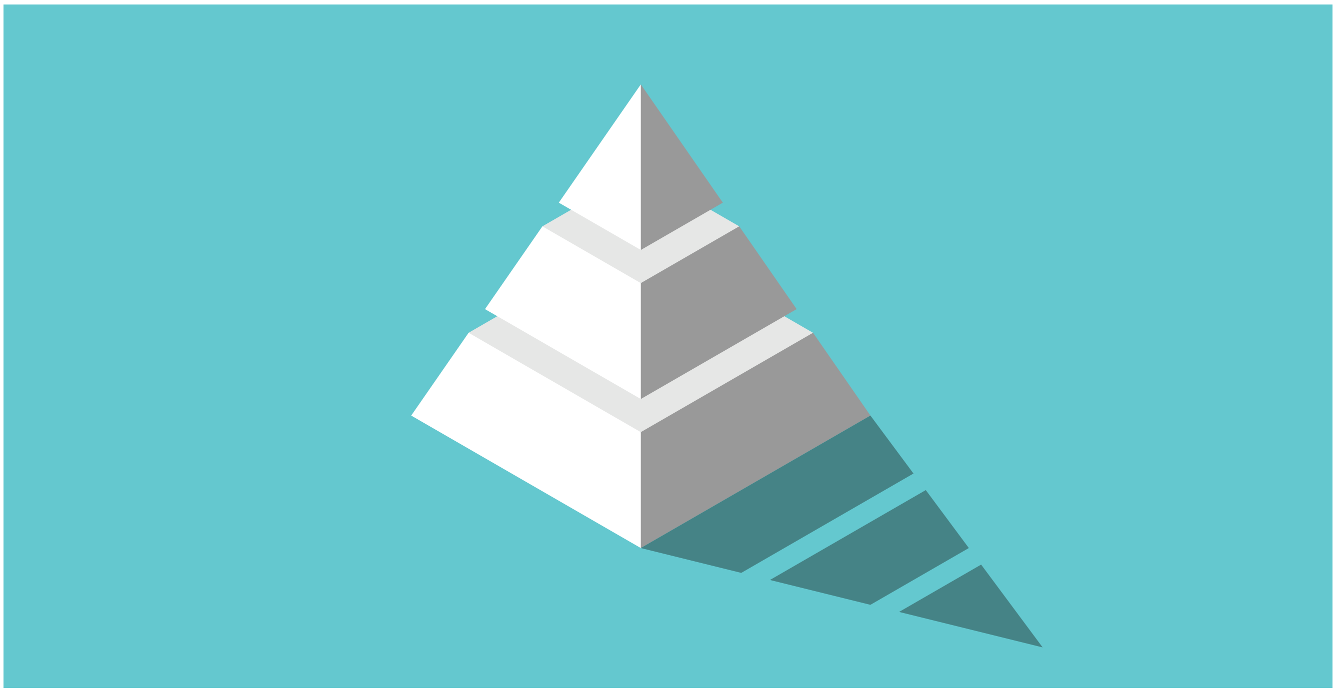
Auditor's Summary

Review of General Excise and Use Tax Exemptions and Exclusions

Report No. 20-09



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THIS REPORT ASSESSES certain tax exemptions and exclusions from Hawai'i's General Excise Tax (GET) and Use Tax. Section 23-71 et seq., Hawai'i Revised Statutes, requires the Auditor to annually review different tax exemptions, exclusions, and credits on a 10-year recurring cycle, including provisions for the Public Service Company Tax and Insurance Premium Tax. This report is our first review under these statutes.

As described by the Department of Taxation (DoTax), Hawai'i's GET and Use Tax, combined, apply to nearly all business activities in Hawai'i, resulting in a $111 billion tax base. In FY2018, GET and Use Tax revenues accounted for $3.55 billion, or 31 percent, of the State's total revenue of $11.32 billion. Notwithstanding, lawmakers may choose to exempt or exclude certain revenues from taxation to promote social and economic goals. Since these exemptions and exclusions reduce revenues to the State, the analysis and recommendations in this report aim at better informing policymakers about the purposes, costs, and benefits of various GET and Use Tax provisions to allow for improved policymaking.

In FY2018, GET and Use Tax revenues accounted for $3.55 billion, or 31 percent, of the State's total revenue of $11.32 billion.

This report reviews 13 tax provisions: 6 GET and Use Tax exemptions and 7 GET exclusions. Overall, we found, with one exception, there is insufficient data to determine whether the *exemptions* reviewed are meeting their stated or inferred purposes. We recommend the one exemption that is not achieving its purpose be repealed and the Legislature consider including clearly articulated purposes along with specific metrics for measuring effectiveness in all new or amended tax preferences. As noted throughout this report, we struggled to determine the purposes of the provisions reviewed and, in some cases, were unable to even infer the purposes. Additionally, we had no objective means to assess whether provisions were achieving their purposes. Including clearly stated purposes for each tax provision and metrics for us to assess performance will permit a more thorough and meaningful analysis of exemptions. We further recommend that all seven *exclusions* be removed from the schedule of future reviews.

Exclusions and Exemptions

POLICYMAKERS USE tax preferences to promote various economic and social goals. Such provisions may allow money that would otherwise be spent on taxes to remain in the hands of taxpayers. For example, taxpayers who own or operate businesses may use those tax savings to create jobs. Other preferences may provide economic support to specific segments of society.

EXCLUSIONS

Exclusions remove revenues from certain activities that were never intended to be part of a broadly defined tax base. Excluded amounts generally are not included in a taxpayer's reported revenues and are therefore not taxed.

Example: The exclusion for gross receipts from sales of securities excludes such revenue from GET. This revenue does not have to be reported. However, in some instances capital gains from securities sales are still subject to Hawai‘i income tax.

EXEMPTIONS

Exemptions refer to receipts from taxable activities or goods that, for policy purposes, are not subject to tax collection.

Example: Contractors can deduct payments made to subcontractors from their gross revenue and avoid GET liability on those amounts. The exemption for amounts paid by contractors to subcontractors shifts payment of GET at the 4 percent retail rate on those amounts to the subcontractor, effectively eliminating the pyramiding of GET. The Legislature hoped that the reduced taxes paid by general contractors would lower the cost of housing.

EXEMPTIONS COME AT A COST. Allowing certain taxpayers to reduce the amount of gross revenues that are subject to GET reduces the amount of tax revenues that might otherwise be available for the State to spend. While direct spending programs are subject to review through the budgetary process, monies the State does not see can be more challenging to evaluate. Identifying whether the benefits of tax exemptions outweigh their costs can be a complex endeavor, but such reviews can provide important information to legislators about the effectiveness of a tax preference and monies that may be available for other state priorities.