

TAX REVIEW COMMISSION

MINUTES OF THE TWELVETH 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 WEDNESDAY, AUGUST 29, 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 Wednesday, August 29, 2012.

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

Staff: Donald Rousslang Titin Sakata and Sondra Kaawa

Others: Frederick Pablo, Director for the Department of Taxation
Mallory Fujitani, Department of Taxation
Hamid Jahanmir, Department of Taxation
Jacob Herlitz, Department of Taxation
Ted Shiraishi, Department of Taxation
John Knox, John M. Knox & Associates
Randy Bauer, Public Financial Management
Phyllis Resnick, Public Financial Management
Christopher Wheeler, Public Financial Management
Lowell Kalapa, Tax Foundation of Hawaii
Ken Takenaka, GCA
Randy Hiyot, House Finance
Gladys Marrone, BIA
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 comments on the minutes for the meeting of July 24, 2012. There were no changes to the minutes. He then asked for a motion to approve the minutes. The motion was made by Mr. Imanaka and seconded by Mr. Ho. The motion carried unanimously.

COMMUNICATION TO THE COMMISSION

Chair Iwase asked Ms. Sakata if there were any communications to the TRC.

Ms. Sakata said there were none.

UPDATE OF BY PUBLIC FINANCIAL MANAGEMENT (PFM)

Chair Iwase called for a motion to adjust the agenda to have Public Financial Management (PFM) present first and the Department of Taxation after. The motion was made by Mr. Imanaka and seconded by Mr. Ho. The motion carried unanimously.

Chair Iwase introduced Dr. John Knox, who he said has been retained by the TRC as a staff researcher/writer to draft the TRC's report to the Legislature. He then asked Mr. Bauer to proceed with the presentation of the PFM Group's report.

Mr. Bauer said the PFM team had prepared a presentation handout showing what he would cover in his presentation.

Chair Iwase said the TRC members could ask questions at anytime. He said the TRC received the 154 pages draft report yesterday, so the members might not have had time to read the report.

Mr. Bauer said the draft is a work in progress and that PFM is still working with some state agencies. He said that the assumptions and recommendations will not change materially, but that there will be some changes from the draft report to the final report.

Mr. Bauer introduced Mr. Christopher Wheeler from the Philadelphia office who is the chief modeler for the project. He said Mr. Wheeler is their most experienced model developer and he has worked on other revenue related projects. He said Mr. Wheeler will walk through the model, as requested by TRC, to show what the model contains and how it can be used. He said that the model will be turned over to the State, along with documentation and training for the appropriate staff, so that it may be used for future policy deliberations.

Mr. Bauer introduced Dr. Phyllis Resnick who has previously met the TRC and said that she is a valuable resource for their economic assumptions.

Mr. Bauer referred to slide 2 of his presentation and said that PFM has received most of the information it needs to finalize the model, but that he hopes that they will get more data from the state agencies. He said that their evaluations are mostly completed and that they don't expect the main recommendations or observations in the report to change. He said that additional assistance on Medicaid data is needed.

Mr. Bauer said PFM has been doing projection models for almost 20 years and that the model they are developing for the TRC will facilitate the analysis of multiple revenue and expenditure alternatives. He asked Mr. Wheeler to demonstrate how the model works.

Mr. Wheeler explained how the model is laid out, what it does and how it can be useful in gauging the impact of different revenue alternatives. He said he will also present the projected fiscal gaps for the State of Hawaii over the next 13 years. He said the model is an Excel based budget projection model that stores historical budget data and also projected budget data under different scenarios.

Mr. Wheeler said they made assumptions for the growth rate for every revenue category and expenditure objects for the general fund. He added that this is a general fund model only. He said that they worked closely with Department of Taxation (DOTAX) to figure out the historical relationships between the taxes and the economic indicators.

Mr. Ho asked how the growth rates assumptions were made.

Mr. Wheeler said the growth rate numbers were based on formulas, many from DOTAX. For example, the formulas showed that if personal income changed by x%, then the general excise tax changed by x%. He said DOTAX has a regression model that they used to support the Council on Revenues in forecasting general fund tax revenues, and that PFM has their own regression model that they compared with DOTAX's model.

Dr. Resnick said the growth rate assumptions are calculated several ways, including using regression analyses.

Mr. McEnerney said he had a follow-up question to Mr. Ho's question. He asked why, for example, the growth rate forecasts for tax revenue from banks and other financial institutions showed a significant decline and never recovered to its level in fiscal year 2011.

Mr. Wheeler explained that there was an unusual transfer to another fund for that particular tax, a one-time anomaly, in fiscal year 2012, which resulted in a negative 35.9% growth rate from the previous fiscal year. He said if they look at the absolute value, not the growth rate, in fiscal year 2013, it would return to a more normal pattern, to about \$30 million.

Mr. Wheeler said the main expenditure is payroll, and that PFM made certain assumptions on the state workforce level.

Mr. Bauer said changes in the assumptions will change the expenditures. He said that this type of model has been used by other governments as part of their collective bargaining process to see the impact of a certain agreement, such as a 3% COLA as opposed to a 2% COLA.

Mr. Wheeler said that with the non-payroll related expenditures, if there was a consistent growth pattern, they did a blended average annual growth rate and a compound annual growth rate to project growth rate for the future. He said if there was no consistent growth pattern, they use a growth rate of 0%, which is a conservative approach. He said in some areas, they assumed that the growth rates are tied to personal income, that is, if the state's economy grows, the expenditures grow at the same rate.

Mr. Ho asked if PFM could explain how the accrual assumption works in the model.

Mr. Wheeler said the accrual basis assumes full funding of OPEB (Other Post-Employment Benefits) liability, whereas currently, the state's retirees' health insurance is on a "pay-as-you-go" basis.

Mr. Bauer said cities and states are establishing trusts and making payments to build their corpus. He noted, however, that this subject is beyond the scope of their study, but that is what they advise their clients to do.

Mr. Ho asked in this accrual, how long the catch up period is.

Mr. Wheeler said 30 years.

Mr. Ho asked for confirmation that the baseline scenario did not include accruals.

Mr. Wheeler said yes, it does not, but the baseline scenario could be altered.

Mr. Bauer said the TRC had asked PFM to comment on whether the state should use cash or accrual basis. He said that generally state budgets are on a cash basis but they all abide by GASB (Governmental Accounting Standard Boards) rules and present their CAFR (Comprehensive Annual Financial Report) on an accrual basis defined by GASB. He said it would be difficult to budget on an accrual basis if that meant that the state had to budget for its OPEB obligations.

Mr. Ho asked why it would be difficult.

Mr. Bauer said the state would have to come up with \$1 billion now, a difficult task.

Mr. Ho asked how we got to the \$1 billion shortfall.

Mr. Bauer said Hawaii was not alone. He said it is a challenging issue that a lot of states are dealing with right now.

Mr. Amemiya said they had talked about healthcare costs but he wanted to know about the retirement costs.

Mr. Wheeler said the retirement costs are included in OPEB.

Mr. Ho asked what rate of return was used in the model.

Mr. Wheeler said they assumed for the Employees' Retirement System (ERS), 5%, OPEB, 4% and for accrual standard, 7.5%.

Mr. Ho asked about the personal income tax growth rates of 7% for the next 4 years. He asked if the growth is coming strictly from volume not adjustments to rates (did the 7% come from higher economic activity or higher income tax rates).

Mr. Wheeler said they evaluated the historic growth, and that the income tax has been growing at 6.5% rate.

Chair Iwase asked if there were any further questions on the model. He then asked Mr. Bauer to present the Executive Summary.

Mr. Bauer said the PFM model suggests the current revenue structure isn't sufficient to continue the current level of service. He said when governments experienced budget imbalance, they often look at both expenditures and revenue sides. He said that PFM doesn't believe that the problems can be solved from the expenditure side only.

Mr. Bauer said new government accounting methods on liabilities due to pension and other post employment benefits is leading the discussions. He said government rating agencies are paying close attention to this issue. He said the states have to address this issue sooner rather than later, or the liabilities will keep growing.

Mr. Bauer said PFM's recommendations take into consideration tax principles of equity, efficiency, reliability, stability, sufficiency, and broadness. He said they recognize the tax principles will be in conflict, and he said there's no perfect tax system.

Mr. McEnerney asked if PFM concludes that sufficiency, reliability and stability are more important than fairness.

Mr. Bauer said it depends on what kind of fairness.

Mr. McEnerney said its balance amongst all people economically within the state.

Mr. Bauer said it depends on the definition of equality. He said horizontal equity is often assumed to be the ability to pay amongst similar types of taxpayers or similar types of entities, such as corporations.

Mr. McEnerney said PFM seems to pick stability and sufficiency over vertically or horizontally equity.

Mr. Bauer said they have made some recommendations in the report that specifically address the tax regressively issue.

Mr. McEnerney said he understands; however, he asked about Mr. Bauer's comment on the most important tax principles, and he asked if there is a conflict, will PFM recommend stability and sufficiency?

Mr. Bauer said he supports equity if it can lead to a tax structure that has sufficient revenue to support the ongoing operations.

Mr. McEnerney asked if PFM would support a reliable and stable tax system that provides sufficient revenues to support ongoing services even if it's unfair.

Mr. Bauer said unfair is a harsh term. He repeated that there is no perfect tax system. He said PFM attempted to address what they considered the most unfair aspects of the system in their recommendations. He said along with addressing the progressivity issue, PFM also addressed tax pyramiding, which they think is a fairness issue since a number of businesses are negatively impacted by pyramiding.

Mr. Bauer continued with PFM's recommendation. He said exporting a portion of the tax burden is fair because visitors consume services that they may not otherwise pay for. He said there is an opportunity to improve the overall tax system via compliance and transparency. He said there is a wide variety of ways that states tax pensions. He 9 states don't tax pensions, 8 states tax pensions fully, and the rest of the states are in between. He said PFM thinks that a reasonable approach is to exempt a certain amount of pension income, but to tax some portions of pensions. He said this approach will allow the state to keep a broad base.

Mr. Bauer said Hawaii is very different from most states in that the state pays for K-12 education. He said in most states, K-12 education is a shared responsibility between state and local governments and that 75% of local taxes (mostly property taxes) is for K-12 education. He said surveys done by interest groups and the U.S. Census Bureau found that the property taxes in Hawaii are among the lowest in the country.

Mr. Bauer said Hawaii has enacted fairly significant tax credits over the years. He said in regard to tax credits for economic development, PFM suggests that policymakers determine the amount the state is willing to invest for those credits and use a cap. He

said a better alternative is to eliminate the tax credits and to use grants, loans, or forgivable loans, with specific performance standards. He said it gives more control and transparency than tax credits.

Mr. Bauer said PFM thinks Act 105, SLH 2011, should be allowed to sunset on schedule. He said they believe it causes pyramiding that reduces economic efficiency.

Mr. Bauer said they recommend a one-tiered corporate income tax rate as oppose to the three-tiered rate.

Mr. Ho asked how our overall corporate income tax rates compared to other states.

Mr. Bauer said the rates are low. He said the rates go up to 11% in other states, such as Iowa, but Iowa allows for deductibility for both corporate and individual income tax purposes, which brings the effective rates down significantly. He said it is hard to compare corporate income taxes because of issues like apportionment.

Mr. Bauer continued on the topic of tax exporting. He said PFM looked at some of the excise taxes such as the insurance premium tax, the conveyance tax, the cigarette and tobacco tax, and the liquor tax. He said PFM also looked at the transient accommodations tax (TAT) and the rental motor vehicle surcharge tax (RVST). He said PFM recommends extending the sunset dates of the rate increase because of the ability to export these taxes.

Mr. Bauer said PFM recommends raising GET as the only opportunity to raise sufficient revenue to fund a trust for OPEB.

Mr. Bauer said PFM will continue to refine its model and to work with DOTAX. He said they will submit their final report by September 24, 2012.

Mr. Ho made several comments on the Executive Summary. He said he is concern about how PFM characterizes the low nature of the GET rate because he did not believe it is accurate. He said the issue of accrual accounting for pension and health care is an important issue for the state.

Chair Iwase called for a short recess.

Chair Iwase reconvened the meeting at 9:24 a.m.

UPDATE ON STUDIES AND INFORMATION REQUESTED FROM DEPARTMENT OF TAXATION

Chair Iwase asked Director Pablo to present information on Tax Assessments, Enforcement and Collections. He thanked Director Pablo for being present.

Director Pablo said “tax assessments, enforcement and collections” is an important topic. He said DOTAX plays a major role in public finance, and he is glad the TRC retained PFM’s services. He said he will give an overview of the operations at DOTAX, how they bring in revenue, and how they could be improved.

He said he started on December, 2010 and Deputy Director Randy Baldemor started on January, 2011. He said they immediately started work on a strategic plan. He said DOTAX is responsible for bringing in \$5 billion that funds 18 departments. He said there are more than a million tax accounts but DOTAX audits less than 1% of them.

Chair Iwase asked if the total state budget last year was \$11 billion.

Director Pablo said it was \$11 billion that includes capital improvement projects that are bond funded.

Director Pablo said he has set 3 goals, which he referred to as the 3 “P”s. He said the first “P” is for people, our taxpayers. He said we need to focus on compliance to make sure we are bringing in the revenue that’s due to the state. He said there’s a lot to do in that area which hasn’t been done, mainly due to staff shortages. He said the second “P” is for processing. He said they a lot of processing is being done manually. He said compliance efforts could be improved by automation. He estimated that DOTAX could have done 300 more audits per year if they had more automation and staffing. He said the last “P” is for productivity.

Director Pablo said in 2009, DOTAX had an 11 % reduction in workforce, going from 409 employees to 360, and that any position that became vacant was frozen and could not be filled. He said in 2010, DOTAX had a 9% reduction in staffing due to furloughs, in 2011 another 9% cut, and in 2012 and 2013, they have similar cuts, not as furloughs, but staff was given time off, which translates to a 5% reduction in available staff time. He said inventory has grown, but the staffing to match the workload has not grown.

Director Pablo went over the organizational chart for DOTAX: (1) Director’s Office, (2) Tax Services and Processing (TSP) Division and (3) Compliance Division. He said TSP Division has 3 branches: Document Processing, Taxpayer Services, and Revenue Accounting. He said they have improved processing and are processing checks faster. He said staffing in this area was at 138, but is now down to 123.

Chair Iwase asked how much staff he needs in this area.

Director Pablo said it depends on their tax modernization plan. He said that there are 29 vacancies now (a 20% vacancy rate) in the processing department, which now has only 94 employees. He said staff time is further reduced by furlough or scheduled time off.

Director Pablo said the Compliance Division has six branches: Collections, Office Audit, Field Audit, Hawaii District, Kauai District, and Maui District. He said Collections staff worked on delinquent tax accounts, Office Audit staff work predominantly with information from the Internal Revenue Service (IRS), and Field Audit staff go out into the field to audit big businesses, with big accounts and big adjustments. He said the three compliance branches are in each of the three district offices on Hawaii, Kauai and Maui. He said the district offices have staffing of about 18 to 23 each.

Director Pablo said the compliance division has an authorized staffing of 143, but has 36 vacancies (20% staffing vacancy). He said staff time is further reduced (by 9% in 2010 to 2011) due to furloughs and (by roughly 5% in the subsequent years 2012 to 2013) due to reduction in hours. He said there were 43,000 delinquent cases in 2011, with roughly 40 tax collectors, or about 1,000 cases per collector.

Mr. Ho asked the estimated tax revenue of the 43,000 delinquent cases.

Director Pablo said the working inventory was about \$478 million. He said in his previous letter to the TRC, there is \$1.2 billion in taxes owed, and roughly half of it has been suspended because of litigation. He said of the remaining \$700 million, some are in bankruptcy and pending write offs (the taxpayer has no assets, or lives on the mainland, with almost no chance of recovering the money owed).

Director Pablo explained the charts on delinquent taxes. He said DOTAX needs to provide education and assistance because there is no way they can audit over a million accounts. He said it is best to do things at the front-end on a corrective basis than to chase people through compliance and audits. He said they also need a new computer system. He said DOTAX has been working with the Chief Information Officer who is very supportive of it.

Mr. Nitta said he thinks what would really help is to know the return on investments (ROI). He asked what the ROI was on the new computer system that DOTAX is pursuing. He said it would also be useful for DOTAX to provide the ROI on staffing.

Chair Iwase said Director Pablo's presentation alluded to possible solutions for DOTAX, but he asked Director Pablo to provide more information on DOTAX's needs, such as how much for new computer system, and how many more staff. He said the TRC has to submit its final report in the second week of December, 2012; therefore, they will work on the report in October and November of 2012.

Mr. Nitta said DOTAX's previous report to the TRC stated that the tax gap is about \$1.3 billion. He said DOTAX reported that about 30% was collected. He said if we applied 30% to the \$1.3 billion tax gap, we will get about \$300 to \$400 million, which is equivalent to what PFM said about the 0.5% increase in GET. He said it is important to note this finding.

Chair Iwase said Dr. Rousslang will present his report on tax adequacy followed by Ms. Sakata's report on eliminating income taxes for those below poverty level.

Dr. Rousslang said the tax adequacy study he did with Josh Fujino is similar in design to the study being done by PFM. He said both studies examined the general fund budget. He said the PFM made adjustments to the Council on Revenues forecasts, whereas his study used the Council's forecasts for his baseline. But looking at the results, he said there was not much difference between the forecasts of the Council on Revenue and those used by PFM. The revenue forecasts are pretty similar, at least through 2018. Both studies use actuarial studies to project the future costs of pensions and benefits for state workers and said that whereas PFM used 9.4% for Medicaid growth, his study used 9.2% and 5.4% for alternative scenarios. Both studies looked at the budget under the current payment system and under an accrual method of accounting.

Dr. Rousslang said the main difference between the reports is that he had two people and little time to devote to his study, so they used a quick short cut to get the expenditure side of the budget. Namely, to get government expenditures outside of pension benefits and healthcare for retired workers and Medicaid, they assumed expenditures for the remainder of the budget would grow at the same rate as personal income. It's a short cut to get all the sum of all of the individual line items that PFM was able to examine in detail.

Chair Iwase asked if that was the way the previous TRC's looked at the question of tax adequacy?

Dr. Rousslang said the previous studies did not subtract out pension and healthcare benefits for retirees, or Medicaid. They just assumed total government spending from the general fund would grow at the same rate as total personal income.

Chair Iwase asked if the previous studies assumed that growth of expenditure would be equal to the growth of revenue.

Dr. Rousslang said they assumed total government expenditures would grow at the same rate as total personal income, but that revenue wouldn't necessarily grow at the same rate as total personal income. He said the previous studies assumed the current level of government services is adequate, which he believes the PFM group also did. The approach is to say "If the current level of government services is to be maintained, costs will go to go up at the same rate as personal income." He said the assumption is not as arbitrary as it may first appear, because the bulk of the government spending is on salaries and wages. So if we assume the government workers are going to keep on a par with the rest of the economy, it is reasonable to suppose that the cost of spending on general government would go up at the same rate as total personal income.

He said the answer to the question "How much government services do we need?" is a matter of opinion. He said his study assumed that the current level of government

services is adequate and would remain adequate if it grew at the same rate as total personal income. That's how they defined "adequate" in the study. He said this view is certainly not universal. During confirmation hearings, Senator Chun Oakland argued that current spending is too low and should be brought back up to prior levels.

Dr. Rousslang said that in his study (with Josh Fujino), they found that by their definition of adequate government services, the current tax structure will be inadequate by 2016 under all but the most optimistic of our scenarios. He said that if accrual accounting is used, the tax structure already falls badly short of providing enough revenue to cover present needs and the annual shortfall may exceed \$1 billion by 2022. He said the results were summarized in Table 7 of their report. He said that in producing the estimates, he updated revenue collections to fiscal year 2012, but that the estimates for spending from the general fund were not been updated since the draft produced in February of 2012.

Dr. Rousslang said figure 1 of the presentation showed the results in the baseline scenario. The first blue bar is low economic growth, the middle one is baseline economic growth and the green one is optimistic economic growth. He said that, by way of comparison, he believes the baseline scenario from PFM for 2013 showed a surplus of \$385 million and a shortfall of \$268 million for 2014. So for 2013 the PFM surplus was above his optimistic scenario and the PFM deficit for 2014 was bigger than the pessimistic scenario from his study. After that, though, the studies were within the same basic range – PFM show deficits of \$232 million for 2015, \$254 million for 2016, and \$332 million for 2017 in their baseline scenario

Dr. Rousslang said his figure 2 showed results by cash accounting. But if we move to accrual accounting we are in trouble right off the bat and the picture is pretty grim. For example, for fiscal year 2013, if we have low economic growth, we have a deficit of \$550 million; if we have medium growth, we have a deficit of \$530 million; and if we have high growth, we have a deficit of \$359 million. The deficits grow each year under all of the growth scenarios.

Dr. Rousslang said they used the report by AON Hewett for the healthcare benefits, which gave them the annual required contribution under 30 year accrual amortization and a 4% or 5% return on assets. That was how they constructed their estimate of the annual required contribution. He said no adjustments were made to the current funding plans for pension benefits, so this assumes the current plans for the retirement pension benefits are okay. He said those plans were based on 7 3/4% assumed rate of return on pension assets, so his estimates could be regarded as optimistic accrual estimates.

Mr. Ho questioned if the overall state budget was \$11 billion and if that was right?

Dr. Rousslang said what he is presenting is just the general fund budget, which was only about \$5 billion

Chair Iwase asked if there were any further questions for Dr. Rousslang.

Chair Iwase said despite the differences in methodology, both Dr. Rousslang and PFM reports found that beginning with the year 2016, the current tax structure was inadequate to meet the needs of government.

Dr. Rousslang said yes, if one defines "adequate" level of government services as being the current level plus growth in line with the growth of the overall economy.

Chair Iwase introduced Ms. Sakata to give the presentation on eliminating the income tax for those below the poverty level.

Ms. Sakata said the topics for her presentation were: (1) determining who is in poverty, (2) who pays Hawaii's individual income tax, (3) tax credits for the poor, and (4) estimating the potential revenue impact of eliminating the income tax for those below the poverty level.

Ms. Sakata said there are two different measurements for poverty used by the federal government, which are poverty thresholds and poverty guidelines. She said the main difference is that under the poverty thresholds, there is no geographic distinction among the different states, whereas under the poverty guidelines, there is a set of figures for Hawaii.

Ms. Sakata discussed the first topic, "who is in poverty". She said for this exercise, since we want to make sure that we distinguish Hawaii from the rest of the United States, we will use the poverty guidelines to determine what income is considered poverty level. She said she wanted to point out that income as defined by the U.S. Census Bureau is income before taxes and does not include capital gains. She said there could be a wealthy individual that has only capital gains, does not have income from any other sources, and thus is considered poor.

Ms. Sakata said, for example, a family of five in Hawaii earning \$30,000 would be considered below the poverty guidelines and considered poor.

Ms. Sakata discussed the next topic, "who pays Hawaii's individual income tax". She said the individual income tax is progressive, as mentioned by PFM. She said the more one makes, the more one pays. She said the marginal tax rates range from 1.4% to 11%, but that everyone pays at the same rate within each bracket: For example, she said everyone pays the same 1.4% rate on the first \$2,400 they make, and pays the same 3.2% rate on the next \$2,400 made. She said the 9%, 10% and 11% tax rates will sunset at the end of 2015 and 8.25% will again be the highest rate. She said the data shows that even though there are a lot of returns with less than \$15,000 of income, most of the tax revenue comes from people that make \$50,000 and above.

Ms. Sakata showed how much people pay on average. For example, the people that make \$5,000 to \$10,000 have an average tax liability of \$86, whereas people who make

\$500,000 or more have an average tax liability of \$116,000. She said that these data are before tax credits. She said for those with very low incomes, credits would further reduce the income tax liability and many would end up with net refunds.

She said the State has food and excise credits for the lower income people with less than \$50,000 of income. She said the credit is on a sliding scale depends on how many people are in the household. She said, for example, a person making under \$5,000 with five members in the household would get a food and excise credit of \$425. She said if there is no tax liability, the person will get a refund check of \$425. She said there is also a low-income household renter's tax credit of \$50 per person for renters that make under \$30,000. She said, for example, if there are five members in the household, the renter's credit amount is \$250. She said the taxpayer doesn't have to have any tax liability to qualify for the credit.

Ms. Sakata said to determine the revenue impact of eliminating taxes on those in poverty, she assumed that poverty meant the taxpayer had both Federal and Hawaii adjusted gross income (AGI) below the poverty guidelines, and she sets their ordinary tax liability to 0%. She said using this methodology, there will be another 100,000 returns without any tax liability.

Ms. Sakata said the reported liability would decrease by an estimated \$17.7 million using 2004 data, but she said the estimated revenue loss is likely higher. She said when she looked at the 12 year average of differences between the reported tax liabilities and the net individual income tax collections, it was \$143 million (14%). She said a possible explanation for the difference is that we have withholding for those who work part-time but they may not file a tax return. She said the reported liability is based on data from returns filed. She said eliminating taxes for this group, if it eliminates the withholding, could produce a possible revenue loss of \$100 million or more.

Ms. Sakata went over hypothetical examples of how the proposal will impact households making \$10,000, \$15,000, and 25,000.

Ms. Sakata said currently, we have some form of reliefs for households in poverty. She said there are food and excise tax credit and low income household renter's credit. She said she had some difficulty defining income, because Federal or Hawaii AGI includes capital losses and depreciation. She said wealthy landlords can depreciate their properties, which reduces their income and can cause their AGI to be below the poverty guidelines. She said if the goal is to help the poor, we can't make it too complicated, and we need to keep it simple.

She said alternative options to providing tax reliefs for the lower income households are (1) increasing the amount of the food and excise tax credit (it's based on a sliding scale based on AGI, but it doesn't distinguish whether you're filing single, head of household or joint), (2) increasing the amount of the low income household credit, (3) increasing the standard deduction (this is not targeted, it will benefit everyone, not just the poor), or (4)

increasing the personal exemption (which is also not targeted and helps everyone, not just the poor).

Chair Iwase asked how many states tax individuals and families under the poverty level.

Ms. Sakata said she didn't have that information but would look into it. She said we would have to look at their standard deduction and personal exemption amounts, because the standard deduction and personal exemption amounts lower taxable income and hence reduce the tax liability.

Chair Iwase asked why use adjusted gross income, why not use gross income?

Ms. Sakata said that our state income tax returns start with the federal AGI, so if we use gross income, we will need to have taxpayers list all the deductions, and we would have to define "income" which could include wages, capital gains, dividends and other income sources.

Chair Iwase said the TRC does not intent to help some rich person with a lot of deductions to lower their taxable income. He said they want to help the truly poor people.

Mr. McEnerney said page one of Form 1040 in the income numbers would have most of the elements the TRC is talking about.

Mr. Nitta said he thinks it's important to remember that if filing is eliminated, the deficit will be larger, particularly, if employers are no longer withholding from these individuals.

Chair Iwase asked if there are legislative proposals being recommended to increase the credits.

Ms. Sakata said last year Director Pablo proposed indexing the standard deduction and personal exemption. She said there may have been some proposals in the past few years to increase the food and excise tax credit.

Chair Iwase asked if the proposals passed.

Ms. Sakata said no.

PUBLIC COMMENTS SESSION

Chair Iwase set a public comments session on PFM's draft report and Dr. Fox's final report on Tuesday, September 11, 2012 at 9:00 a.m.

NEXT MEETING

Chair Iwase rescheduled the next meeting for Wednesday, October 24, 2012 at 9:00 a.m.

ADJOURNMENT

The meeting was adjourned at 11:51 a.m.