TAX REVIEW COMMISSION

MINUTES FOR THE THIRTEENTH 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 27, 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 27, 2017.

Members Present:	Colleen Takamura, Chair Vaughn Cook, Vice-Chair Dawn Lippert John Knox
Members Absent:	Raymond Blouin, Billy Pieper and Nalani Kaina
Staff:	Seth Colby, Titin Sakata and Noe Kaawa
Others:	Randall Nishiyama, Department of the Attorney General Randy Bauer, PFM Group Consulting LLC Donald Rousslang, Department of Taxation Sean Hao, Office of the Auditor Ron Shiigi, Office of the Auditor Megan Johnson, Office of the Auditor Kevin Dayton, Star Advertiser Jana Moore, CAN Sam Lee, CAN Peter Fritz

CALL TO ORDER:

Chair Takamura called the meeting to order at 1:30 pm. She said the TRC had no quorum and there would be no decisions made at this meeting.

APPROVAL OF MINUTES:

Chair Takamura said approval of the minutes from the Thursday, July 6, 2017 meeting was deferred until the next meeting.

QUESTIONS AND ANSWERS FOR THE PFM GROUP LLC ON THEIR HAWAII HIGH LEVEL FINDINGS MEMO REGARDING THEIR STUDY OF HAWAII'S TAX SYSTEM:

Responses from the PFM Group LLC to questions previously received from the TRC on the high level finds memo.

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

Chair Takamura said the TRC requested a meeting to go over the responses PFM provided to the questions related to their high level findings memo.

Mr. Bauer said before starting, he wanted to offer an explanation for every ones understanding of the high level findings provided. He said the high level finds was the opportunity to have discussions about the issues being considered as PFM does the written evaluation and report. The point made prior to their written responses was that none of the high level findings were recommendations. They were just observations, findings, believed to be supportable conclusions but weren't necessarily going to be in their report as recommendations. He wanted the TRC to understand that and that it was more like a sounding board as opposed to this was their report to the TRC as recommendations.

Chair Takamura said she would go through what she had questions to from the responses provided. First was the retiree healthcare and pension. She said she referred back to the contract and it mentioned to look at the unfunded liability for pension and healthcare, so she expected to see information related to the pension.

Mr. Bauer said they relied on exactly what the contract told them to do and one alternative was to take as a goal to raise additional revenue for the annual required contribution for the Employer-Union Benefits Trust Fund (EUTF). Anything else related to the state requirement was not something PFM took on as a charge. The 2012 TRC study they had done looked more broadly at what they had estimated as requirements for the state and built a model to look at that. PFM just responded to the specifics of the RFP and was confident based on the reading of that that they knew what that figure was and was responding to.

Chair Takamura asked if PFM would be able to provide the TRC with figures on the pension as well.

Mr. Bauer said that was outside the scope of what we have been working on together. PFM could do that analysis but would have to be discussed as to what that would require them to do. Within the context of the report to be submitted to the TRC in just over a week, they couldn't do that analysis.

Chair Takamura said if it were outside the scope, would PFM be able to do it as a separate study and how much it would cost for the estimate of the pension.

Mr. Bauer said it was possible to work on an analysis for the TRC. They were not trying to run up the bill, but it wasn't something they had up to this point in time considered just because it wasn’t in the scope. He said he would be happy to try and figure out what that would mean in terms of an initial analysis.

Chair Takamura said if PFM could do that for the TRC

Mr. Bauer said of course.

Chair Takamura said regarding renter housing affordability, it does not include any assistance some get, was that correct?

Mr. Bauer said that was correct. He said this was one of those areas PFM tried to provide some context to the overall issue of tax burden because renters were often not considered as homeowners in this type of analysis. While in Hawaii, PFM participated in a major meeting that talked about the issue of renters. He said they thought it would be useful and presented this as an area of interest and not as a major component of the analysis they were doing.

Commissioner Knox said he had a vague memory of some recent study on the GET export factor and what was the most recent he was aware in that literature they were going to review.

Mr. Bauer said this was an area he thought their subject matter expert Dr. Chris Wheeler had mentioned in the response that he was going to develop his own analysis not only from the literature and was still being worked on as PFM prepared their draft report for submission next week.

Commissioner Knox said if they could check with the state's chief economist about his knowledge of the most recent stuff from Hawaii.

Mr. Bauer said they met with the state's chief economist and had a discussion around that and he led us to a couple of resources, but frankly, this was not an area that there a significant amount of on- going research, though they were hopeful that Dr. Wheeler would provide from their team would help move some of that analysis forward.

Commissioner Knox said it was being discussed a lot out here and there would be attention to that.

Mr. Bauer said since PFM were last in Hawaii five years ago, this topic was discussed and it should be since the economy was so much different than most states because of how many visitors Hawaii has that contribute in terms of the economy. He was surprised that it hasn’t gotten more scholarly attention because they keep coming back to studies done ten, fifteen, twenty years ago when they hear about "well, where was the basis, was it fifteen percent, seventy percent, thirty percent, thirty-three percent". They don’t see a lot of recent scholarly research on what that number was.

Commissioner Knox said thank you because the industry was changing, structure of the industry was changing and structure of visitor expenditures was changing, etcetera.

Mr. Bauer said any specific or targeted focus was what PFM wanted to learn about what that number was could be something that would benefit the state a lot and in their charge, that was a component or part of all in which they were looking at. Just focusing on that would benefit the state.

Commissioner Knox said while Dr. Wheeler may be aware of it but to be sure if the chief economist did already tell you to follow up with him because they had initiated in the last year or two, a study on the current visitor expenditures down to very precise categories. So there would be some new data at DBEDT on that.

Mr. Bauer said that was helpful and they would follow up with them.

Chair Takamura said it was mention that PFM could explore some of the options for expanding the GET base and asked if they could give the TRC how much that would cost to do that work too.

Mr. Bauer said the beauty of the GET was that it was very broad and weren't very many exemptions to it. For the analysis done in 2012, they did a "what if" the GET rate was increased as an example since there weren't many things that could be done to the GET. It was easy enough to for PFM to expand on that.

He said from the charge that was presented to PFM, they looked at GET in terms of the other aspects they were asked to look at which was primarily tax burden and regressivity and then opportunities to increase revenue. They saw it as a conflict if you just increase the rate. He said he understood that the presentation provided a couple of meetings ago suggested perhaps the GET wasn't as regressive as sometimes suggested but generally it was going to be regressive. They didn't look changes to that in terms of raising revenues but would analyze that for the TRC.

Chair Takamura said she was also looking at expanding the base for GET and looking at exemptions that maybe should be removed. There were so many of them and some big ones that maybe shouldn't be there or looked at to see if it should be taxed. She brought that up because one of the previous recommendations to the last TRC was to eliminate the exemptions for non-profits and that's a big thing.

Mr. Bauer said that has been an issue around non-profits and taxation for about twenty years and as they work through it, he was conflicted on it, but they would certainly provide some type of analysis for that so the TRC could make decisions.

Dr. Colby said the real numbers for amount of claimed deductions were going to be included in the report he provides.

Chair Takamura said her question related to the vape and e-cigarette tax and that there was information for other states and wanted to know if there was information about Hawaii.

Mr. Bauer said that was a minor tax and there were eight states taxing e-cigarettes or vape products. Minnesota has by far the highest tax rate of ninety-five percent of the wholesale price, and they estimate raising less than five million dollars from it next year. This was going to be a product that over time would be a greater base to apply the tax to, but was not a very big revenue source right now.

He said by contrast, should the state decide to legalize recreational marijuana, if you look at the demand within states like Colorado and Washington which had legalized it for a while and at what had developed in the way of taxing that which was at retail at a straight excise tax that could be in the range of twenty-five to sixty million dollars for Hawaii. That would require Hawaii to legalize marijuana for recreational purposes, develop all the necessary regulations and administrative structures for it. That was what the experience has been in other states and could possibly be a bigger revenue source than e-cigarettes and vape products were.

Chair Takamura said she was looking at a tourist tax imposed in certain areas similar to Miami. It's not a GET or TAT, but just an additional tax.

Mr. Bauer said what they found in their research on the Miami government website was that six percent was comprised of taxes that were already being applied in Hawaii and he was not sure if there could be a new tax.

Chair Takamura said someone had told her that when they went to Miami, on their bill was a tourist tax added on and she knew Hawaii had that for GET and assumed that that’s what they were talking about.

Mr. Bauer said they had identified it as activities already being taxed by Hawaii.

Chair Takamura said it would be an additional tax onto the GET.

Mr. Bauer asked on what?

Chair Takamura said it didn’t include hotel but for goods and foods purchased.

Mr. Bauer said what they identified was the tax was on hotels, food and a couple of other activities, but he doesn’t see that as a new base the TRC could apply a tax to.

Commissioner Knox said he wasn’t sure but it looked like those taxes were earmarked for particular uses related to tourism.

Mr. Bauer said yes, but it was obvious one could choose to use those earmarks or not. He couldn’t see a different base in Miami as opposed to what Hawaii was already taxing.

Commissioner Knox said if we had anything at all that was going to be related to more tourist taxes, we were going to fall into that on-going debate about to what extent it was appropriate to reserve it for visitor things, and to what extent it could be used for general fund things, and to what extent we would play the "shell game" pretending that some things were tourist related when they weren’t. We have quite the controversy about that.

Mr. Bauer said that’s what you run into with the tourism industry. He suspected if they did specific bench-markings of Hawaii against some other areas they compete in at least in the United States, Hawaii was already on the high end and that’s not to say that was the wrong place to be. From what PFM understood from discussions with Hawaii's tourism people, Hawaii already markets to the high end and wasn’t looking for the spring breakers trying to find the cheapest place to go to have a week of fun. So some of that was already acceptable and how far you can go would require some analysis that they were more able to do then PFM.

Chair Takamura said she had a question on resort fees. She had gone to a convention and the state had spoken about TAT and mentioned that mandatory fees were subject to TAT, therefore if there was a resort fee, there wasn't a choice whether one paid or not.

Mr. Bauer said that maybe an area that PFM didn't have right and they were checking on that.

Chair Takamura questioned Mr. Bauer if Airbnb was not charging TAT on rentals.

Mr. Bauer said the use of Airbnb was something they would not do and referred to that industry as a whole. That was an area discussed and wasn't sure if PFM had right. The beauty of having this type of discussions with the TRC and why they do high level findings was to figure out those areas. More research was being done on that.

Chair Takamura asked for the elimination of pension income up to twenty-five thousand dollars and foreign pension income, why were they listed separately.

Mr. Bauer said they were looking if there were any legal issues related to foreign pensions and was a minor alternative. When they did the study in 2012, they recommended and he strongly believed as someone involved in tax policy for a long time, that pension income should be treated closer to an area of income then it was. He said one alternative was to treat foreign pension income differently within the state, but would need to find out if that could be done legally. There may be major issues of equal protection.

Chair Takamura said if someone had Hawaii pension and mainland pension, would they get fifty thousand and was that what PFM was thinking.

Mr. Bauer said yes. Ultimately that would be for policymakers to decide. PFM was just suggesting an approach to pension income could be to tax some of it as opposed to what Hawaii had right now, which was not to tax any of it. Some of the details like exempt some portion of pension income and one thought were more for lower income individuals. Frankly, in most places twenty-five thousand per year of pension income was a pretty good pension on top of social security and any other income one might have. One could consider that a lower income person's pension but the TRC would have to decide where that level was and PFM believed Hawaii should tax some share of pension income.

Commissioner Lippert referred back to Airbnb in the high level findings and asked if PFM would be able to quantify how much revenue was raised by Airbnb.

Mr. Bauer said they had not figured that out yet and was one area they were still working on.

Commissioner Lippert asked if PFM would be able to figure that out for the TRC report.

Mr. Bauer said he hoped so, but the problem with merging industries was figuring that out. One of the tenets of taxation was an old tax was a good tax because it gets figured out. Who it hits and how much it hits. However, with emerging industries like Airbnb and the car-sharing industry, it was harder to get at to figure out tax incidence.

Commissioner Cook said he had a follow up question to looking and analyzing emerging types of business models and industries and wanted to know if PFM would be looking at those as potentially new revenue but also considering replacement cost that could be replacing some other tax that could be going down at the same time.

Mr. Bauer said that was a good point. Obviously if people were now using e-cigarettes instead of regular tobacco products then there should be some replacement associated with that. They would at least mention those kinds of trends. There weren't a lot of them and one of the taxes they had mentioned and would analyze to some extent because he thought it could become more prevalent, would be taxes on sugary products sugary beverages, and there was evidence in places that had instituted those taxes and people change to different products like bottled water. That's for the TRC to figure out if there would a loss of whatever revenue stream there was.

He said this has happened to places that taxed disposable bags and a lot of those places that enacted that tax got a fair amount of revenues and then it fell off precipitously because people decided they were going to substitute with bringing their own bags, and then it became a question of what do you do if that happened.

Commissioner Lippert asked if the bag one was something PFM looked at for Hawaii.

Mr. Bauer said they could, but in their experience was that they perceived Hawaii to be a fairly green state. The TRC may want to associate that with changes in behavior. On the revenue side no place that enacted it has been able to sustain the tax as a revenue stream as consumers shift in the way they do business.

Commissioner Lippert said she would be interested in quantifying that shift and understanding it, and even from a non-revenue perspective. One thing when trying to figure out taxes was to get less of the behavior we don't want and more of the behavior we want.

Mr. Bauer said they would add it since they've analyzed it for other places so it wouldn't be difficult to do it for Hawaii.

Chair Takamura said with eliminating deductions for real property tax, would it for individuals and businesses.

Mr. Bauer said he believed that was the numbers they were looking at. They analyzed it and tried to put them into categories. Hawaii was unique of the states as property tax burden was low and primarily because of how K-12 education was funded. If the TRC was looking for ways to change the way the structure existed and a case to be made for it, then how would you make the change? One way would be to change the mix between state revenue, primarily individual income tax and property tax which would be to eliminate that deduction in its entirety.

Chair Takamura said she knows commercial rates were higher than residential rates for real property taxes.

Mr. Bauer said PFM could try and split that out.

Chair Takamura said she asked if there were any compliance issues that could be looked at to collect the revenue due to the state.

Mr. Bauer said first of all, if those compliance issues related to what was happening right now with the implementation of the DoTAX's new system, there was a contractor whose entire scope was to provide the state with how that project was going. PFM could not provide any greater insight into that but the contractor could, and they certainly did not have the resources or expertise to do so.

He said they did approach compliance in a couple areas. One was the area that most states were looking at in terms of compliance that relates to sales tax and standards of nexus, and how you collect taxes that were already owed, and not necessarily collected. There would be significant discussion and analysis around that. Greater emphasis on audits and those functions within DoTAX were cost effective and started that analysis. There were multiple states that had demonstrated efficacy of putting resources there and didn't think Hawaii put as much resources there as it could and could benefit from it.

He said another area was a tax gap analysis once the software was in place for the new system. When he was Budget Director for the State of Iowa, they developed one of the earliest tax gap systems in conjunction with a vendor that basically took their payments for that system out of the initial revenue it generated and it paid for itself in less than a year, and generated on an annual basis twenty-five to fifty million dollars fifteen years ago. This would be an area discussed but was an area that would need to finish its implementation of its new system before you're going to be able to put that in place.

Commissioner Cook said his question related to the tax burden and the relative tax burden of Hawaii tax fairs versus other jurisdictions, and he was surprised that Hawaii had a relatively low tax burden because the perception or feeling was Hawaii had a relatively high tax burden. He asked if Mr. Bauer could expand, maybe in the differences in why some studies say Hawaii had a relatively high tax burden and other studies say Hawaii had a relatively low tax burden.

Mr. Bauer said he apologized that Dr. Wheeler wasn't able to participate in the discussion but would explain the concepts. What PFM had used and generally found most useful in these kinds of discussions of taxation was a model similar to what Washington, DC did on an annual basis. It was a well designed by several PhD Economists and they basically filled out tax returns based in an understanding of things like BLSs, studies of household expenditures at different income levels for taxpayers within each of the largest cities in the fifty states and looked at the entirety of what the cost of living was, what the tax structures were in those areas and then identify at different income levels what was the tax burden. He said he found that to be useful not just because it was an aggregate number of what's happening with tax burden, but it was actually what households experience at different income levels which were reasonable increments throughout the country, and that allowed for reasonable kinds of bench-marking and what did that mean for individuals in urban areas across the country. For Hawaii, since you were separated from the rest of the country, it may not be quite as useful as other places.

He said PFM replicated their 2012 study and expanded to a statewide look as opposed to just looking at Honolulu, and what it meant for the State of Hawaii. There was going to be a difference as some of the other studies done by the Tax Foundation or the Federation of Tax Administrators (FTA) was taking aggregate numbers and applied them to the state as a whole. What PFM said was for these bands, for these households with these characteristics this was what their tax burden looked like. So it was a different way of looking at it. Both had advantages and disadvantages but he tends to believe that their method was more practical in the way you could examine what tax structure meant to what may be the typical households in a community or state.

Commissioner Knox said the tax burden was usually tax revenues divided by something and, if the standard approach was across the country, was divided by households per capita that really overstated the burden for Hawaii because the numerator actually contained a lot of revenue from not-residents. It could also be divided by other things like measures of the economy, how much the economy bears GDP or personal income.

Mr. Bauer said that was an area he was trying get Dr. Wheeler with Dr. Rousslang because Dr. Rousslang had asked a question related to some of that aspect as it related to how they characterized the GET. Hawaii had a very unique structure for its revenue source and sought to make a connection. He would not suggest that this approach was perfect and not sure of any perfect approach but PFM would do their best to take apart and explain where they thought it worked or not for Hawaii. He said he believed that it was a little bit more practical in its application than some other ways of looking at it. As Commissioner Knox mentioned, any time you start talking about averages, it got skewed by both ends of the scale, and most of these kinds of approaches looking at tax burden never talked about the middle point of discussion. There almost always averages but it at least avoids that concern.

Commissioner Knox said on the matter of qualitative assessment of the impact of actions on overall economy of major sectors, it was indicated it was out of scope.

Mr. Bauer said it depended on what the TRC was asking and asked Commissioner Knox for an example of what the TRC was asking PFM for.

Commissioner Knox said he had an issue because the contract did include a statement "the study shall include a qualitative assessment of the effects of the proposals on the overall economy and on its major sectors". So it was part of the scope. The concern that some of them had was that part of the scope was raising revenue and immediately the suspicion went up because PFM was only looking at helping out the state and not look at what it was going to do to the economy and in the long run were we going to have less revenue because we're going to strangle the economy. That had to be given some consideration.

Mr. Bauer said he appreciated Commissioner Knox pointed that out. He said he would like to preface his remarks by saying that there were no perfect taxes and every tax had some dead weight loss. You're taking revenue that would otherwise be dedicated to consumption, investments or something else in the economy that could benefit it. Then one's hope was the policymakers would use it in ways that would have a similar amount of benefits. That’s why it was really hard to say what that kind of assessment was, but they could say that assessments as to where there particular industries that would be more impacted by some of those changes. One of those Bedrock principles of taxation was as neutral as possible in the economy in terms of picking winners and losers, and they could certainly relay that to any of the recommendations they were making. Taking those kinds of principle of taxation and apply them.

Commissioner Knox said since PFM was going to tell the TRC about other things that maybe an add-on to what they were currently doing, if Mr. Bauer would let the TRC know what he thought they could do to address that within the scope and within the current budget; and if he were to say the perfect thing for your concern was something a little different, a twelve page, white paper looking at the major findings literature. He said he was looking at that as a reference document for consideration to be brought up at anytime. There was going to be a proposal coming up by the TRC and thinks it could have legs that could stand up for a long time.

Mr. Bauer said Hawaii's tax structure kind of fits what we were. We were an island economy that had aspects that were very different from other states and we capitalize on some of those aspects. Clearly because of issues of being so far from a lot of whom we participate in terms of the U.S. economy and it kind of constrains us from being a leader in certain industries but there could be some going forward that that's not such an issue as we get into a more individual economy. He said he doesn't think Hawaii had done a bad job of capitalizing on who, where and what we were in relationship to the trading partners of the rest of the U.S.

Commissioner Knox said we tend to ring almost religious ideological perspectives to some of these and need responses. Some of us were very committed to social welfare and anything like that was good. Others were very concerned about protecting the industry and any revenue was bad right off the bat. If the TRC could get something which was fundamental, an educational piece that could inform and get them off the knee jerk reactions.
Mr. Bauer said they were trying to do that both five years ago and now, but if there was more they could do, they would be happy to discuss it with the TRC. He said they would try to build some of the discussions into the study. Anyone who thinks the revenue structure was not going to have any impact on anybody, raise a lot of revenue and everyone's going to live it was just a fantasy.

Commissioner Knox said on the bottom of page 16, Mr. Bauer said yes the sentence would be bolded. He said he was concerned about that one particular sentence. He thought about him being clear about the GET, whether it was regressive of not, having that summary sentence was complex and asked for it to be simplified.

Mr. Bauer said the high level finds was not going to be like the report. Their plan was to provide a written draft and then the TRC would have time to read it. He and Dr. Wheeler would come to Hawaii and sit with the TRC, and go through the draft before the final report. They looked forward to having that continued dialogue with the TRC.

Commissioner Knox said he had questions about having a menu of alternative rather than a response that yes, these were alternatives but when it came to the recommendations, were they going to be a bunch of optional individual things or were they possibly packaged alternative strategies which was what they were looking for.

Mr. Bauer said that was a good question and why these were discussed with the TRC. What PFM was going to do was present to the TRC the various alternatives like a vape products tax, carbon tax, recreational marijuana tax, sugary beverage tax, changes to the existing excise taxes, changes to the exemptions that exist and so forth. They would all be listed separately, the revenues would be estimated and present these alternatives to the TRC. They felt the TRC was in a better position to say whether gathering some of the consumption taxes was an area to focus on or saying that the balance has shifted, and in most places their wealth taxes were greater, so the TRC thought these things should be done to rebalance towards wealth taxes.

Commissioner Knox said the TRC's original intent was first, we asked about regressivity and recommendations or ideas that make that better even though you're telling us we're pretty good.

Mr. Bauer said they would present the TRC, clearly there were three things asked of PFM. Tax burden analysis; ways to make the system less regressive and agreed with Commissioner Knox that amongst states, Hawaii certainly was not more regressive than most, but was middle to less regressive; and present options in the area of additional revenues and how to package those revenues. They thought is should be packaged while at the same time being mindful of the other two studies so that they don’t create more burden or create a system that was more regressive in its component parts that exist currently. It could be sliced and diced however the TRC wanted.

Commissioner Knox said that was the intent and was just making sure that that's where they were going that there might be a package of things but that package was packaged because of the consideration of tax burden and regressivity.

Mr. Bauer said what he might suggest for the TRC since they gave PFM their direction was in the draft, present an array or menu of alternatives and then if the TRC wanted them to quote them in ways for the final report or recommendation, they would do so. He said he didn’t want to suggest to the TRC what they should suggest to them.

Commissioner Knox said could he just talk a little bit more about the bullet on shifting K-12 education expenses to the city to lower state cost.

Mr. Bauer said he has consulted with half the states and a lot of them were on a structured relationship between state and local government, and Hawaii was by far the outlier in its relationship on the confronting responsibilities for the largest component of local government spending for K-12 education. The state essentially had full assumption of those costs and no other state was close. So if the TRC was talking about how you would change the burden of state taxation, well, the primary way would be to shift more of that responsibility of funding K-12 education to local governments and that would probably require them to raise property tax as Hawaii was very low compared to just about any other state.

He said there had been people that had suggested to PFM at meetings that maybe there should be a state property tax to pay for those things, but the problem with that was Hawaii's constitution said you can't. You would need to change the constitution and changing the constitution was difficult, and would take a long time, but changing that mix won't be that difficult and wouldn’t take a long time. The state could change the way the statute currently divides up those responsibilities and that could be done overnight. That was why PFM presented that alternative and then, if the state so desired it could dedicate that revenue that was now paid by property tax either to taking care of those concerns about funding its pension or retiree healthcare obligations or it could redo its existing state taxes, which would be a choice.

Commissioner Knox said he would be shocked if this state could do that overnight.

Mr. Bauer said of course they couldn’t do it overnight but that was the whole point of these types of commissions. To raise those issues and say should we as a state become like other states or maybe we shouldn’t because we were unique, and like the way we decided to fund these services. It comes with implications and if you look at any study that just looked at state taxes, Hawaii would be in the top three, but if you combined state and local taxes, it starts moving down because now those local taxes in other states that pay for K-12 education were in the mix whereas if you looked at just state taxes they were not in the mix anywhere else not to the extent they were in Hawaii. He said it really gets down to the question of what was the sphere one was going to look at as it related to taxation.

Commissioner Lippert said she had a question about that and it seemed to her that not having that much property tax was a contributor to regressivity due to people may not be making money here or they may have expensive properties here, and that's an issue here in Hawaii, and were not contributing to the tax base. Do these two issues interact in the report?

Mr. Bauer said yes, those were issues and as Dr. Colby pointed out in his presentation was Hawaii's tax structure was progressive for the individual income tax but it taxes at a very low income level. Whereas other states tax brackets where people were paying taxes were higher than Hawaii. There was inflicting of pain on those lower income individuals and they were not homeowners.

Commissioner Lippert said it would be helpful to understand from a qualitative perspective if we started shifting the balance towards property tax and what would be the impact on the regressive nature of our system.

Mr. Bauer said it depends. For example, some states do a significant homestead credit and if you had a significant homestead credit for lower income individuals that could mitigate some of the property taxes. In Hawaii, people with lower incomes didn't own homes because they can't afford to and all these types of things would be taken into consideration.

He said in states that had really strong circuit breakers, the amount of property taxes paid was tied to their income and did not go over a certain percentage. That kind of structure could be developed and property taxes was not as regressive as some of the analysis the TRC would see because it depended on the construct.

Commissioner Lippert said her last thought was Hawaii had such a high proportion of empty, very valuable properties, like investment properties and that played into that too.

Mr. Bauer said Hawaii was a unique state but you're not South Dakota and some of those considerations were different then they were in other places.

Commissioner Cook said he wanted to follow up to the discussion but found himself conflicted because as the TRC, he believed the mandate was to look at state taxes and what was discussed was a fundamental shift taking expenditures normally covered by the state and pushing it to the counties. As for the TRC's role, he was conflicted on that and appreciated the analysis to see what the numbers work out to be. In the high level memo, on page 12, there was an estimated tax impact of thirty-five million dollars, but as he read that he thought what was being conveyed was it would be to shift the public libraries general fund operating costs. He asked if Mr. Bauer had a ballpark figure of what that would be, to shift K-12 education to the counties.

Mr. Bauer said he hears that the TRC was suppose to focus on the state tax structure, but the inter-relationship between state and local government one can't get away from. If the state changes the way it views its relationship of the local government, then the state tax structure may change remarkably. That may be one of those areas where it's inside the "balloon" with state and local governments, and if you expand it in one area, it expands out from the other, but it was up to the TRC to decide if it was outside what was viewed as their charge. PFM was pointing out ways that could be changed within the state tax structure and if you changed that fundamental relationship between state and local governments.

He said he would not have necessarily brought it up but they had heard it whether in person or on the phone from stakeholders in Hawaii on multiple occasions that the state structure was tilted and that local government should be taking on more responsibilities. The word around the country was Hawaii was really an outlier and that's not a bad thing and it is what it is, so they were identifying that for the TRC's consideration.

Commissioner Knox said his last question was on compliance and was unsure whether there would be recommendations or examples that were tried.

Mr. Bauer said clearly compliance was a big area of discussion. If Hawaii's legislature considered taking action on it, were issues on how states were pursuing changes to nexus as it relates to sales and use taxes. The controlling word from the U.S. Supreme Court was still Quill versus North Dakota which requires "physical presence" for one to compel out-of-state retailers to collect sales tax, but a variety of states had done a variety of things to try and get greater collections. Amazon was now collecting sales tax for all fifty states since April 1, 2017 so that was good.

He said he believed Hawaii had a piece of legislation, a piece that everyone looked at as a "be all in" since you can't overturn Quill which is what Colorado had done which related to imposing reporting requirements on retailers if sales were over a certain dollar amount. He said in a couple of years, there was a case currently working its way through the federal court system and a South Dakota case was going to come before the U.S. Supreme Court to decide whether to overturn the Quill case or not. He said other areas around compliance like more auditors and better software would be mentioned.

Commissioner Lippert said there has been talk here locally about motor vehicle and gasoline tax, what were the trends there.

Mr. Bauer said a carbon tax.

Commissioner Lippert said both, one was the gasoline piece as we see more electric vehicles and vehicle fleets were changing and there was concern by the Department of Transportation (DOT) about adequacy, and what that looked like and misaligned incentives where DOT may want to take the state and what was best for the public versus what was best for the revenues.

Mr. Bauer said Hawaii would be the perfect state for doing a tax structure that was based around miles or usage as opposed to gas. Most places that have tried this, like Oregon was faced the problem of interstate transportation and interstate commerce and Hawaii wouldn't have that problem. It would make sense particularly as electric cars and other things become more important. The other issue raised in the high level was the whole idea of taking the tax structure to the next step of a carbon tax and thinks Hawaii was uniquely situated of the states to be the first to get into the realm of carbon taxes.

Commissioner Lippert said for the vehicles and gasoline piece, it would be helpful was provide some high level industry trends and to try to get ahead of it by providing some predictability of transportation and to align policy goals with the tax structure.

She said she also wanted to share some important working being done by the Climate Leadership Council at the national level, a bi-partisan group on a way of structuring a carbon tax. So right now, Hawaii has the barrel tax and in some ways it was de facto of a carbon tax because it's taxed per barrel of oil and only on oil, and not uniformly applied. A carbon tax made more sense and would be fairer.

Mr. Bauer said he was shocked when looking at Hawaii. He assumed all of our electricity was geothermal, but we used a lot of coal to generate electricity. As Commissioner Lippert mentioned, Hawaii had a barrel tax, but there was also the greenhouse gases that were emitted from manufacturing activities could all be a carbon tax.

Commissioner Lippert said that would create a more level playing field around a carbon tax as opposed to just a barrel tax. Coal was supposed to phase out by 2022. Sending those signals on broader perspectives made a lot of sense.

Mr. Bauer said he was not aware that coal was phasing out of electric generation by 2022.

Commissioner Lippert said most likely and that's when the contract was up. There was the new power supply improvement plan for the electric utilities that was just approved by the Public Utilities Commission (PUC).

Dr. Rousslang asked if the carbon tax would hit airlines.

Commissioner Lippert said the carbon tax could be structured in any different way, but the way the barrel tax was structured it hits airline fuel because a portion of every barrel goes into creating jet fuel.

Mr. Bauer said in terms of how you could structure a carbon tax, no state has one so it was like having a blank slate. You would have to figure out what was going to be taxed. There was a paper by Berkings that lays out the different things that could be taxed, what could be the base and where you would apply the tax. This was all high level at this point.

Commissioner Lippert said another interesting piece on the airlines in anticipation of this, many of the airlines has been really actively working on fuel efficiency as well as biofuels. So in some ways by creating signals you create economic pathways for those kinds of decisions.

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

Chair Takamura said discussion and action on the outline for the draft report would be deferred to the next meeting.

DISCUSSION AND ACTION REGARDING APPROVAL FOR TRAVEL EXPENSES OF TAX REVEW COMMISSION MEMBERS ON RELATED TAX REVIEW COMMISSION BUSINESS:

Chair Takamura said since the TRC had no quorum, the discussion for approval of travel expenses of TRC members related to TRC business would be deferred to the next meeting.

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

There were no written comments to the TRC.

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

There were no public comments to the TRC.

NEXT MEETING:

Mr. Bauer recommended the next meeting be scheduled giving the TRC ample time to review the draft report.

The next meetings were scheduled for Friday, August 11, 2017 at 1:00 PM and Tuesday, September 12, 2017 at 1:00 PM.

ADJOURNMENT:

The meeting was adjourned at 3:10 PM.