

Small Business Regulatory Review Board

MINUTES OF REGULAR MEETING

November 21, 2019

Conference Room 405, 235 South Beretania Street, Leiopapa A Kamehameha Building
(State Office Tower), Honolulu, Hawaii 96813

- I. **CALL TO ORDER:** Chair Cundiff called the meeting to order at 10:04 a.m., with a quorum present.

MEMBERS PRESENT:

- Robert Cundiff, Chair
- William Lydgate, 2nd Vice Chair
- Dr. Nancy Atmospera-Walch
- Harris Nakamoto
- Mary Albitz
- Jonathan Shick
- Mark Ritchie

ABSENT MEMBERS:

- Garth Yamanaka
- James (Kimo) Lee

STAFF: DBEDT

Dori Palcovich
Jet'aime Alcos

Office of the Attorney General

Margaret Ahn

II. APPROVAL OF OCTOBER 17, 2019 MINUTES

Mr. Nakamoto made a motion to accept the October 17, 2019 minutes, as presented. Mr. Ritchie seconded the motion, and the Board members unanimously agreed.

III. OLD BUSINESS – After Public Hearing

- A. Discussion and Action on the Small Business Statement After Public Hearing and Proposed Amendments to HAR Title 13, Chapter 234, Section 26, Fees and Charges, promulgated by Department of Land and Natural Resources (DLNR)

Discussion leader Ms. Albitz introduced Mr. Edward Underwood, Administrator at DLNR's Division of Boating and Ocean Recreation (DOBOR), who reminded the members that a comprehensive rule amendment packet for passenger fees of cruise ships was previously presented to this Board. Since then, the fees were removed from the rules due to concerns from the cruise ship operators.

Concerns involved DLNR unable to charge a different fee for a foreign carrier versus a domestic carrier, and how to implement the fees. DOBOR engaged Cruise Lines International Association-Alaska (CLIA-Alaska) to discuss the various concerns and recommendations. Overall, these changes were likely to result in a net loss for the State with respect to passenger fees for DOBOR facilities. Since October, DOBOR has sent out

notices to businesses in billing statements and through emails informing them of the amendments.

Public hearings were held on Hawai'i island, Maui island, and O'ahu. No one attended the public hearings to provide testimony. One written testimony was received from CLIA-Alaska, which recommended a one-year delay for increasing certain fees that could be applicable to cruise vessels. As DOBOR estimated that CLIA-Alaska's proposals would result in a net loss with respect to passenger fees for DOBOR facilities, it was not included in the final rules.

Mr. Ritchie made a motion to move the proposed administrative rule amendments onto the Governor for adoption. Ms. Atmospera-Walch seconded the motion, and the Board members unanimously agreed.

B. Discussion and Action on the Small Business Statement After Public Hearing and Proposed Amendments to HAR Title 18, promulgated by Department of Taxation (DoTax), as follows:

a. Chapter 231, Administration of Taxes, Section 3-14.17, Revocation of licenses because of abandonment;

Discussion leader and Second Vice Chair Mr. Lydgate introduced Mr. Jacob Herlitz, DoTax Administrative Rules Specialist who stated that the rules were promulgated a few years ago where a tax license would be revoked due to abandonment after 90 days when DoTax posts notice of its intent to revoke the license to petition DoTax not to revoke the license.

The proposed rule will change the period from 90 to 45 days to mirror the period for which the intent to revoke must remain posted under the section's subsection (d). The proposed rules also make non-substantive amendments to correct cross-references to other sections.

Second Vice Chair Lydgate made a motion to move the proposed amendments to the Governor for adoption. Ms. Albitz seconded the motion and Board members unanimously agreed.

b. Chapter 235 Income Tax Law

1. Proposed New Section 3-01, Distribution of credit for partnerships, S corporations, estates, and trusts;

Discussion leader and Second Vice Chair Lydgate explained that the proposed new rules add a new section that creates a general rule for how income tax credits may be distributed when the method of distribution is not specified by statute or the statute states that distribution shall be determined by a rule.

Mr. Herlitz explained that whenever the Legislature creates a tax credit that can be claimed at the "entity level," there is always a question as to how the entity may distribute the credits to its partners, etc. Thus, this new rule will create a default rule so the Legislature

will no longer be involved in every single tax credit; as such, this default rule will automatically take effect. The default rule is also based on a pro rata distribution; so, one's ownership stake in the partnership would equate to the percentage of the credit.

Second Vice Chair Lydgate made a motion to forward the rules to the Governor for adoption. Mr. Ritchie seconded the motion, and the Board member unanimously agreed.

2. Proposed New Section 17-01 through 17-19, Motion picture digital media, and film production income tax credit

Discussion leader and Second Vice Chair Lydgate stated there was a substantial amount of testimony submitted at the public hearing. Mr. Herlitz explained that the proposed new rules provide guidance for the administration of the motion picture, digital media, and film production income tax credit, i.e., "film credit." Although the process of claiming film credits can be complicated, the rules clarify how the aggregate cap is applied, how credits are allocated and distributed, what constitutes a qualified production, and what qualifies as production costs for which the credit can be claimed.

Mr. Herlitz confirmed that there was a lot of testimony at the public hearing. One of the changes DoTax made to the rules, after the public hearing and based on the submitted testimony, relates to the film credit being tentatively allocated based on a first-come-first-served system combined with a mandatory two-year claim period for claims of \$250,000 or more. This new allocation system will likely benefit smaller production companies that are not already given small-claim priority over all new claims.

Ms. Titin Sakata, DoTax Rules Specialist, clarified that the Governor signed off on this rule November 7; it became effective on November 17th. Because the rule-making process started several years ago, she believes that nothing should be a surprise to the industry as there have been many meetings with the stakeholders and with DBEDT for clarification purposes.

Mr. Ricardo Galindez, Co-founder of Island Film Group, testified that the film industry is a very fragile industry. Island Film Group, which consists of attorneys, is the largest tax credit filer in Hawaii that helped with drafting the initial legislation that created the film tax credits. Thus, Island Film Group knows this industry and the requirements of the tax credits inside and out.

Mr. Galindez proclaimed that for reasons unknown to him, DoTax's process of promulgating the rules was less than transparent as DoTax, at times, refused to meet with the stakeholders. While some of the comments outlined in the pre-public hearing statement reflect changes, which the small business stakeholders were in agreement, the post-public hearing statement reflects many other changes that stakeholders were not privy to or aware of. Because of this, there are now provisions in the rules that hinder small business.

Mr. Galindez attended the two public hearings and takes issue as to whether DoTax adequately addressed Island Film Group's concerns. Also, requested meetings with DoTax were ignored; it is unknown at this time what actions, if any, it will take against DoTax.

Ms. Donne Dawson, DBEDT's Hawaii Film Office Manager since 2001, testified that she was very instrumental in establishing the film tax credit legislation in 2006. Her role at DBEDT is to statutorily certify the tax credits by interfacing and explaining them to the production companies. She is also charged with administering the film program and securing film permits for production, which is very complicated work. For the industry as a whole, tax credits are the number one way the State attracts business which results in economic growth and development in Hawaii's film industry.

One of Ms. Dawson's main concerns about the rules is the immediate effective date. Also, verbiage of the adopted rules and verbiage of the proposed rules posted on the Film Office's website are very different. In the interest of transparency, fairness, and business operations, Ms. Dawson has requested that her office be given time to pull the notifications on the website that have been there for years and repurpose them. In particular, the key document on the website is a flowchart showing the process and steps to go through in applying for and receiving film tax credits with an estimated time frame to receive the credit. She has to now notify the production companies that the dynamics of the rules have changed in mid-stream.

Ms. Dawson noted that one of the main rule changes is a mandatory third-party independent CPA review for all production companies filing for the credit. While this will take some of the burden off the Film Office, the CPA firms will now have to rely on the agreed upon procedures. Letters of engagement have already set fees that were agreed upon with the production companies and now it is questioned whether additional staff hours and costs to applicants are needed in order to conform to the new set of rules.

She added that the \$500,000 or less threshold of anticipated credit for the smaller production companies, which is greatly appreciated, will be able to submit a priority position. Anything \$2,500,000 and above requires splitting of the tax credit over the course of two years. However, it is unclear to her what is being done about productions that are between the \$500,000 and \$2,500,000 threshold. Therefore, time is needed to understand the rules and to properly explain to those clients who spend hundreds of millions of dollars in the state. She estimated that approximately \$50,000,000 in tax credits were generated last year.

In response to Second Vice Chair Lydgate's inquiry as to why there is such a disconnect with DoTax, Ms. Dawson stated that there has been communication with DoTax, and that she has tremendous respect and gratitude to DoTax and the individuals responsible for promulgating and handling these rules. She believes the reason for the expeditiousness in adopting the rules may be due to a 2016 State audit where it was noted that there were no rules for the tax credits. At that time, the auditor placed the responsibility and timeline for adopting rules on DoTax. In an effort to meet the mandates, be responsive to the industry, and for the agency to be responsible for certifying the credits, a fast speed occurred.

Second Vice Chair Lydgate stated that monies from some of the larger productions as well as some small businesses go to funding other entertainment efforts, especially in Kauai, thereby having a very positive effect on small business. Ms. Dawson confirmed that there probably is not one sector in Hawaii that does not depend heavily on the film industry to make its living, at least indirectly.

In response to Mr. Ritchie's inquiry, Ms. Dawson stated that in addition to "timing" of the adoption of the rules, another concern is that the substantive changes were made in a way that certain costs are required to be qualified or not qualified. This is different than what was previously allowed and understood; an example is the change in how per diem is now qualified. She confirmed that the qualification requirements for certain expenditures are that they must be subject to income tax or excise tax.

She added that considering there is a rolling \$50,000,000 cap on the tax credit, the key element of the rules is the "allocation" method and how they are going to be distributed fairly, knowing that the cap is insufficient. She reiterated that the Film Office's concerns are the effective date and how the program is going to be rolled out to the industry. In terms of effectively rolling out the program, it may take one year, which may not be realistic. As the Film Office is statutorily responsible for film permitting as well as the administration of the tax credits, Ms. Dawson's time is constantly pulled away to handle problems that surface and to mitigate any resolution about the ground filming.

She also added that Hawaii's reputation is "on the line." Because she deals with very high-level studio executives, she believes that this does not look good and she is concerned that it will be difficult for the Film Branch to recover from the changes in the rules. Further, there may be some ramifications in terms of studios willing to make decisions to come to Hawaii as she is currently unable to adequately explain what the new rules entail.

Chair Cundiff appreciates everything that the Film Office has done because the film industry is a critically important element of the State's economy. He has concerns over "contracts" that are secured to bind production companies to come and produce film in the state over a set of rules that are current. When the contracts ultimately change due to changes in the rules there could possibly be legal ramification as well as all the other ripple effects where production companies are concerned about coming to Hawaii due to the changes in the rules.

Chair Cundiff reiterated the process by which the rules come to this Board pre- and post-public hearings. While the Board makes recommendations on the rules, which relate directly to small business, it does not have control on how the Governor will respond to those recommendations. Thus, based on the information provided to the Board today, it appears that the timing of the submission of documents was not followed. It also appears that there was no allowance for a "roll-out period" with consideration of the State's Film Office responsibilities to inform and counsel those production companies who are now put in a bind over the immediate implementation of the rules.

Mr. Herlitz responded that his office follows Chapter 91, HRS, which requires that agencies submit to this Board a *small business statement after public hearing*, without the requirement of any specification of time. Regarding having any flexibility on when the rules may be implemented, he admitted that there is very little flexibility, in general, but rules can be delayed in their implementation for a short period of time, 30 to 60 days. Chair Cundiff noted that this would not help many of the production companies.

Mr. Nakamoto stated that he is very disappointed with the process and the lack of communication between DoTax and DBEDT, particularly for and on behalf of the State of Hawaii and its small businesses which are the heart of the economy. Ms. Albitz added that DoTax continues to perform the bare minimum for outreach and makes no effort to solicit testimony from small businesses.

Upon hearing the testimonies, Ms. Sakata explained the history and timeframe of the film credits and how they relate to general excise taxes and income taxes. The rules, as presented, are the result of DoTax cleaning up and clarifying the guidance and requirements of the statutory intent, bearing in mind that the Legislature may make any changes it deems necessary to change the intent of the rules and its requirements.

Chair Cundiff stated that he shares in the disappointment of the Board members to the extent where one of the primary goals of this Board is to drive people together prior to final rule-making so that the stakeholders are involved in generating rules that will have the minimal amount of impact to small business. He also shares this Board's disappointment in regards to the appropriate time to view the impact prior to public hearing, through the public hearing process, and even after the public hearing process where there may be a time period to regroup and decide what would be the best course of action to take; it does not sound as if this process was followed.

He further stated that even though the rules were signed by the Governor, the Board is still able to send a letter to the Governor post-public hearing and provide comments where the Board foresees the potential for negative impact to small business. Another comment might be to encourage DoTax to get involved in communication with the stakeholders. Mr. Ritchie added that other comments may include adopting the rules before the Board had an opportunity to review the post-public hearing statement as it relates to the Board's statute and process along with timing issues.

Mr. Galindez believes that overall there is a fundamental disconnect even with the information provided by DoTax today. Some of the changes were anticipated by the film industry, based on the statute, involving a change in the allocation of tax credits and the CPA review. However, there are approximately 15 other changes, such as restricting airfare, where there was no notice to the stakeholders and where DoTax had fundamentally changed the statutory language in the rules. He believes these additional changes to the rules were done without proper deliberation and which reduces the value of the tax credit.

Based on the information provided, Chair Cundiff stated that the Board can provide a letter to the Governor with specific areas of concern relative to the rules; outside of that, other issues should be taken to the Legislature. Mr. Ritchie added that, overall, there appears to be three concerns: 1) the timing issue as to when the rules were submitted to the Governor and when the rules and *small business statement after public hearing* were submitted to this Board; 2) establishing a period of time for the implementation of the rules given the challenges the State's Film Office would be tasked with; and 3) any unresolved concerns the stakeholders voiced today.

Second Vice Chair Lydgate made a motion for the Board to send a letter to the Governor that outlines: 1) the timing concern as to when the rules were submitted to the Governor and when the rules and *small business statement after public hearing* were submitted to this Board; 2) the establishment of a time period for the implementation of the rules, given the challenges the State's Film Office will be tasked with; and 3) any and all unresolved concerns voiced by the stakeholders today. Mr. Nakamoto seconded the motion, and the Board members unanimously agreed.

c. Chapter 243 Fuel Tax Law:

1. Section 4-01, Refund of fuel taxes in excess of 1 cent per gallon for certain fuels used for operating agricultural equipment in areas other than upon the public highways of the State;

Mr. Herlitz explained that the proposed rules amend section 18-243-4-01, which requests refunds of fuel tax arising from the operation of equipment in areas other than upon public highways in the State. Under the current rule, this section specifies that certain information need not be furnished along with forms requesting the refund of fuel tax. The proposed rules amend the law by requiring taxpayers to furnish this information.

In addition, under the current rules, taxpayers may only apply for refunds on a quarterly basis if the refund amount is over \$1,000; otherwise claims must be made annually. The proposed rules allow all taxpayers to make refund claims quarterly regardless of the amount.

Second Vice Chair Lydgate made a motion to move the proposed amendments on to the Governor for adoption. Mr. Shick seconded the motion, and the Board members unanimously agreed.

2. Section 4-02, Refund of fuel tax on diesel oil and liquefied petroleum gas used for operating motor vehicles in areas other than upon the public highways of the State

Mr. Jacob Herlitz stated that the difference in Section 18-243-4-01 versus Section 18-243-4-02 is the type of gas being used. One of the refunds is for agricultural equipment and one is for diesel oil and liquefied petroleum gas used for operating motor vehicles in areas other than State public highways.

Second Vice Chair Lydgate made a motion to move the proposed administrative rule amendments on to the Governor for adoption. Mr. Ritchie seconded the motion, and the Board members unanimously agreed.

C. Discussion and Action on the Small Business Statement After Public Hearing and Proposed Amendments to HAR Title 20 Chapter 26, Public and Commercial Activities on Mauna Kea Lands, promulgated by University of Hawaii (UH)

Discussion leader, Ms. Atmospera-Walch introduced Mr. Jesse Souki, Associate General Counsel at UH, who explained that the proposed amendments were presented to this Board in June 2018. The Office of Mauna Kea Management (OMKM) met with small business

groups including commercial tour operators to discuss the drafting of the rules. In addition, the general public was invited to participate in open houses and a survey; also, many community meetings were held to provide opportunities for input on the proposed rules.

Commercial tour operations are the primary existing commercial use on Mauna Kea. Following the transfer of the function of commercial tours by the Board of Land and Natural Resources, UH issued permits to commercial tour operators (CTO's). The permit function, including its compliance, is managed by OMKM. Act 132 (2009), which grants UH rulemaking authority for the subject rules, identifies commercial tour activities as one of several examples of public and commercial activities that could be covered by administrative rules.

CTO's provide an important management function for the University. CTO's reduce the number of vehicles that visit the area by tourists, ensure that visitors are transported by drivers certified in first aid and serve as interpretive guides for non-English speaking visitors. Conditions of the CTO permit and OMKM policy does not allow certain activities such as driving in certain areas or allowing their passengers to hike to the summit. This helps reduce impacts to natural, cultural, and scientific resources and provides a measure of public safety. UH intends to continue to allow CTO's.

The primary concern of the existing tour operators was the status of their current permits after the rules became effective and how new permittees would be selected. UH cannot guarantee permits for existing operators. However, a record of safety, educational programming and safe equipment are prerequisites to any interested operator. Existing operators were also encouraged that the implementation of the new CTO provisions under the rules would be gradual and involve input from existing and interested CTOs.

Mr. Souki added that the rules are with the Governor's office and currently waiting for signature and adoption. Chair Cundiff thanked the UH representatives for attending the meeting as he remembered the rules coming in front of this Board before the public hearing. He also appreciated UH for taking this Board's input, at that time, and meeting with the stakeholders; this always benefits the process.

Ms. Albitz made a motion to continue the process for the adoption of the rules. Mr. Ritchie seconded the motion, and the Board members unanimously agreed.

IV. NEW BUSINESS – Before Public Hearing

A. Discussion and Action on Proposed Amendments to HAR Title 13, Subtitle 11, Chapter 13-256-73, Kaneohe Bay Ocean Waters, promulgated by DLNR

Administrator Mr. Underwood explained that Kaneohe Bay has a long-standing issue with the way the rules were originally drafted based on the Kaneohe Bay Regional Council recommendations as it pertains to nonprofit entities operating on Kaneohe Bay. Although there are ten commercial operators in Kaneohe Bay, there are supposed to be no new commercial operators in the Bay. Thus, DOBOR's alternatives are limited because implementation of this rule is guided by the 1992 Kaneohe Bay Master Plan, which requires maintaining commercial activity levels and not allowing any new commercial activity.

Small businesses affected include those that want to operate ocean activity tours for profit in Kaneohe Bay. Overall, the changes will clarify ambiguous language relating to educational and not-for-profit operations in Kaneohe Bay. DOBOR could not find any other methods of compliance that would still be within the recommendations of the Kaneohe Bay Master Plan to limit commercial activity in Kaneohe Bay.

DOBOR met with affected businesses to discuss proposals that would be fair and compliant with the Kaneohe Bay Master Plan. While small businesses recommended allowing increased commercial activity, DOBOR could not implement this because of the guidelines of the Kaneohe Bay Master Plan. Mr. Underwood added that the BLNR already approved the rules to move forward to public hearing.

Ms. Albitz made a motion to move the proposed rules on to public hearing. Mr. Ritchie seconded the motion, and the Board members unanimously agreed.

B. Discussion and Action on Proposed New HAR Title 13, Chapter 146, Fees, promulgated by DLNR

Mr. Curt Cottrell, Administrator at DLNR's Division of State Parks, explained that Hawaii's state parks are one of the State's crown jewels in terms of providing for its residents, cultural access, and the tourism industry; he introduced Property Manager Mr. Sang Pil Kim, and Legal Fellow Mr. Robert Park.

Prior to 2016, the only state park charging an entrance fee was Diamond Head; fees were not charged to residents. As most of the existing fees are based on 1999 rates, DLNR is now looking to increase the fees to today's levels. The following parks are currently collecting fees via public/private partnerships: Iao Valley State Monument, Haena State Park, Hapuna Beach State Park, Akaka Falls, Waimea Canyon, Koke'e State Park, Makena State Park, and Nuuanu Pali Lookout.

He noted that Hawaii has record-breaking tourism numbers, however, the parks are beginning to show wear and tear. He distributed rate sheets along with expenses of the State parks, noting that roughly \$4,000,000 was spent last year. There is also a current \$40,000,000 backlog in maintenance. Another handout depicted current vehicle rate charges versus the proposed new rates.

In response to a question posed by Mr. Ritchie regarding charging fees, Deputy Attorney General Ahn explained that fees are a perfect example as to what should go through the administrative rule process as people should be able to comment on the fees without an Agency quietly increasing fees without transparency.

Mr. Cottrell stated that the proposed rules are trying to navigate through the high level of tourism and provide future flexibility. Mr. Kim added that ideally, they would like to reassess the rules every five years. Currently, there is no income stream from residents as the ratio is primarily 98% visitors.

During the discussion, Ms. Dawson added that the Film Office supports the Division of Parks' work and what it is currently doing. The film industry is directly impacted by the

condition of the state parks, which is the number one permit request for filming, partly due to the beauty of the parks. She concurred that the State has been charging substandard fees.

Chair Cundiff thanked DLNR's representatives for their insightful presentation noting that the fees and expenses need balancing with the park's beauty and natural resources and land. Clearly, waiting twenty years to increase fees is quite long. While everybody recognizes the fees necessity, the push-back is, "what am I getting for this?"

Mr. Ritchie made a motion to move the proposed amendments forward to public hearing. Ms. Atmospera-Walch seconded the motion, and the Board members unanimously agreed.

V. ADMINISTRATIVE MATTERS

A. Update on the Board's Upcoming Advocacy Activities and Programs in Accordance with the Board's Powers under Section 201M-5, HRS, on the following:

a. Discussion and Action on the Board's Draft Annual Report Summary for Submission to the Hawaii State Legislature, under Section 201M-5, (f) HRS

Ms. Albitz has a change to her business name listed in the Report and Chair Cundiff will change the Chair's Message. Mr. Ritchie suggested sending the Report once more before formal submittal. If there are any last-minute changes, please let DBEDT staff know.

Mr. Ritchie made a motion to accept the Board's draft Annual Report Summary for submission to the Hawaii State Legislature subject to the suggested changes. Mr. Shick seconded the motion, and the Board members unanimously agreed.

b. Meetings with Board Members and State Department Directors

Ms. Albitz met with DLNR, DOBOR, on October 17, 2019. She complimented DLNR on stakeholder feedback.

VI. NEXT MEETING – The next meeting is scheduled for Thursday, December 12, 2019 in Conference Room 405, 235 South Beretania Street, Leiopapa A Kamehameha Building (State Office Tower), Honolulu, Hawaii at 10:00 a.m.

VII. ADJOURNMENT – Mr. Ritchie made a motion to adjourn the meeting and Ms. Atmospera-Walch seconded the motion; the meeting adjourned at 12:17 p.m.