project into four separate areas:

1. Economic policy
2. Tax policy
3. Modeling
4. Benchmarking/best practices

Ms. Patterson went over the project timeline. It is a high level overview to give the TRC a visual graph of the approach that the PFM is going to take. The PFM believed it was possible to accelerate the timeline by about a month, but deferred to the TRC.

Mr. McEnerney asked if PFM was done with everything up to March 12<sup>th</sup>.

Mr. Cape said yes, they have completed all of deliverables up to that date. He said that like any plan, the document was simply a project plan. The PFM is at the TRC's disposal, and they would be happy to modify the timeline for the additional deliverables to meet the TRC's expectations.

Ms. Patterson went over the process for gathering information. She said they had provided a written information request a few weeks earlier and that Ms. Sakata helped secure some of the data for them. She said the PFM has a project management website to keep all that information organized.

Mr. Ho asked if the quality of information that PFM received is it up to specification.

Ms. Patterson said they are useful, and absolutely yes.

Mr. Cape said what they have seen so far was impressive in terms of the amount and quality of information available. He said the PFM also reviewed a number of previous studies. He said that from what they have seen, the information is well documented.

Mr. McEnerney asked about the revenue models, (1) how will PFM set up those revenue models? And (2) will they be based on historic collections over the last few years, or have they already done that?

Dr. Resnick said PFM would look at several patterns over time. For example, what they found in Colorado was that the sales tax was becoming less productive than in the past. The question was whether this was due to the recession or to demographic and structural changes in the economy. She said she felt very strongly that it was the latter – the aging of the residents in the State and the way the tax base is constituted. Colorado only tax goods, not services. As people aged, they stop buying stuff and consumed more services.

Mr. McEnerney stated that Hawaii's current tax structure has sun-setting provisions. He asked whether the PFM would evaluate the tax system as of present and project tax revenues based on the current tax system, or provide alternatives.

Dr. Resnick said she believed the PFM would be doing both.

Mr. Cape said the PFM would first establish a baseline. They would start with economic activity and translate that into tax liability, then translate tax liability into cash, and split the cash over the fiscal year to see how the tax system generates the revenue spent every day. Then they would look to see what determined the revenue and then plot that forward to get the baseline. They would examine the elements of expenditure to determine whether the state has a spending problem or a revenue problem. They would examine a number of scenarios.

Mr. McEnerney asked if the model would include sensitivity analysis. For example, if Hawaii experienced another major recession similar to that of the last two years, what would happen to tax revenue?

Mr. Cape said yes, the PFM would examine various scenarios. Ms. Patterson referred to pages 12, 13 and 14 of their handout, which provided screenshots of the models.

Ms. Patterson said that the PFM would provide a monthly project update containing high level summaries of their activities, and describe any issues that require resolution. They would also do regular conference calls as needed. They would also schedule briefings for project sponsors, stakeholders and any groups as directed by the TRC.

Mr. Cape said PFM's philosophy is that there is no such thing as too much communication with a client or too much input from stakeholders, policy makers, and advocates. They would consider the points of view from a broad range of individuals.

Mr. Cape referred to page 14 of their handout to illustrate the features of their model. He pointed out that the models were in Excel format and they were built in an open architecture. The model would be for the TRC to keep and use. The PFM would train the TRC's staff on how to use and modify the model for future needs. As former government managers, they understood the frustration of dealing with consultants that had proprietary models and that for every modification to the models, the clients had to pay more. He said the PFM was committed to improving the capacity of their clients and helping them modify the models for future needs.

He said PFM has a quantitative studies group which that builds sophisticated models that are used every day on Wall Street.

Ms. Patterson referred to the screenshot of their benchmarking to give the TRC an idea of how extensive their benchmarking was. She said it would also provide a basis to determine which new policy would be appropriate for Hawaii.

Mr. Amemiya mentioned that PFM's proposal noted that Hawaii as an island economy. He said using the same models already built for other state might not work.

Mr. Cape explained that PFM would benchmark Hawaii like other states. Due to Hawaii's uniqueness, they would examine the economic factors in the Pacific Rim and other global economic factors.

Dr. Resnick said they brought global perspective to their examination of the Hawaii's economy.

Mr. McEnerney said no state other than Hawaii has a gross excise tax system as complex and as broad as Hawaii. He said if PFM was looking outside the United States to see if there was any other nation that had such system, he would be interested to know what country and how their tax system worked.

Mr. Cape said a lot of countries used a value added tax. The PFM would also be looking at Puerto Rico which had some similarity to Hawaii. However, he said benchmarking did not substitute for analysis. It was a guide for gauging how things worked in other places. His personal point of view was that benchmarking showed what worked and did not work in other places. He admitted that benchmarking Hawaii would be tricky. Thus, they would carefully and methodically work through it with everyone to make sure they achieve the best results.

Dr. Resnick said with respect to the revenue options, she recognized that what worked in other places might not work here. They would spend a lot of time learning about Hawaii's economy to see what was the appropriate system taking into account Hawaii's unique characteristics. She said she was sensitive to what Hawaii needs as an island state.

Mr. Cape said the models that would serve the TRC well into the future. He said the real strength to the models was the ability to stay alive without the need to hire a new consultant every year or two years in order to reassess any changes made.

Mr. Cape summarized that the PFM was all seasoned government professionals that enjoyed doing their work. They recognized the unique challenge and were ready for it, but that they would need the Commissioners' input and guidance during the exercise.

Mr. McEnerney said one of the concerns he had was projecting needs. The retirement and medical systems were hard to get a handle on. He asked if PFM would be dealing with those issues.

Mr. Cape said they would look into the retirement and medical systems. As part of PFM's strategic consulting, they had a practice that specialized in benefit and pension redesign. He said PFM has staffs that had set up open trusts and forecast their needs. He said they would investigate whether an open trust would be right for Hawaii, or if Hawaii should continue to pay post employment benefits on a pay as you go basis.

Mr. Cape said Robert Atmore, President of the Governmental Accounting Standards Board (GASB), was a colleague. He said the PFM has an inside line into GASB.

Mr. Taketa asked in coming up with recommendations, how would they balance factors like quantity versus quality, fairness, ease of administration, and so forth.

Dr. Resnick responded that they would essentially analyze each of the revenue options for all of those factors. She said she believed that the most important factor would be adequacy. If the tax system was easy to administer, politically feasible, and whatever else, but did not solve the adequacy problem, then it was not worth considering. They would work with people in Hawaii to determine the qualities of life that they want to achieve with the future revenue system. Often, those goals could not be met, it would be difficult to find a system that is fair, adequate, and easy to administer.

Mr. Cape said there was always a tradeoff between volatility and stability in terms of revenue.

Dr. Resnick said it has to be a collaborative effort.

Mr. Cape said they could provide a list of the advantages and disadvantages of various revenue scenarios. He said there were a lot of choices, and the hardest thing would be to choose the best scenario.

Mr. Imanaka asked if the study was going to be within the fee proposed or would there be a circumstance in which that there would be additional costs depending on what the TRC requested.

Mr. Cape said that PFM anticipated doing everything in their proposal. If there were additional items beyond the scope of the proposal, within reason, there would be no additional fee. If the PFM were expected to perform a completely different analysis, substantially different from the scope of work, then they would certainly talk to the TRC about it. Mr. Cape hoped to generate some efficiency gains by working with Dr. Fox so projects could move together and provide synergy.

Mr. Ho asked if PFM's asset management business was the municipal assets that they managed.

Mr. Cape responded yes.

Mr. Ho asked if that was the primary business.

Mr. Cape responded that the business started with the financial advisory work with bond analysis, and then as an offshoot of the bond analysis, there were escrow funds and things like that they started to manage. They entered the business and began to grow that business, acquired a number of other companies, and were still in the acquisition mode, building the money management business.

The PFM was first a bond advisory, then money management, and lastly, the strategic consulting business because the city in which they were founded, Philadelphia, was nearly bankrupt. They were not sure how bad their fiscal condition was; hence, the city commissioned PFM, their

financial advisors, to put together a team to try and figure it out a solution to their problem. The work was documented in a book called "A Prayer for a City". It described how PFM helped Mayor Rizzo turn the finances of Philadelphia. Because of Philadelphia, other clients asked if the PFM could help them with fiscal management. Today, PFM is in the top tier of money managers in the country with only governmental clients and one of the premier strategic and management consulting firms for governments as well.

Mr. McEnerney said simplicity was an important aspect of tax administration. Another concern to him was collections. He asked if PFM would present alternatives and methods to improve collections.

Mr. Cape said yes. PFM defined "collectability", which they studied for the state of Pennsylvania, as how hard is it to get voluntary compliance for a new kind of revenue source, how complex it is to administer and enforce, and what is the audit yield. They would present the positive and negative aspects of their various options.

Mr. McEnerney asked if those options would improve collections of both the reported and unreported taxes.

Mr. Cape said there were ways to study that, and they would build such scenarios.

Chair Iwase thanked PFM for their presentation and mentioned that they had another meetings scheduled.

He then called a short recess.

Chair Iwase made some brief comments before going into executive session. He said that on February 23, 2012, he received a call from the Lieutenant Governor's Office informing him that the requirements of the Sunshine Law were not met because the agenda was not properly filed with their office. The TRC received a letter from DOTAX explaining the situation.

Chair Iwase said that they would enter the executive session to discuss the legal matter with Deputy Attorney General Randall Nishiyama.

#### **EXECUTIVE SESSION MEETING, PURSUANT TO SECTION 92-5(a) (8), HAWAII REVISED STATUTES**

Chair Iwase adjourned to go into Executive Session at 9:58 a.m.

#### **CALL TO ORDER - RECONVENED**

Chair Iwase called the meeting to order at 10:04 a.m.

He said the TRC went into executive session to discuss the Sunshine Law violation. The TRC had been advised by the Deputy Attorney General on the course of actions to take, which included the ratifying the meetings where the agendas were not properly posted with the Lieutenant Governor's Office. He said DOTAX had reassured the TRC that they had undertaken measures to rectify the situation.

Chair Iwase asked for a motion to ratify the approval of the minutes of August 4, 2011 meeting. The motion to ratify the approval was made by Mr. Imanaka and seconded by Mr. Nitta. The motion carried unanimously.

Chair Iwase then called for a motion to ratify the approval of (1) the minutes of September 8, 2011 meeting, (2) the draft solicitation for professional services, (3) the amendments to the draft solicitation for professional services for the economic study, and (4) the solicitation for professional services. The motion to ratify the approval of all actions taken at the September 29, 2011 meeting was made by Mr. Ho and seconded by Mr. Nitta. The motion carried unanimously.

Chair Iwase called for a motion to ratify approval of (1) the minutes of the September 29, 2011 meeting, (2) the minutes of the October 31, 2011 meeting, (3) to update the study on Internet Sales and if funds are available update the GET study, and (4) to amend the solicitation for professional services by reducing the scope. The motion to ratify the approval of the actions taken at the December 22, 2011 meeting was made by Mr. Imanaka and seconded by Mr. Nitta. The motion carried unanimously.

Mr. McEnerney referred to a letter to the TRC dated February 27, 2012 from the senators dealing with the GET issue. The legislators asked the TRC to make some comments concerning the GET and use tax issues. He suggested that if the TRC planned to make comments, they would do so before the end of the legislative session.

Chair Iwase responded that the Legislature were aware of the TRC's intend. They had secured a consultant to update the GET and the Internet Sales studies. The studies might address the issues raised by the Legislature depending on what Dr. Fox could accomplish with the \$30,000 budget.

Mr. Taketa notified the TRC that the Governor had nominated him to a four year term to the Board of Accountancy. The State law prohibits him from serving in both capacities; therefore, he regretfully announced his resignation from the TRC effective immediately. He said it was an honor to serve with the TRC and he was confident that they would carry out their charge. With the help of PFM, the TRC would be on the right track. He thanked all of Commissioners for working with him and wished them well. He also thanked the staff of DOTAX and said that it has been a great learning experience. He said he learned that the staffs were very dedicated to serving the public.

Chair Iwase thanked Mr. Taketa, congratulated him on his nomination, and thanked him for his patience as, along with Mr. McEnerney, they waited for two years for a meeting to be called (a quorum to be established).

**NEXT MEETING**

To be determined

**ADJOURNMENT**

The meeting was adjourned at 10:13 a.m.