

TAX REVIEW COMMISSION

MINUTES FOR THE TWELFTH MEETING OF THE
TAX REVIEW COMMISSION
HELD AT 830 PUNCHBOWL STREET
DEPARTMENT OF LABOR & INDUSTRIAL RELATIONS ROOM 310-313
IN THE CITY AND COUNTY OF HONOLULU
STATE OF HAWAII, ON THURSDAY, JULY 6, 2017 AT 1:30 PM

The Commissioners 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 Thursday, July 6, 2017.

Members Present:

Colleen Takamura, Chair
Vaughn Cook, Vice-Chair
William Pieper II
Nalani Kaina
John Knox
Raymond Blouin
Dawn Lippert

Staff:

Ted Shiraishi, Seth Colby, Titin Sakata and Noe Kaawa

Others:

Randall Nishiyama, Department of the Attorney General
Randy Bauer, PFM Group Consulting LLC
Sean Hao, Office of the Auditor
Ron Shiigi, Office of the Auditor
Megan Johnson, Office of the Auditor
Erin Conner, Senate Ways & Means
Alika Ke-Paloma, Senate Ways & Means
Dane Wicker, Senate Ways & Means
Robert Nishimoto, State Senate
Tom Yamachika, Tax Foundation of Hawaii
Peter Fritz
Jana Moore, CAN
Katarina Ruiz, CAN

CALL TO ORDER:

Chair Takamura called the meeting to order at 1:00 pm.

APPROVAL OF MINUTES FROM PREVIOUS MEETING:

Chair Takamura said the first order of business was the approval of the minutes from the June 6, 2017 meetings. She asked if there was any motion to amend or approve the minutes.

Commissioner Kaina moved the motion to approve the minutes of June 6, 2017 and Commissioner Cook seconded the motion. The motion carried unanimously.

DISCUSSION AND PROGRESS REPORT FROM THE DEPARTMENT OF TAXATION ON THE ANALYSIS OF THE COSTS AND BENEFITS OF ELIMINATING THE CORPORATE INCOME TAX:

Eliminating the Corporate Income Tax presented by Dr. Donald Rousslang, DoTAX

https://tax.hawaii.gov/stats/a9_2trc

UPDATE FROM PFM GROUP CONSULTING LLC ON PROGRESS REPORT ON STUDIES OF HAWAII'S TAX SYSTEM:

Mr. Bauer said provided to the TRC was a memorandum related to high level findings in the areas of their purview for the work the TRC tasked them to do. To give some background of their project plan for this TRC and the 2012 TRC, they provided what they called high level findings to get a sense of direction in terms of what was found through analysis and gathered information related to the three topics.

He said high level findings were not necessarily conclusions but more like supportable assertions. They don't lead in a direction to recommendations, but were major points of observations based on their analysis that were thought to likely lead to some conclusions that were listed with the charges given to PFM. Those relate to understanding the tax burden or the state looking at opportunities to reduce regressivity. It was important to note what was requested of PFM wasn't to determine whether or not the tax structure was or not more regressive than it should be, but to identify opportunities or alternatives to reduce regressivity.

He said the final area was related to the concept of what were revenue alternatives that may allow the state to deal with some of what was identified as additional needs for expenditures in future. To be primarily associated with additional expenditures necessary for the state's needs for its pension system and other post employment benefits, mainly healthcare.

Understanding that this was just a snapshot, a little glimpse of what PFM looked at to complete the studies for the TRC. This would give the TRC and he doubts would be particularly earth shattering kinds of findings, but there were also some things that could be useful for some explanation. For example, PFM had shared this with DoTAX of which they provided some very germane and helpful comments. It probably bared some explanation or discussion on a couple of points PFM made and related to areas that were discussed.

He said in the area of who bears the burden of Hawaii's taxes, an area he felt was important, which was to understand how PFM reached their findings and how they analyzed it. There was two primary ways that tax burden was analyzed and the method PFM chose was one done on an annual basis by the District of Columbia's Chief Financial Officer and they looked at tax burden based on representative families at certain income levels for a family of three that included a child.

He said they liked the analysis and how it was done for the city in the District of Columbia and each of the largest cities in all fifty states. They liked the analysis because one, it took into consideration specific credits, exemptions, deductions, etcetera that existed within major taxes within each of those cities and states that gave kind of a real world perspective on what families at certain income levels were paying and felt this is what should be most focused on. There were also a number of very good studies related to tax burden that looked at it differently. They look at what was the aggregate tax burden, what was the incidence and start to define cohorts of income also relevant and appropriate.

He said most of the graphs and tables were based on the most recent analysis by the District of Columbia and using the data they generated, and for Hawaii it would be the city of Honolulu. That would not be all that was done for the final report. As done in 2012, the data would be taken and applied to the state as a whole to get a broader based analysis of what that would look like for the state, but for purposes of comparison, it was useful. He would note that was the analysis of both state and local tax burden. He personal believed that that should be the level at which you analyzed tax burden because states vary widely, in terms of what was the responsibility of state government and what was the responsibility of local government for providing services, but make no mistake those services were mostly being provided by state and local governments. Often it was a split of whose responsible for it and whom the taxpayer needed to pay for it to, though it doesn't make that much difference like in the State of New York, about two-thirds of the responsibility was paid for by state government for K-12 education as opposed to Hawaii where one hundred percent was provided by the state.

He said understanding where the money came from was important. If you split them out separately, one would think the state's proportion in Hawaii was so much higher than a lot of other states and it was simply because of that significant component of K-12 education spending done at the state level in Hawaii and larger shares at the local level in other states. This was kind of the background on the concept of who bears the burden and when looked at, some discussion on tax burden related to middle and upper income taxpayers shifts a little because it doesn't look as burdensome as seen in other studies.

He said it also showed that Hawaii had a progressive individual income tax structure that tends to balance off the regressive nature of the broad based GET, broader based than many sales tax and use tax structures in other states. That was an important factor to consider when looking at a tax structure as a whole. One thing PFM pointed out consistently was you could have regressive and progressive features of individual taxes and recognize that, but they must be blended together to see what the structure as a whole looked like. If you picked apart individual components, you don't look at the broad picture or have a balanced perspective of what's going on.

He said another factor to take into consideration were the data shown was from the tax year 2014, before the changes to the income tax for tax years 2015 and 2016 removed some of the temporary changes in brackets that were made back in when the economy was having problems. The legislature had chosen to reinstate those higher brackets. However, if the governor would choose not to reinstate those brackets, this burden analysis would actually shift and would look less progressive than shown in the numbers here. He doesn't know what going on with that legal issue and points that out as it relates to the data that was analyzed was more on the progressive on the system that exist for those top brackets 2015 and 2016 for the state.

They believe the changes the legislature approved related to increasing the earned income tax credit or putting back in place the brackets that existed before 2015, for example. Those were progressive measures that reduce regressivity in the system as a whole and based on what the TRC asked PFM to look at, which was how to make the system more progressive or reduce regressivity. Those already do that and were areas they would have certainly would have examined if the legislature had not chosen to make those changes.

He said they also believe that some of the credits that existed that were refundable credits like the renter's credit, food credit were good approaches and would suggest as the TRC was looking at the system as a whole, it may not be sufficient to reduce regressivity in the overall system as much as if you were to expand some of those. As it related to regressivity, it shouldn't be a surprise they would suggest that most of the changes related broadening the base of the GET or increasing the rate of it and it certainly was not going to improve the system as it related to regressivity and there's some debate on excise taxes as it related to how those may impact regressivity and other public policy choices that may have public benefits that should also be taken into consideration.

The last section was most substantial in terms of practical impacts. The analysis mostly based on information provided by the Department of Budget and Finance related to what was needed in additional annual required contributions for both the pension system and retiree healthcare plan, and that was some substantial dollars in the range of over \$500 billion growing to over \$700 billion by the year 2023. They had identified alternatives based on the existing tax structures, some of those were analyzed in 2012 and others were not.

He said there were some new kinds of excise taxes talked about like sugary beverage tax, medical marijuana or in some states recreational marijuana which was a tax that didn't exist in the past, a vapor or e-cigarette tax, a new tax that doesn't raise a lot of revenue but that may change in the future. The most significant tax PFM identified that some tax commentators had started to pick up on which may have some applicability for Hawaii would be some form of a carbon tax depending on how it was instituted, what the basis and rate would be could be a significant source of revenue. It doesn't exist in any other state. However, Washington tried to pass it through voter initiative but it was not approved by the voters. There were some characteristics of Hawaii as an island that would in some ways that this may be more beneficial to this state than a number of states.

He said they identified some of the other areas and would be updating the analysis as it relates to issues with E-Commerce that was not a new tax even though some people don't seem to quite understand that is was just collecting the tax owed. There were a variety of measures going on in

some states, court challenges in other states and state initiatives in that area. PFM thinks it was not a huge revenue source but estimated it to be \$30 to \$40 million of additional revenues for the State of Hawaii but was subject to a fair of debate, but there were certainly some of those kinds of tax collection issues related to existing tax sources that maybe worthwhile in terms of consideration.

He said the last hearing that was kind of talked about as it related to their study that they think was probably not right for a lot of analysis relates to the implementation of the tax collection system. First, you have a vendor that was responsible for kind of determining what's happening in that particular area, who was more qualified and had access to more information. Also, the governor had announced an initiative to have the Chief Information Officer (CIO) as it related to the system with so much moving parts that they don't feel like it would be beneficial to weigh in on that issue. They had looked at other states in the area of tax collections that had made system changes, but haven't found a lot of evidence except for material changes in levels of collection.

He said what they do have was nationally about two-thirds of the states have missed their revenue estimates during the current and prior fiscal years related to these major tax collection areas. In their perspective it was an in fluxion points in terms of states and revenue collections in their two primary areas, and missing those revenue estimates all across the country that it was a specific issue related to these new systems. They were not suggesting that there weren't some issues and certainly some revenue that hasn't been collected that may have been collected in the past, but the good news was the liability was still going to exist and suspected would eventually be collected.

QUESTIONS AND ANSWERS FOR THE PFM GROUP CONSULTING LLC ON STUDIES OF HAWAII'S TAX SYSTEM:

Chair Takamura said she wasn't sure about the rest of the TRC members, but she really didn't have a chance to review the PFM findings and felt more time was needed in case there were questions on what was presented. She asked if the findings were part of the draft report PFM was presenting later.

Mr. Bauer said yes, the findings were a layer used to build up to their final report. Ultimately it would be up to the TRC to make recommendations. At this point, they sought to provide the TRC with background information that the TRC could chew on and would be happy to discuss things further or answer any questions, but that was kind of the background on the burden section as it relates to regressivity based on what was identified in the tax burden analysis.

Chair Takamura said if the TRC had questions on the high level finding report and was PFM submitting a draft final report at the next meeting.

Mr. Bauer said the project plan was still on track. They were sending out bi-monthly reports on the project and were working on the draft. The project plan for the next TRC meeting assuming it was after the first week in August was he and their economist Dr. Chris Wheeler would attend and be available to answer questions in person. At this point would be to figure out when was the next meeting could be in terms of scheduling and availability.

Chair Takamura asked if there was going to be a draft report or not being submitted at the next TRC meeting.

Mr. Bauer said the project plan called for the TRC to receive final draft report the first week in August.

Commissioner Knox said if there was going to be a section or summary of the high level findings or should the TRC get comments about that.

Chair Takamura said that's what she was trying to get to and thought of having a short meeting with PFM Group to go over questions on the findings. Maybe the findings could be presented and at a meeting have the answers or responses to the TRC questions.

Mr. Bauer said sure, if the TRC wanted to provide them with questions by email, they would be happy to provide the TRC whether by call or follow up memo responding. When they submit the draft as provided per the timeline, he suggested the TRC take at least a week to digest it and then arrange for a meeting.

Chair Takamura said to Mr. Nishiyama that the TRC may need a meeting for questions the TRC may have for the PFM Group.

Mr. Nishiyama said yes.

Chair Takamura said the TRC would need a meeting to compile all the questions for PFM and another meeting to respond. She asked if they could respond by email.

Mr. Nishiyama said they should be responding at a meeting.

Chair Takamura said the TRC would need to have two meetings. It was late for the TRC to have gotten the findings yesterday and to collect their thoughts.

Mr. Bauer said they were following the project plan and the way it was structured, and the high level findings were going to be provided the first week in July and the final draft report the first week in August, which the TRC will have. He understood the need for the TRC to digest it and they would be happy if the TRC wanted to arrange another meeting, they would participate. He suggested when the next meeting was scheduled after receiving the final draft report, leave enough time to digest it.

Commissioner Knox said if the TRC had questions, comments or suggestions on the high level findings, there would be a meeting just for that. So, there would be two rounds of questions, one for the high level findings and another on the final draft report?

Mr. Bauer said the high level findings was certainly a document for the TRC to give them feedback or questions on, but it was foundational, there was no recommendations and didn't want to spend a month chewing over it.

Chair Takamura said she didn't think so but wanted a week to think about it and then have a meeting to set the TRC questions for the PFM Group.

Mr. Bauer said it won't take PFM long to respond. If the TRC wanted to have a meeting to formulate a set of questions, he felt it would take at least forty-eight hours to generate a response.

Chair Takamura said with the way the TRC had to operate, it had to be done within meetings.

Mr. Bauer said he understood that the TRC had open meeting requirements and that the TRC should set the schedule and they would try to be flexible in accommodating in terms of scheduling.

Commissioner Knox said the writing was very legible, very readable and he had a very constraint amount of time when he went through it, but had a number of queries and questions about it. The one thing he was concerned about getting on record and in the minutes was that Mr. Bauer mentioned PFM was not making recommendations and sometimes there could be confusion on that point. On page eleven and on the proposed revenue initiatives, could be interpreted as a recommended package, which he didn't think was PFM's intention.

Commissioner Kaina said she did not read it that way at all.

Mr. Bauer said he agreed with Commissioner Knox as it may be too strongly worded. He would go on record and wanted the minutes to reflect that all PFM was doing up to that point was identifying alternatives for the TRC, was analyzing them all, and was making no specific recommendations. This was a point which was valid and to keep in mind that what the TRC wanted identified was entirely appropriate as for the possible additional funding needs for this state, but that was only looking at the revenue side of the equation. It was not looking at any other changes to expenditure methodologies or choices, and it was also saying we would bite this off all at once. This was not the way most states end up handling this very large and structural issue that Hawaii was not in any way alone in dealing with issues related to pension and post employment benefit obligations. He didn't think the goal needed to be on how to raise \$500 million in additional revenue either, but at least you could identify alternatives, weigh them and if the TRC was make recommendations, what would be the list.

Commissioner Knox said he thought PFM did what the TRC asked for and provided sort of a menu of things. Although everyone around the table understood that, he wanted to make sure it wasn't misinterpreted.

Commissioner Kaina asked Mr. Bauer if the high level findings were a quick overview of the report and the revenue alternatives listed was what PFM would be providing more information on or would there be others that may be added in the course of the bigger report.

Mr. Bauer said the list was what PFM had identified and was not considered low hanging fruit, but they're fairly evident from their work in this area, what's going on in other states, and what's going on legislatively. They had catalogued every legislative action from the last two years as it related to what was going on in other states. If the TRC had some other thoughts or ideas, they would be happy to assist.

DISCUSSION AND ACTION ON PROPOSAL FOR A REPORT WRITER FOR THE TAX REVIEW COMMISSION:

Chair Takamura said at the last meeting, an investigative committee was formed to review candidates for a writer and their recommendation to the TRC was Dr. Donald Rousslang. She said he had the tax knowledge and was the writer of the 2005-2007 TRC report. She asked for a motion to approve.

Commissioner Pieper moved the motion to approve Dr. Rousslang as the writer for the TRC report and Commissioner Cook seconded the motion. The motion carried unanimously.

DISCUSSION AND ACTION TO OUTLINE FOR DRAFT REPORT OF THE TAX REVIEW COMMISSION:

Chair Takamura said at the last meeting a committee was formed to draft an outline for the draft report, but deferred this discussion so the committee could work with the writer on the outline to present at the next meeting.

DISCUSSION AND ACTION REGARDING REIMBURSEMENT OF TRAVEL EXPENSES FOR TAX REVIEW COMMISSION MEMBERS ON TAX REVIEW COMMISSION BUSINESS:

Chair Takamura said she and Commissioner Cook traveled to Oahu to attend a presentation by Dr. Rousslang on the corporate income tax which was outside the regularly scheduled travel to attend the TRC meetings. She said she realized as the TRC begins their report, TRC members may need to travel for other related TRC business. She proposed that the TRC approve travel expenses for TRC members on other TRC related business that was not specifically for a TRC meeting.

Commissioner Pieper said he had two questions. First, how much was left of the TRC budget? Second, what was the best practice? How was this type of situation handled in the past?

Commissioner Kaina said with respect to what is being talked about was not official TRC meetings and meant something else.

Chair Takamura said yes, like herself and Commissioner Cook traveled to hear Dr. Rousslang's presentation of the TRC study. That was not a TRC meeting. She was not sure if the draft outline committee would need to travel to meet with Dr. Rousslang.

Commissioner Pieper said he had no problem with that concept and that made sense, but this was not the first time the TRC had neighbor island commissioners. What was done in the past and how was it determined? Who approved it and how much money was set aside for travel. It's some fairly simple questions that perhaps Mrs. Sakata could answer.

Mrs. Sakata said in the past, neighbor island TRC members were reimbursed for travel to attend just TRC meetings. This TRC was the first to have a neighbor island chair and vice-chair that has to travel to Oahu other than the TRC meetings and the example was to attend Dr. Rousslang's presentation at UH-Manoa. Since this was about using the TRC budget as a whole, the TRC should implement some type of procedure or approval method.

Commissioner Kaina said the TRC needed to know the remainder of its budget especially since they just hired a writer. She said if members start using the TRC budget for their own meetings and December came and there was no money to pay the travel expenses for neighbor island TRC members to attend an official TRC meeting. Her concern was the budget and necessity of travel for the sub-committee.

Commissioner Cook said he and Chair Takamura try to schedule meetings before or after the official TRC meetings, but that presentation was on a different day. Chair Takamura said if they need to travel other than for scheduled meetings, it would probably be between meetings.

Commissioner Kaina said again, it was important to know what was left of the budget and getting a sense of how many more meetings the TRC would need to have and were needed to complete our task. She was concerned that things potentially could come up and may not have the money to cover these expenses.

She said if there could be a planned schedule and that the TRC could approve now, the reimbursement for travel expenses incurred to attend Dr. Rousslang's presentation, but what this TRC needed was an estimate of how many more meeting was necessary to ensure that the remaining budget was sufficient.

Chair Takamura asked if Mrs. Sakata could provide the TRC with how much of the budget was expended and provide that information at the next meeting.

Commissioner Pieper said he also wanted to know how much of the remaining budget the TRC planned to use and what would be the process for approving TRC related expenses prior to being used, especially when things could not be done by phone.

Chair Takamura asked for a motion to approve reimbursement for travel to attend Dr. Rousslang's presentation.

Commissioner Kaina moved the motion to approve reimbursement for travel to attend Dr. Rousslang's presentation and Commissioner Pieper seconded the motion. Chair Takamura and Commissioner Cook recused themselves from the vote. The motion carried with votes from Commissioner Kaina, Commissioner Pieper and Commissioner Knox.

PRESENTATION ON HAWAII INCOME TAX BY THE DEPARTMENT OF TAXATION:

Hawaii Tax System: Income Tax presented by Dr. Seth Colby, DoTAX TRP Officer

https://tax.hawaii.gov/statsa9_2trc

QUESTIONS AND ANSWERS FOR THE DEPARTMENT OF TAXATION ON HAWAII INCOME TAX PRESENTATION:

Commissioner Kaina said to clarify in terms of residents, what Dr. Colby was talking about was only residents earning income in the state of Hawaii and could be taxed because we still would have residents that weren't earning enough income. The focus was really income earners.

Dr. Colby said yes. For example, a person could own twenty acres of land in Kahala that was probably worth a lot of money, but unless that person was declaring any income, we wouldn't know about it and were not non-residents.

Commissioner Knox asked Dr. Colby if the brackets came from historical or pre-inflation situations decades ago that has never been changed.

Dr. Colby said his tenure in Hawaii was very limited so in terms of historical tendencies, he couldn't speak to it.

Mrs. Sakata said the brackets were changed during the Lingle Administration. It was expanded by twenty percent but the rates were the same.

Dr. Colby said Hawaii still had the most tax brackets of any state in the country.

Commissioner Knox asked if there were many states that do indexing.

Dr. Colby said some do, some don't and it was not like Hawaii was the only state that doesn't index.

Commissioner Knox asked why the upper incomes get targeted.

Dr. Colby said the upper income earners were usually the ones that would utilize the renewable energy tax credit for installing solar systems versus middle income earners whom were less likely because they couldn't afford it.

Commissioner Knox said he was very struck by the tax brackets and seemed almost common sense for a TRC to say something about that. Presuming that some type of analysis would be useful in backing that up and didn't seem it would be part of PFM study.

Mr. Bauer said in terms of the number of brackets?

Commissioner Knox said if there was a more rational indexed bracket system.

Mr. Bauer said indexing was a different issue than a number of brackets, but his perspective on the number of brackets was that it was not that difficult to figure out your taxes using software or

the tax table and calculate. He said that Hawaii has more than most but doesn't think that had much material impact on much of anything.

Commissioner Knox said maybe it offends his sense of aesthetics.

Mr. Bauer said simplicity was good but at the same time, he was not a fan of a flat tax either.

Commissioner Knox said he was just establishing it was not something PFM was looking at.

Mr. Bauer said no.

Commissioner Knox said was there anything done recently in Hawaii or that the TRC could do simply and quickly to buttress any sort of recommendation on this or it really wouldn't make all that much difference.

Dr. Colby said he could think of many permutations that would result the same amount of revenue using fewer tax brackets. He didn't know what analysis Commissioner Knox was looking for.

Commissioner Knox said he didn't know either and could say to the legislature to come up with something that made more sense and index it.

Dr. Colby said indexing would be about twenty percent of our income that the state would not be reaping as much benefit from inflationary costs as other things. People weren't getting bumped up into other income classes due to inflation.

Chair Takamura said maybe the TRC could get statistics on how much people have in taxable income for each bracket, and then if we wanted to change it, we could do the calculations for it.

Dr. Colby said he was going to include that in his final paper to the TRC.

Commissioner Kaina said was there any information, historical or otherwise on why we had so many small brackets.

Mr. Yamachika said the brackets were there since the sixties.

Commissioner Cook said Dr. Colby mentioned about three quarters of the people moving to the State of Hawaii were over the age of sixty-five. He asked if it could be attributed to the exempt pension and social security.

Dr. Colby said there were a lot of baby boomers in Hawaii but would not venture say it was a tax correlation thing and we definitely won't make it hard for pensioners to retire here except for the cost of living.

Commissioner Kaina said Dr. Colby wasn't saying that people moving here was growing but the net population of aging people here was growing.

WRITTEN COMMENTS ON HAWAII'S TAX STRUCTURE OR ITEMS LISTED ON THE AGENDA:

Chair Takamura said there were no written comments to the TRC.

PUBLIC COMMENTS ON HAWAII'S TAX STRUCTURE OR ITEMS LISTED ON THE AGENDA:

Mr. Fritz said the TRC may want to take note of in the Supreme Court today, they looked at the amount DoTAX collected from the county surcharge of essentially twenty-four million and the DoTAX budget was twenty-eight million. There was an interesting question raised that it was entirely possible that that twenty-four million, as the result of a Supreme Court decision maybe reduced because it seemed like the state taxed the county. He said he wasn't sure how that figures into the model or anything else, but there would be a reduction.

He also said that Mr. Knox did a study on the budget for a past TRC and the last TRC built the model, has anybody bothered to exercise some due diligence with twenty-twenty hindsight with what the economy did or what the legislature did and how that worked in the model and was it accurate. He said he wasn't asking for an answer now and wasn't sure if anyone had ever used it. He was curious about that.

Chair Takamura said the TRC would take that into consideration.

NEXT MEETING:

The next meeting was scheduled for Thursday, July 27, 2017 at 1:30 PM.

ADJOURNMENT:

The meeting was adjourned at 3:37 PM.