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# **Hawaii General Excise Tax Expenditures**

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**DEPARTMENT OF TAXATION**

**STATE OF HAWAII**

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**WEB SITE: [tax.hawaii.gov](http://tax.hawaii.gov)**



## Introduction

This report presents general excise tax (GET) exemptions that constitute tax expenditures and opportunities to export tax. This is the first report of its kind; the Department of Taxation (Department) has not previously reported on GET exemptions or tax expenditures due to the inability of the legacy tax system to collect and produce such data. Act 94, Session Laws of Hawaii 2015, requires the Department to publish a report on tax expenditures no later than 20 days prior to each regular session of the Legislature.

Given that Rollout 2 of the Tax System Modernization project (TSM) for business taxes was completed on August 15, 2016, **only** the future formatted tables of exemption data have been included in this report; no data have been included. In addition to the limited tax filing period covered in this report (August 15 – November 30, 2016), only electronic filing exemption data were captured during this timeframe. Consequently, taxpayers filing paper returns (using the older format return) would not have their exemption data captured. Beginning in 2017, data from **both** electronic and updated paper returns will be captured to provide comprehensive exemption data.

This report does include the description of the data that will be reported, the Department's methodology in determining and measuring tax expenditures, and tables categorizing GET exemptions as tax expenditures at the wholesale and retail rate as well as the exemptions that represent opportunities to export tax.

Finally, unlike other reports prepared by the Department, this report is not merely a presentation of data but relies on the determination and categorization of tax exemptions. These decisions are based on a set of debatable assumptions about what constitutes an ideal tax system and what constitutes a tax expenditure.

## Data Source

Data for this report are collected from the Department's GenTax system. This is the Department's new system that is being rolled out as part of the TSM Project. The data are from Form Schedule GE. Form Schedule GE is required to be filed along with a taxpayer's periodic and annual GET returns. Form Schedule GE reports the amounts and types of GET exemptions claimed. The data are as reported by taxpayers without any adjustment for audit.

## **Tax Expenditures**

This report presents GET exemptions that are tax expenditures at the wholesale rate (0.5%) and the retail rate (4%), and also presents tax exemptions that are not tax expenditures but are opportunities to export the tax burden.

It is important to understand that the decision to label exemptions as tax expenditures at the wholesale or retail rate or not as tax expenditures at all is based on economic parameters and assumptions and is subject to debate. Thus, if the Department's assumptions change, then the distribution of exemptions among the categories may change.

A tax expenditure is not the same as a tax exemption. For this reason, this report does not present data on all GET exemptions, but only on those the Department considers to be tax expenditures. For purposes of this report, tax expenditures are those tax breaks – whether credits, deductions, or exemptions – that are deviations from a uniform tax on consumption of residents.

### **Tax Expenditures are not Revenue Estimates**

In presenting data on tax exemptions, it is crucial that a clear distinction be made between tax expenditures and revenue estimates. The data presented in this report should not be relied on as an estimate of the amount of revenue that may be realized by repealing an exemption. The reason is that the data presented in this report provide only the amounts of each exemption claimed. To properly estimate the revenue effect of repealing an exemption, substitution and behavioral factors must be accounted for.

Substitution means that if a certain exemption is repealed, a portion of the taxpayers that had been claiming the repealed exemption may be entitled to claim a different exemption for the same activity. As an example, take the enterprise zone exemption. It is possible that taxpayers engaged in business in enterprise zones are exporting the goods and services they sell. Thus, if the enterprise zone exemption were repealed, the taxpayer may instead claim the exported goods and services exemption. This would limit the revenue impact to some amount smaller than the amount claimed under the enterprise zone exemption.

Behavioral factors are the behavioral responses of taxpayers affected by the repeal of an exemption. If an exemption is repealed, some taxpayers may cease engaging in formerly exempted activity. In this case the repeal would not yield the full amount of the tax expenditure, because the gross income previously exempted would no longer be generated.

Additionally, tax expenditures are valued at the tax rate they should be taxed at to achieve the assumed ideal tax system. These assumptions may not agree with the actual tax rates that would apply if an exemption were repealed. For example, each exemption categorized as a tax expenditure at the wholesale rate may not qualify for the .5% rate under the wholesale rules of section 237-4, Hawaii Revised Statutes.

## Tax Expenditures at the wholesale rate (.5%)

The tax expenditures reported in this section are those that exempt activity that would ideally be taxed at the wholesale rate of GET. These are mostly business-to-business transactions. Ideally, all business-to-business transactions would be exempt from GET. However, in reality most are subject to GET at the 0.5% rate and thus our assumption becomes that all such transactions should be taxed at the 0.5% rate. Labeling exemptions of business-to-business sales as tax expenditures at the 0.5% rate is based on the assumption that all business-to-business sales should be taxed equally.

<b>Tax Expenditures at the wholesale rate (.5%)</b>		
Exemption	Amount of Exemption claimed (\$)	Value of Tax Expenditure (\$)
Air Pollution Facilities §237-27.5		
Aircraft leasing §237-24.3(11)		
Aircraft Service and Maint. Facility §237-24.9		
Conv., Conf., and Trade Show §237-16.8		
Common Paymaster §237-23.5(b)		
Contracting in Ent. Zone §209E-11		
Federal Cost-plus Contractors §237-13(3)(C)		
Hawaii Convention Center §237-24.75(2)		
Hotel Operator/Suboperator §237-24.7(1)		
Coin operated devices §237-18(a)		
Producers and Promoters §237-18(b)		
Insurance and Realtors §237-18(e)		
Tour Packagers §237-18(g)		
Motor carriers §237-18(h)		
Intercompany Charges §237-23.5(a)		
Labor Organizations §237-24.3(9)		
Maintenance Fees §§237-24.3(2) & 24(16)		
Merchants' Assoc Dues §237-24.3(8)		
Orchard Operator 237-24.7(4)		
Import Services/Contracting §238-2.3(1)(C)		
Petroleum Refining §237-27		
Professional Employer Orgs §237-24.75(3)		
Certain Property Used by Producers §238-4		
Reimbursement of payroll §237-24.7(9)		
Services to Ships and Aircraft §237-24.3(3)		
Shipbuilding and Ship Repairs §237-28.1		
Stock Exchange Transactions §237-24.5		
Subcontract Deduction §237-13(3)(B)		
Sugar Cane Payments §237-24(14)		
Wholesale Transactions §237-29.55		

### **Tax Expenditures at the retail rate (4%)**

The tax expenditures reported in this section are those that exempt activity that would ideally be taxed at the retail rate of GET. Unlike tax expenditures at the wholesale rate, these are not business-to-business transactions but transactions between businesses and final consumers or the equivalent thereof.

<b>Tax Expenditures at the retail rate (4%)</b>		
Exemption	Amount of Exemption claimed (\$)	Value of Tax Expenditure (\$)
Affordable Housing §237-29		
Disability Provisions §237-24(13)		
Prescription Drugs §237-24.3(6)		
Enterprise Zones §209E-11		
Mass Transit §237-24.7(2)		
Non-profit Organizations §237-23		

### **Opportunities to Export Tax**

The following exemptions do not qualify as tax expenditures but are GET exemptions that may represent a lost opportunity to export tax. These consist of exemptions of exports and of sales to the federal government. Exemption of exports is not a tax expenditure because it is provided to prevent pyramiding of tax rather than to encourage a certain industry.

<b>Opportunities to Export Tax</b>		
Exemption	Amount of Exemption claimed (\$)	Value of Tax Expenditure (\$)
Diplomat and Consular §237-24.3(10)		
Exported Services §237-29.53		
Foreign Trade Zone §212-8		
Out-of-state sales §237-29.5(1)		
Sales to U.S. gov/credit unions §237-25(a)		
Scientific contracts §237-26		