

## **TAX REVIEW COMMISSION**

MINUTES OF THE THIRTEENTH MEETING OF THE  
TAX REVIEW COMMISSION  
HELD AT No. 1 CAPITOL DISTRICT BUILDING  
250 S. BERETANIA STREET, FOURTH FLOOR  
DEPARTMENT OF BUSINESS ECONOMIC, DEVELOPMENT & TOURISM  
DIAMOND HEAD CONFERENCE ROOM 436  
IN THE CITY & COUNTY OF HONOLULU  
STATE OF HAWAII, ON WEDNESDAY, OCTOBER 25, 2012 AT 9:00 A.M.

The members of the Tax Review Commission (TRC) met at the Department of Business Economic, Development & Tourism Conference Room, in the City and County of Honolulu, State of Hawaii, on Wednesday, October 25, 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:** Randall Nishiyama, Attorney General's Office  
John Knox, John Knox & Associates  
Hamid Jahanmir, Department of Taxation  
Lowell Kalapa, Tax Foundation of Hawaii  
Jeffrey Au, PacifiCap  
Paul Harleman, Senate Minority Research  
Ken Takenaka, GCA  
Randy Hiyoto, 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 to the minutes of August 29, 2012 meeting.

Mr. Amemiya said he thought that on page 12, Chair Iwase said despite the differences of methodology, both Dr. Rousslang and PFM reports found that until the year 2016, the current tax structure was adequate.

Chair Iwase said no, he said the current tax structure was inadequate.

Mr. Ho said the current tax structure was inadequate subsequent to 2016.

Chair Iwase said he thought both Rousslang and PFM reports found that until the year 2016, the current tax structure was inadequate to meet the needs of government and asked Dr. Rousslang to verify his statement.

Dr. Rousslang said unfortunately he did not have his study with him but PFM Group's baseline scenario projected the current tax structure to be adequate until 2016.

Chair Iwase asked to make amendment to page 12, to read, "... 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."

Chair Iwase asked if there were any other changes to the minutes.

Mr. Ho said on the same sentence, he would add "under the baseline scenario" after "2016."

Chair Iwase said he did not say that at the last meeting.

Mr. Ho said he was trying to capture what's accurate.

Chair Iwase asked for a motion to approve the minutes of the August 29, 2012 meeting with the change as discussed. The motion was made by Mr. Imanaka and seconded by Mr. Nitta. The motion carried unanimously.

## **COMMUNICATION TO THE COMMISSION**

Chair Iwase noted a response from Jeffrey Au, dated September 18, 2012, to a comment by Lowell Kalapa, dated September 16, 2012 regarding the high tech tax credits.

## **DISCUSSION AND APPROPRIATE ACTION RELATING TO THE TAX REVIEW COMMISSION'S DRAFT FINAL REPORT TO THE LEGISLATURE REGARDING ITS EVALUATION OF REVENUE AND TAX POLICY AS REQUIRED BY SECTION 232E-3, HAWAII REVISED STATUTES**

Chair Iwase said he has confirmed with Dr. Rousslang and Mr. Nishiyama that the deadline for the TRC to submit its report to the Legislature is December 17, 2012 (30 days before the start of the legislative session).

Chair Iwase said the TRC members have the draft report for discussion and action. He said that the draft will be the consensus of the commissioners. He said that there will be amendments to the draft report. He asked for some leeway from the members for stylistic and organizational changes. He said Dr. Knox is in charge of drafting, modifying, and producing a final draft.

Chair Iwase said he put together a draft so that the TRC members have a starting document to work from and it also assist in meeting the printing and reporting deadlines. Chair Iwase said the draft is organized by (1) introduction, (2) principles of tax policy, (3) findings of the consultants and DOTAX studies, (4) TRC's observations and recommendations, (5) summary and conclusions (which may or may not be necessary), and (6) appendices.

Chair Iwase said he wanted to share his thoughts that all of the TRC members join the commission with the belief that they would be doing something that would be helpful in moving the state into the 21<sup>st</sup> century. He said the TRC started with retaining two consultants: (1) Dr. William Fox to study the GET, Income Tax, E-Commerce, and (2) PFM Group to evaluate whether Hawaii's current tax system will provide sufficient revenues to meet near and long term needs, and to examine alternative tax structures that could improve Hawaii's ability to generate sufficient revenues.

Chair Iwase said what he found alerting is the PFM's findings of the significant budget shortfall that will exist shortly and will continue to the year 2025. He said the Rousslang-Fujino study estimated the budget shortfall to about \$3 billion a year beginning in the year 2022.

Chair Iwase said the PFM study provides recommendations, a package of recommendations to address the budget shortfall, a cumulative shortfall by 2025 of \$17 billion under accrual accounting system (the obligation to make future payments of pensions and other post-employment benefits due to activities in the current year would appear in the current year's budget). He points out that the past TRC, in particular the last two TRCs, also performed tax adequacy studies (was the revenues sufficient to meet expenditures). He asked Dr. Rousslang if his understanding is correct.

Dr. Rousslang said yes, assuming tax revenues grow at the same rate as the economy.

Chair Iwase said what PFM did was to take a longer range view to year 2025. He said there has been no dispute regarding the estimated budget shortfalls. He said there has been dispute on what the TRC could recommend, with some that argue the TRC is limited to the revenues-side only. Chair said he disagrees. He said the TRC must understand the expenditures-side to determine whether the current tax structure is adequate. He said as a part of the recommendation, he suggests that a Simpson-Bowles type of commission be created and empowered to deal with the expenditure side. He said he doesn't know if the State Legislature would go as far as the Congress.

Chair Iwase said the TRC's report is not a Simpson-Bowles type report. He said they are not passing the buck because they cannot pass the buck. Chair Iwase said he believes in the importance of a report that deals with both the revenues and expenditures. He said if they look at it purely from the expenditures standpoint, the state government will have to shut down, more furloughs, or combination of possible solution that may be unacceptable. He said there is a need for a packaged solution.

Mr. McEnerney thanked Chair Iwase for the summary. He said it's clear that the TRC understands there is a revenue shortfall facing the state. He said the problem the TRC is facing is that they have to deal with tax policy in fairness and equitable matters. He said he doesn't think the TRC is in a position to say what tax structures should or should not be adopted because that is the purview of the Legislature.

Mr. McEnerney said the TRC can report that the State has a shortfall in revenues and in order to address the shortfall, the TRC provides a list of options that can be selected. He said he doesn't think it's the TRC's position to say they approve or disapprove of any particular option to increase revenues. He said he has a problem with the way the PFM's report is integrated into the draft TRC's report because it appears that the TRC is adopting the PFM's report. He thinks the PFM's budget model is outstanding. He said the model is a tremendous advantage, and it is one of the best things that any of the TRCs' has done.

Mr. McEnerney said he thinks the TRC has to look at fairness. He said fairness has two aspects to it: (1) People with equal revenues (ability to pay) should be taxed in equal ways, and (2) People of Hawaii should believe that everyone pays their fair share of taxes.

Mr. McEnerney said the PFM reported that gambling could potentially bring a huge source of revenue. He said he doesn't think the TRC can recommend increasing the current taxes, for example, the GET, without providing an alternative, such as having gambling in Hawaii or taxing internet sales.

Chair Iwase said he is fully aware that the TRC should not simply adopt the consultants' recommendations. Chair Iwase said the report mentioned that serious consideration should be given to the recommendations of PFM. Chair Iwase said that he believes in what PFM did. He said PFM attempted to balance the various tax principles, for example, increasing the GET by 0.5%, doubling the food and excise credit, eliminating the 0.5% of business to business transactions, and eliminating the tax on poverty level. He said he is open to the idea of putting the PFM budget model to use, but he believes that a solution is to create a package solution to deal with the significant shortfall.

Chair Iwase said that there is a hole and we have to fill the hole. He said the draft report address how to balance the various principles of tax policy. He said the draft report also provide comments on exemption on pension income, similar to the recommendation of the previous two Commissions on this topic. He said the 2000-2002 TRC said maybe pension income should not be taxed and more studies should be done.

Chair Iwase said capturing e-commerce revenue is also in the draft report. He said based on Dr. Fox's study, there is an estimated six figures amount of lost tax revenues due to e-commerce, but based on his reading of Quill Corp vs. North Dakota, he disagrees with Dr. Fox's assessment. Chair Iwase said States can try to tax e-commerce via expansion of nexus by (1) economic nexus, (2) click-on nexus, or (3) streamlined sales tax agreement, but ultimately, it is the Congress that has to act, and the TRC recommends addressing the e-commerce issue via action by Congress, not by the State. He said we have to work with congressional delegates.

Chair Iwase said the draft report states the TRC's recommends eliminating individual income tax for the poor. He said based on the Sakata study, because she points out that it may cost that State a significant amount, the TRC is recommending the alternative ways of providing relief to the poor such as increasing the food/excise tax credit, low income renter's tax credit, the standard deductions and/or personal exemptions. He said the TRC attempts to address fairness issues in the report.

Then we move on to a Simpson-Bowles type study which is you have to look at the other side too and when you do that, utilize the model to make the adjustments. One recommendation the TRC can consider is on page 4.3, under the PFM recommendations to say something like "the TRC also recommends the PFM budget model now licensed to the state should be utilized to create alternative scenarios which could well differ from the PFM package." Chair Iwase thinks all policymakers have to understand it has to be looked at from a package standpoint. You can't fool around with I don't want to touch that tax because I'm going to lose an election. We see this foolishness happening now. I hope you feel as outraged as I do the log jam that's up there. I'm not **partisan** about it. This log jam is created by both sides. They couldn't even agree on a bi-partisan committee and he characterized it as a meteor coming and if that meteor hits us, we're going to have a Winslow, Hawaii if we keep kicking this can down the road and those people who are now just starting out in their jobs or are in their thirties and forties will get screwed, and we can't let that happen. So the package to Chair Iwase is important. When you do the model, put together a package. When you do an expenditure cut, do the model and put together a package, but address the shortfall, that's the ball.

Mr. Nitta said please don't kick the package to me. Just too kind of reiterate what Chair Iwase said, he definitely agrees that the TRC should add some sort of verbiage at the end of that section, right at the bottom of 4.3 about utilizing the model to come up with some sort of package. In a way he kind of agrees with Mr. McEnerney that yes, he doesn't agree with everything PFM recommended and he went about to create his own package. Unfortunately it generates even more revenue, but it's the idea of the concept of the package. Obviously something needs to be done, but its how do we get there and people will always argue we should do this, we shouldn't do that, but the general idea is we have to do something nobody can argue against.

Another thing he wanted to point out is the format of section 4. There is something that kind of does strike him is the TRC comment at the bottom of section 4.3 on pension, this blurb that the

TRC talks about he doesn't feel that should be part of the PFM recommendations section. He thinks PFM should have its own section. He doesn't want the TRC referencing \_\_\_\_\_

Mr. McEnerney asked to interrupt because he wanted to respond to some of the things being said by Chair Iwase and an ideal point to put it in. He said he does reports all the time. He does reports for Juries and knows the first thing you say to a jury or judge is the thing they remember. The problem he has with the whole set of 4 is 4.1 is PFM. He would like 4.7 to be PFM and he would like 4.1 to be exactly what Mr. Nitta was talking about. The TRC wants this and here are the following items. I would have a lot less objection to this report if we did exactly what Mr. Nitta is talking about and it started in 4.1.

Mr. Nitta said 4.1 kind of gives a background and if you go back to 4-1 and the top of 4-2, right before you hit the PFM recommendations, it kind of gives a background that kind of rolls into the PFM recommendations. So, maybe that could be 4.1 and we did spend 80% of our budget on the PFM report so to shove it all the way to the back may not be the smartest thing to do whether it's 4.2 or 4.7. He doesn't really care but thinks PFM should be left on its own to give the impression to the reader that this is what PFM recommended and the TRC is in support of a package but not necessarily the details of how PFM get there, and by us commenting on the pension purely on the pension to him, gives that false impression that we agree with everything else.

Chair Iwase said okay, alright

Mr. Imanaka said he doesn't mean to interrupt but just a thought he had since the issue is on the table and he agrees that there may be a misperception about what the TRC is trying to accomplish here. What we're recommending, not recommending and what this report is all about. He suggested the TRC considers early in the report, basically spelling out what this is about and emphasizing what the TRC thinks is important about it and why. He would consider an executive summary of some sort that encapsulates the more salient aspects of the report for the benefit of someone who is not going to thumb through the report.

Chair Iwase question Mr. Imanaka on his point, where would you want to put it?

Mr. Nitta said in section 3.3 under PFM recommendations. We discussed the package and maybe that's what \_\_\_\_\_

Mr. Imanaka responds to Chair Iwase's question and said right in front before the introduction

Chair Iwase said so we put something in front, in an executive summary that says what?

Mr. Imanaka said he didn't think there was any disagreement that this TRC has done the state a great service by coming up or having the benefit of a model that can be used forever more by the state in which we have not had before, that's number one. Second, he would suggest that the TRC consider emphasizing that we're not adopting anything and this is our report that we are implementing recommendations. Third and also perhaps number one, emphasize what our

mandate is and how we approached our work so that it's clear at the **offset** in mind of the reader as they go through the material, what it is exactly \_\_\_\_\_ talks about

Mr. Amemiya said he agreed and he would add a number four, that whole description that Mr. Nitta made about we can't kick the can down the road. The enormity of the problem needs to be right up front.

Chair Iwase said that it may be up to Dr. Knox to come up with an executive summary based on what the TRC was talking about

Mr. Ho said he agreed with the notion that we are not from a communication efficiency standpoint as well as from a philosophical standpoint allow the PFM recommendations, the revenue recommendations to be construed as the TRC's recommendations, one. Secondly, he is in complete consensus that the modeling PFM did was indeed extraordinary. He would note that all it really does is validate what Mr. Rousslang's study had done, so kudos to DOTAX. But describing \$299 million in a package against what is reasonably in short order if we look at the budget in his view, just doesn't see the value it serves. He thinks the thrust from his standpoint; the commission's work is to eliminate the gravity of the situation and the need for tax policy that takes the total situation into account not just the next session. His bottom line is the thrust of the TRC's findings that needs to find its way to the front of whatever communication the TRC puts out in the form of a report.

Mr. Nitta said he definitely agrees with Mr. Ho and it sounds like everybody wants this executive summary in the front. He thinks the content is in the report and we just need to pull it out from the report to re-emphasize the important pieces that the TRC is trying to make clear and summarize it on a one page executive summary.

Mr. McEnerney said he didn't agree with one page

Mr. Nitta said that's the point of an executive summary. It should be short and sweet.

Chair Iwase asked Mr. Nitta, to send to him, something for the executive summary that says one; the ball is a shortfall, a huge budgetary shortfall that must be addressed. Two, what the TRC is doing is attempting to deal with this problem with one hand tied behind it's back or one eye blinded, and that is we have to look at this from a revenue perspective and so what we have in this report an attempt to address or to make suggestions on how to address the tax system, address from a revenue standpoint. Three, he's not clear on recommendations or how to make clear the TRC is not recommending the PFM recommendations. It is not our recommendations but is a method of dealing with the issue, or something of that nature.

Mr. Ho said he doesn't know how those recommendations deal with the issue

Chair Iwase said okay, he'll explain how he looks at it. To him, PFM dealt with shortfall in their baseline model. The shortfall in their baseline model is based on current expenditures and pay as you go accounting. He has no problem pointing out in the executive summary that the shortfall

issue could be even greater if the accrual method is applied and that is not a certainty. He mentioned that he got emails from the National Council of State Governments that the state treasurer was going to go to Moody's and try to lobby them because Moody was suggesting the investment return estimate on a percent was going to be lowered which makes our problem worse. His understanding from Mr. Rousslang is that GASBY may be making adjustments to the projected investment return, and if that happens the situation becomes even worse. Now he's relying on the cash basis current level of services because that's real and that's what we're doing as a state. What happens with the accrual method is something he feels should be pointed out. What happens to the rates on investment returns that are used in the budget process has to be pointed out and the suggestion being that this "meteor" is bigger than what we see.

Mr. Ho said he disagreed and what is real is really what the economic obligation is. What is not real is the pay as we go obligation and his concern is that supporting a package of fixes that only in a very short period of time supports what he doesn't believe to be realistic economic scenario is problematic.

Mr. McEnerney said he completely agrees with Mr. Ho, but we've moved away from the executive summary and wants to go back to that for a minute because we can't have all of that in the executive summary. It sounds like stuff for the report. He wants to go back to what Mr. Nitta actually did with regards to collections and instead of saying in the executive summary "revenue" he wants it to say "collectible revenue" because we have this huge shortfall and one of the reasons for this shortfall is the state doesn't have adequate support for DOTAX to collect the revenues that the legislature says they ought to be paying. That's a big issue here.

The state just lost a \$700 million case

Chair Iwase said it was for TAT not GET

Mr. McEnerney said but the point is, \$1.3 billion in revenue is a big number and the executive summary needs to add what he thinks the biggest problems we face today is. DOTAX and the AG's Office do not have adequate financial support to enforce the tax that the legislature has said we need to pay to cover either the cash or accrual responsibilities the state faces, and part of that is because the Hawaiian people don't believe that they are being taxed in a fair way and we need to have that up front. We need to take a position on that.

Mr. Amemiya asked Mr. McEnerney how he got to that

Mr. McEnerney said because people who believe the system is fair will comply. For example, you're driving on the expressway and the speed limit is 55 but the traffic flows at a different rate. It doesn't mean that people are intentionally breaking the law; it means that they see those around them acting in a particular way and they will act accordingly, and that's what happens with our tax system. Why do you think people that do repair work in your home don't have a GET license? It's because they're working on the weekend and they want to be paid in cash. Now I won't do that because I'm an accountant and I'm scared to death of the result but many of my neighbors do and these are people avoiding the GET. We are not hiding this fact, this is



what's happening. Why do they do it? Because they feel it's unfair and it's too high of a tax and that's untaxed revenue.

Mr. Nitta said he doesn't know if they believe it's unfair or if they believe they can get away with it but there's no enforcement

Mr. McEnerney said he thinks the more people believe a system is fair the more likely they are to follow it

Chair Iwase said let him work it out with Dr. Knox to create an executive summary and maybe the TRC won't need another meeting on November 28<sup>th</sup>. What they'll put into the executive summary is one, stuff that explains our mandate and the point the TRC is looking at is revenue. Two, we are going to make clear in this executive summary what the TRC is recommending. We have clear recommendations in this report. He would like to keep what we have about PFM as a suggestion in the report but in the executive summary look at addressing the shortfall. It has to be done in a very comprehensive way. We can mention the package, and we can talk about the model. Mr. Nitta, you had something to pass out? Is that something you wanted to add?

Mr. Nitta said he could

Chair Iwase said this is just looking at the recommendation section, but I get what Mr. Ho is saying about the accrual versus cash, and Dr. Knox, we need to think about creating a different section for the pension income, maybe another number?

In the recommendation section 4.1, pass the PFM recommendations and talk about utilizing the model and depending on what Mr. Nitta's spreadsheet looks like, suggest that also as another scenario that can be looked at. The whole thrust being it has to be looked at as a package because this is a huge problem and it has to be dealt with in that method.

Mr. McEnerney questioned if the final paragraph on 4.8 be the final paragraph of the executive summary? That seems to be it and it takes how many pages to get to it. Let's put that as the last point in the executive summary so they can see it. That's what we believe should be done.

Mr. Nitta asked if there could be a change in wording. Second to the last sentence instead of "right after with its singular focus" can the word "may" be changed to "will" and in the last sentence instead of "could change" can the word "could" be changed to "should."

Mr. Imanaka said he fully supports and compliments \_\_\_\_, however, his thoughts which are directed more towards Dr. Knox, that perhaps there could be some footnotes to Simpson-Bowles and have some explanation in the footnote about what that is for those who may not be aware of that commission.

Chair Iwase questioned if a link would be okay?

He also asked to give him and Dr. Knox a couple of days before he emails the executive summary out for comments and the TRC will schedule a meeting.

So the TRC will add an executive summary which was intended but thank you very much for helping to shape it. There were some good suggestions and we're going to make it very clear exactly what we're recommending but Chair Iwase is still trying to figure out how to deal with the wording for the package.

Mr. Nitta said his spreadsheet could be something that the TRC could use as its own package of recommendations. These are just looking at the proposal \_\_\_\_\_. He said he did this spreadsheet back when the TRC received the initial PFM report which was revised. So if we take each item one at a time, he would say the TRC wouldn't adopt the pension exemption, we wouldn't eliminate the deduction for property taxes because that has no effect, he would like to keep the next two combinations\_\_\_\_\_

Chair Iwase asked what they were looking at

Mr. Nitta said the column all the way to the right

Chair Iwase asked if its blank, does that mean you disagree with what PFM had said with respect to pension exemption, eliminating the deduction. When it's blank, you're excluding it from your scenario?

Mr. Nitta said right, what PFM said is that we should reduce the pension exemption and I'm saying for whatever reason it doesn't have that much of an impact, and thinks the TRC shouldn't even touch it. Looking at regressivity and this is in line with Mrs. Sakata's study, and he would definitely be for that as a part of fairness and equity to low income and poverty level people in Hawaii if we decide to raise the GET, and really the GET number is the biggest number and if you don't do that, there's no way we're going to get to \_\_\_\_\_

Chair Iwase asked what ST was?

Mr. McEnerney said its timeout. It's the only way out without looking to other sources of revenue sources like gambling or something like that, but we're working inside the model here not outside.

Mr. Nitta said he did look at those too on 3-7

Chair Iwase asked what SD was?

Mr. Nitta responded standard deduction. He said he thinks he wasn't clear that he doesn't want to eliminate individuals having to file taxes. We should increase standard deductions, increase exemptions, increase food credit, etc.

Chair Iwase asked to drop back, and asked what Mr. Nitta was saying about eliminating individuals from filing taxes with an AGI of \$20 thousand or lower

Mr. Nitta said to him, it sounds like if you make less than \$20 thousand, you don't have to file a tax return and he wants to make it clear that he doesn't support that

Chair Iwase said so what Mr. Nitta is saying is to increase the standard deduction

Mr. Nitta said yes, there's a drill down into this category

Chair Iwase said we're going to have to explain this if it is adopted

Mr. Nitta said it's kind of explained in the PFM report

Chair Iwase said well you're going to have to explain it

Mr. Nitta said but it's in line with the PFM report and if you look at 4-5, number two, based on the Sakata study, "the TRC recognized the impact of recommendations on the state coffers may be significant. Therefore the TRC provides alternative recommendations of increasing ..." and he agrees with number two, not number one. It should have the same effect.

Chair Iwase said you got to help the writer explain your thing if this is adopted

Mr. Nitta said okay

Mr. McEnerney said you can work with Dr. Knox in clarifying that but he wanted to go back and make sure that up front, Mr. Nitta knew that the TRC is working inside the model and there are other sources of revenue out there like gambling that could also increase revenue if the objective is to make revenue go up. We should be looking at all the other sources of revenue out there not just what's inside.

Chair Iwase asked what 74.5 was?

Mr. Nitta said the 74.5 would be his agreement of the sunset of Act 105 but right above that, he didn't agree with the pyramiding of the .5% and he's not entirely in favor of the increase of corporate income tax. To him, the next four are fine but the item on TAT which is not in the PFM report because that's not going to kick in until 2015, so we could take out \$80 million from my spreadsheet and I'm in agreement and the TAT people won't like me. On the very last point, there's going to be some kind of impact if we do some administrative shuffling for DOTAX, get them more personnel and this new computerized system. There obviously is going to be some impact and if we looked at the IRS when they got their new system, he believes the number was in the ball park of about 15% and if you apply that 15% to \$1.3 billion that's known; he threw out a number of \$150 million that's not in the calculation. Again, it's something that's down the line that will help.

Mr. McEnerney said so actually if you put that in, it's almost exactly the same revenue number as revised PFM because \$150 million out of \$449 million is awful close to \$300 million

Mr. Nitta said but the \$150 million is not \_\_\_\_\_

Mr. McEnerney said that's something that would go up not down

Mr. Nitta said it would raise revenue

Mr. McEnerney asked what it would cost to put it in, that's the issue

Mr. Nitta said that's DOTAX is going off the proposal

Mr. McEnerney said then the TRC doesn't know the cost

Chair Iwase said that DOTAX told them that the people who were going to put in the service contract were reluctant to give a cost estimate for a return on investment because they don't know who the provider may be. So, this was more again based on historical data

Mr. Nitta said if you want to compare apples to apples, you can take out the \$80 million for TAT and his number comes out to \$370 million, revised GET \$300 million

Chair Iwase said to be clear, Mr. Nitta's \$449 million, \$496 million & \$249 million is exclusive of the \$150 million

Mr. Nitta said it does not include the \$150 million but does include the \$80 million

Chair Iwase said he was thinking if we mention the importance of the package approach and it has to be dealt with in this broad way. As I mentioned earlier, he was thinking of putting another paragraph about PFM recommends a model to be utilized and say for example, a proposal from one of the commissioner's was this.

Mr. McEnerney said he had a problem with that

Mr. Nitta said he had a problem with that

Chair Iwase said he is trying to do what Mr. McEnerney was saying about keeping everything within the model and what Mr. Nitta is doing if this data were to be put into the model, it should kick out \$449 million, \$496 million, but it's again, I agree with Mr. McEnerney this model is something different. This is one of the great value

Mr. McEnerney asked to clarify something and said yes, he agreed with some of what Chair Iwase said but he thinks we also have to be outside the model and \_\_\_\_\_ there are other sources of revenue that the state should consider. This model is a great predictor of what you would do in a scenario with what you have and Mr. Nitta's example of here's an example a commissioner has

derived that shows how the revenue impact would be which takes the focus off the PFM report. It says PFM said this and another person said that, and this is why the model is so good because you can look at these.

Mr. Nitta said he didn't want his name on this thing the TRC is figuring out

Chair Iwase said how about it be another scenario that would point to this. Again, it's the package approach not endorsing it.

Mr. Nitta said the key is the package. If it was just GET and the reduce regressivity, to him go hand in hand because you can't raise the tax for the poor and expect them to pay more without not getting something back

Chair Iwase said and upfront, which was Mr. Ho's concern which is his concern. In the executive summary we have to make clear what has been addressed. What has been addressed is the revenue scenario that was put forth, whether it was PFM or Mr. Nitta's spreadsheet. It's an addressing of budget shortfall from pay as you go current level of services.

Mr. McEnerney said footnote Mr. Ho, cash as you go is not enough and that's got to be in there

Chair Iwase mentioned to Dr. Knox that what needs to be in there is the accrual basis and although we have no documentation on GASBY nor do I want to cite a bulletin from the National Council of State Governments. But it's out there that there is talk to reduce the investment return percent that can be used and felt the TRC should touch upon it.

Mr. Ho asked for clarification on the necessity for a package

Chair Iwase said he thought the TRC would have to show what kinds of stuff that has to be done and the enormity of this issue. You can put a figure out there Mr. Ho and its nothing which is his thinking. He would like to let the public know this is the kind of stuff that needs to be looked at. We have to look at pension, we have to talk about increasing the GET and looking solely from a revenue standpoint and \$300 million is too much for any one person to comprehend, but if you told me you were going to take \$100 out of my pension, I would know what that means so the people need to know. So this is the kind of stuff the TRC has to look at if we're going to address this issue. Again, the TRC is not recommending specific things and we can't go with what's popular at the time, and stay away from what's not popular. We are not elected and the TRC has to say it. The bi-partisan commission was willing to say it but some of the politicians ran away.

Mr. Ho said he understood that but his concern is that the casual reader of this document then will say that the TRC is recommending these changes and really what the TRC is saying is here's the scenario and here is what you should be worried about. These are just potential what ifs.

Chair Iwase said you did nothing then by the year 2016, we would have a shortfall on the cash basis of \$200 - \$300 million. He thinks the realization has to come in that if they keep moving this thing down the road and do nothing \_\_\_\_\_

Mr. Ho said he guesses his issue with the package is that it honors the notion of the cash number is the right number

Chair Iwase understands what Mr. Ho is saying but it's a contractual obligation for a lack of a better term. You made this promise to those people who are on a pension to pay this amount of money, you made a promise to those people who are in this health fund to pay for that kind of health care and you don't break those kinds of promises. So in order to meet those promises, this is the kinds of shortfalls we are talking about and what we were dealing with is on a cash basis and at least the bill is being paid. But what he thinks is going to come from all of this too is raiding the funds. You have to stop raiding the funds or else these other things will get even worse.

Mr. Amemiya said stop raiding the funds and thinks one of the concerns of the public is that we're going to raise the GET and somehow this money is going to find its way to front something else. So the TRC needs to make it very clear and that it's very important that should major tax revenues increase that it goes to a paying down the unfunded liabilities.

Mr. Ho said he agrees with that

Chair Iwase said that's great because that is part of the Simpson-Bowles bill. That the money that is generated from the saving from one hand and revenue enhancement from the other, goes to pay down the deficit but there's a cap.

Mr. McEnerney said then we have a problem here because the state has a provision that says if the state collects more than the obligation to pay, then the state has to return it to the taxpayer. So are we going to be able to say that we're going to start funding the unfunded future liabilities that is an obligation that does not create an excess

Chair Iwase said there would be no excess

Mr. McEnerney said not from accounting standpoint

Chair Iwase said he guesses if there was a surplus and you don't pay down the unfunded liability, one could argue that's a surplus

Mr. McEnerney said that's what he's trying to find out

Mr. Rousslang questioned why that would be different from pension fund. In the pension \_\_\_\_\_ is money that was paid into the pension ahead of the obligation

Mr. McEnerney said so the TRC is covered on that side if we say the excess funding that from \_\_\_\_\_ today must be used to pay down any future obligation on an accrual basis or however it's calculated

Mr. Nishiyama said that would appear to be the case

Chair Iwase said he knew that ERS had a trust fund but asked if the health fund created a trust fund and nothing is being paid into it

Mr. Nitta said under the cash basis if the TRC does a full recommendation of 3-6 won't there be a surplus

Mr. McEnerney said yes if the cash basis of accounting is used

Mr. Rousslang said \_\_\_\_\_ is that \_\_\_\_\_ that goes into the trust fund like the pension and is that treated as a current expenditure, right? You can go in purchasing assets

Mr. Ho said this in part his issue with the package and all the package does is support the cash obligation of the state and it doesn't even address the liabilities of the state. We can't walk away from a liability. It is what it is

Mr. Rousslang said so basically what the TRC is saying is if you just go with the can, you're just kicking the can down the road

Mr. Ho questioned if that was correct?

Mr. Rousslang said yes

Mr. Nitta addressed Chair Iwase that in the TRC's report, the PFM baseline scenario uses cash basis, PFM baseline scenario they use accrual basis but a few pages later with the full implementation, we only show cash basis. Is there a reason for that?

Chair Iwase said because that is what they used

Mr. Nitta said can't we also show an accrual basis with the full implementation

Chair Iwase questioned if we'd want to show a deficit?

Mr. Nitta said well, we show both a few pages earlier

Chair Iwase asked Mr. Rousslang if he would be able to do that and come up with the numbers

Mr. Rousslang said he was not sure, but thought it could. It seems to be simple enough to subtract \_\_\_\_\_

Mr. Ho asked if he could do that because that is an issue he is having if you subtract the package from the accrual just a few years out, the deficit is like \$700 million right away. What's the point of the package?

Chair Iwase asked what the TRC would be recommending.

Mr. Ho feels that what the TRC may want to consider recommending under the principle of sound tax policy which is in 2.2, there's this issue of raising adequate revenue and thinks the real rub is the sufficiency is so enormous there that you basically undermine stability with uncertainty and those are the three principles of raising adequate revenues.

If you think about the accrual method, sufficiency is totally dysfunctional and therefore by definition that undermines stability and certainty so we don't have a model that can raise adequate revenue. In his view that is his conclusion that the TRC has come to.

Chair Iwase said the TRC now has said the tax structure is inadequate

Mr. Ho said yes

Chair Iwase questioned why did the TRC get together for? What can we do other than the Simpson-Bowles?

Mr. Ho said okay, Simpson-Bowles

Mr. McEnerney replied that maybe that's almost step one and maybe we have to move that paragraph up from the bottom of the executive report to the top, and we have to do that as part of this package because we can't raise enough revenues to meet the obligations, so something has to give.

Mr. Ho said creating efficiency in DOTAX to get at additional revenues is a pure wind down the road

Chair Iwase asked what the TRC thought about that. I think that what you're saying and we're only talking about 4.1 and what 4.1 becomes is on a cash basis we get a crater that is Halemaumau. We go with the accrual basis; we get a crater like Winslow, Arizona. Now we have to do something

Mr. McEnerney suggested it be said just a bit differently and say from a cash basis the problem is obscured and the problem is covered in smoke. The reality of life is accrual basis and its right in front of us and it's not five or six years down the road. Can we make it even cleaner that they have to look at the accrual basis because the cash basis gives a false sense of security.

Chair Iwase asked if anyone knew what accounting methods other states were using

Mr. Rousslang responded that PFM Group said that most states use the cash accounting

Chair Iwase asked if there were any godlike associations that tells the states they're wrong

Mrs. Sakata said GASBY



Chair Iwase asked what GASBY's leverage on the states is

Mr. McEnerney said what do the credit markets look at, that's a very good point

Mr. Ho said the credit market will let you buy a state of Hawaii bond, buy a state of Alabama bond and if we choose not to address what is as a real liability than that would be reflected in our credit cards

Mr. Imanaka said isn't that relative Mr. Ho that all of the states are in the same bucket and credit markets will correspond and react unless we're sticking up like a sore thumb

Mr. Ho said if the systemic risk is up given our liability, then amount of money you pay for that debt will go up and relatively if your risk is greater than that of another state it will go up even further

Chair Iwase asked what GASBY's leverage is

Mr. Rousslang said on the comprehensive end on your financial report, they can force you to present your budget in certain ways and they have now added the accrual for healthcare put in, the expected return of assets if you have any, and now they've added the same thing for pension. However, they're doing it on a year you start basis so we don't have to go back and look at the fact that we have these huge unfunded stock to begin with, and it's only to extent in which the unfunded stock is growing

Chair Iwase said if GASBY says by 2015 the states would have to \_\_\_ and what happens if the states say no and that they're going to stay with the cash basis

Mr. McEnerney said they won't float a bond issue

Chair Iwase asked if they have that kind of power

Mr. McEnerney said yes, they won't float a bond issue \_\_\_\_

Mr. Rousslang said that would be like your \_\_\_\_ is uninspected

Chair Iwase said okay. So we have an alternative here which he is hesitant but that's what the rest of the TRC is trying to say that this hole is going to be so big that there is nothing we can do. Again, so what do we do?

Mr. McEnerney said that when the TRC should move the Simpson-Bowles thing up to the front and say look you can't meet the obligation that's there and you can't do anything about it from revenue only. Collective revenue will not meet accrual basis obligations therefore you must do this

Chair Iwase asked the TRC how they felt

Mr. Nitta said he would really like to see what that bottom graph would look like. The PFM recommendations under full implementation under the accrual basis.

Chair Iwase asked if DOTAX could work on that

Mr. Rousslang said he thinks so

Mr. Nitta said they would be able to simply produce that for us

Mr. Ho said maybe PFM could

Mr. Nitta said if they did the other graph, this one should be done in five minutes

Chair Iwase asked if Mr. Rousslang to ask PFM and for him to work on it also

Mr. Rousslang made one suggestion that PFM has presented in their baseline that would kick the can down the road to 2025 if we stay on a cash basis. What the TRC could do is say it's impossible to raise the GET to 9.4% or whatever

Mr. McEnerney said it's something you have to go up the front with the current tax structure the way it is. We need the Simpson-Bowles approach and that's right up front and then we go to alternatives like we need a 15% GET rate in order to meet this obligation

Mr. Ho said he could fully accept that because what he fear of the package is that it will be construed, that if we put this through and then we're good

Mr. McEnerney said that's right and that was his concern about this whole thing

Chair Iwase said why we don't do this, if the TRC has any problems to the other recommendations 4.2, this is E-Commerce and other GET issues; 4-4 and the recommendations is federal legislation which he left hanging but he was going to add "with the growth of internet sales in the 21<sup>st</sup> century it is imperative that Congress needs to authorize states the ability to tax internet and E-Commerce sales while states can continue to enact mechanisms to attempt to circumvent Quill. State leaders must work closely with and urge and assist our Congressional delegation to enact federal legislation which is the only address Quill.

Mr. McEnerney said could we also add as an interim step if nothings done because he would hate to have this go for five years and nothing happens. He really thinks the simple approach to this is to say on the N-11 which is the individual income tax return to add a provision that says have you purchased more than pick a number

Mr. Nitta said he understands where Mr. McEnerney is going with that but there are a couple of problems. First, administratively to add a line like that is a lot harder than people think it is and

second, you're going to get the people who will comply and do it, you're going to get those who won't comply won't do it. So now we're going to have the same people paying more of the tax

Mr. McEnerney said we have the same problem with compliance right now. We have people that don't comply with our system, don't file income tax returns, don't pay get like they should and they're not doing anything about it. This way we have a measure of enforcement we didn't have before. We still have a problem with enforcement

Mr. Nitta said why would there be more enforcement because if you're required to pay tax on income and you're hiding income, why wouldn't you be able to go after that person

Mr. McEnerney said we are not talking about income, we're talking about purchases out of state but people are doing this, buying \$5 thousand of stuff from the mainland and bringing it back and are not paying the 4% tax on it. Those people ought to be paying it and we agree on that. The people who will comply will actually pay that and those who aren't going to comply won't comply no matter what you do.

Mr. Nitta said so how is that different from the handyman that's working the weekend?

Mr. McEnerney said it isn't

Mr. Nitta said so why isn't there an extra \_\_\_\_\_

Mr. McEnerney said we're talking about increasing the taxes on people across the state anyway

Chair Iwase said no we haven't, not if we change what we're going to do

Mr. McEnerney said that he just got through saying that as a result of this \_\_\_ recommendation that there won't be any tax increases for the people in the state of Hawaii

Chair Iwase said not if you want to word it the way you want to word it

Mr. McEnerney said he was all for that

Chair Iwase said if we're going with changing 4.1, we're not talking about any tax increase, we're saying that the tax increase would be so enormous that we better go with the Simpson-Bowles

Mr. McEnerney said he's all for that but back to his response to Darryl, which is what are we going to put in this report about the alternatives the state has. This is another alternative like gambling. I agree that gambling is a horrible way to increase revenue because it's very regressive but it's a way to increase revenue.

Mr. Nitta said it's a way, but he doesn't think it's a fair way

Mr. McEnerney said he didn't think it's a fair way either but it's a way to increase revenue

Chair Iwase said he wasn't sure if first of all that it would increase revenue but obviously it would increase administrative costs and third, what kind of penalty would be attached to this?

Mr. McEnerney said his thought on this is you have a number, if you pay more than this amount, if you buy more than "X" amount you go to a table and say this amount is an amount that is added to your tax obligation. There's no penalty and you don't have to get a GE license and is a very easy way to do it

Chair Iwase asked if there were any problems with 4.3

Mr. Nitta said that 4.2, the last full paragraph right before 4.3 there is a Dr. hanging out there and thinks it should be Dr. Fox

Chair Iwase said he and Dr. Know was going to come up with another draft and asked if there were any problems with 4.2, 4.3 & 4.4? There will be stylistic changes if the TRC has no problems with the substance. He would like to add a couple of inserts for E-Commerce and eliminating income tax is 4.3, 4.4 is DOTAX assessment and enforcement

Mr. Nitta said 4.4, number two, under our recommendations \_\_\_\_

Chair Iwase asked Mr. Nitta to help write it and submit it to Dr. Knox

Mr. Nitta said 4, 5 should we discuss the film credit

Chair Iwase said no, the TRC is looking at the big picture but the important thing here is to say is if the state is going to do tax incentives then here are some recommendations.

Let's go back to expedite 4.1 and his thinking is the TRC is going to put upfront what we're recommending to make clear specifically what the commission is saying and to highlight Simpson-Bowles. The TRC will have input on that and we will try to get that out to you by next week. He would like to keep the PFM recommendations just to let people know what it takes to deal with the cash basis. I have also asked Mr. Rousslang to ask PFM to run the number for us on what kinds of tax increases would have to occur to \_\_\_\_ the accrual basis because we have to show just how severe this problem is

Mr. McEnerney said he has no problem with that as long as it is crystal clear that it is the PFM report and not the TRC's report

Chair Iwase said it looks like the TRC will be having another meeting but we will have to make a decision and print the report with blue covers

Chair Iwase said they will put together an executive summary that will emphasize the magnitude of the problem as well as our mandate and having to look at it solely from a revenue perspective, and then we'll go on to say these are our recommendations (4.2 to 4.6) with respect to 4.1 in this

draft will keep some of the language the same but will add to it if PFM can provide to us an accrual basis scenario and the kind of adjustments needed to meet that. Hopefully, we get to point out in tax increases cannot be addressed solely from a revenue perspective and emphasize a Simpson-Bowles type commission

Mr. Ho said stylistically 4.1 would become more of an example of what would have to be

Chair Iwase said the next meeting is Wednesday, November 28, 2012. A redraft will be sent out to the TRC and hopefully we will be able to get some numbers from PFM addressing the accrual basis scenario

Mr. Nitta said he had one quick question regarding 3-4, which is contained in the PFM section and was wondering if this one bullet point could be clarified about the GET being the lowest consumption tax in the country. He knows this is PFM's report and this is verbatim but I don't know how \_\_\_\_

Mr. Ho said could we say that the TRC would note that however with the lowest rate with the largest base

Chair Iwase said what they tried to do in 3 is not editorialize

Mr. McEnerney said it's so wrong and we've talked about it so many times. It's still a wrong statement and it shouldn't even be there or it needs to be clarified

Chair Iwase said if we're going to editorialize this section then there are other areas I wanted to editorialize

Mr. Nitta said that's the other thing too is if we do it to one then \_\_\_\_

Mr. Ho said we can editorialize the executive summary

Mr. Nitta said more of a reason why not for people to discredit what PFM did based upon their understanding of GET because that's primarily what we rely on so heavily. If people knew that PFM doesn't have a grasp of GET, they may dismiss their entire report.

Chair Iwase said he wanted to ask this question, they say proposed increase of \_\_\_\_ would leave the state with the lowest combined state and local tax rate \_\_\_\_

Mr. Nitta said what they are saying might be true

Chair Iwase questioned why that might be factually incorrect

Mr. McEnerney said you got someone coming down in a balloon in a field and there this far from the ground, there is an economist standing there and the guy in the balloon says where am I? The economist says you're two feet off the ground and the guy says you're totally correct and

it's totally unhelpful; and that's what we got here a statement that is totally correct and totally unhelpful, and may be misleading.

Mr. Ho said he thinks the insinuation is that the burden created by that tax because the rate is low is low where as the burden is substantial. So the rate may be low but the burden is huge, and that's why he thinks it's incorrect.

Mr. Imanaka has no problem with some mention of it in the executive summary. He doesn't think the TRC is here to defend it because it is what it is and I think that would be the appropriate way to deal with it

Chair Iwase mentioned to Dr. Know that on page 3-4, please note that we are going to delete that bullet point

#### **NEXT MEETING**

Chair Iwase scheduled the next meeting for Wednesday, November 28, 2012 at 9:00 a.m.

#### **ADJOURNMENT**

The meeting was adjourned at 10:53 a.m.