

**IMPLICATIONS OF THE STREAMLINED
SALES TAX AGREEMENT FOR
GENERAL EXCISE TAX REVENUES**

*Prepared for the State of Hawaii
Office of the Auditor*

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Introduction

This report examines the effect that participation in the Streamlined Sales and Use Tax Agreement (SSUTA) would have on Hawaii General Excise Tax (GET) revenues. The intent is to provide an estimate of the revenues that Hawaii could expect, in 2006 terms, if it was a full participant in the SSUTA and if vendor collection of the GET becomes mandatory. There is also discussion of the amount of revenue Hawaii might expect under the SSUTA as remote vendors agree to voluntarily comply.

The report is divided into six sections. The first section after this introduction is a summary of the findings that is followed by a section that provides a thumbnail sketch of the GET. Sections on e-commerce sales in the U.S., e-commerce sales to Hawaii people and businesses, and the taxability of e-commerce under the GET are next. The final section provides estimates of the GET revenue that Hawaii could expect to receive through conformance to the SSUTA.

The GET² when levied on final sales of goods and services is similar in concept to the retail sales taxes that are imposed on sales of goods and services in other states and is considered as a sales tax in this paper.³ As with all other sales taxing states, Hawaii levies a corresponding use tax “on the use in this State of

¹ The author thanks Dr. Tu Pham and Bernard Wilson of the Hawaii Department of Taxation and Ray Kamikawa for very helpful discussions related to this study.

² See Hawaii Code 237 for GET legislation.

³ See Fox (2002) for a discussion of why the GET can be treated as a retail sales tax, albeit with a much broader base than the average state.

tangible personal property which is imported by a taxpayer in this State whether owned, purchased from an unlicensed seller, or however acquired for use in this State (18-238-2)” and “on the value of services or contracting as defined in section 237-6 that are performed by an unlicensed seller at a point outside the State and imported or purchased for use in this State” (18-238-2.3). Sales tax revenues are generally collected on sales of goods and services in Hawaii and use taxes are normally collected on goods and services that are purchased (or produced) outside Hawaii for use in Hawaii. The terms use tax, sales tax and GET are used somewhat interchangeably in this paper.

Participation in the SSUTA is primarily expected to affect revenues by assisting states in collecting the use tax. The SSUTA can assist states by enhancing the probability that vendors will collect the use tax on behalf of buyers, though the effects on revenues can differ during the next several years versus the longer term depending on whether and when Congress enacts legislation requiring remote vendors to collect taxes on behalf of buyers. Hawaii’s use tax legislation requires buyers to remit the GET on their own if the vendor did not remit the tax, but voluntary compliance by individuals is generally believed to be very limited. Voluntary compliance by business purchasers is much better than for individuals, though businesses appear to be much less compliant with the use tax than with the sales tax.⁴ In the near term, Hawaii’s participation in the SSUTA can only affect revenues by increasing *voluntary* compliance by *vendors* (as opposed to buyers)

⁴ For example, in an audit of registered taxpayers Washington State (2003) found 27 percent non-compliance with the use tax but only 1 percent noncompliance with the sales tax.

since vendors without nexus cannot be required to collect the tax.⁵ Vendors have an incentive to voluntarily comply because the SSUTA provides for an amnesty from all past sales and use tax liabilities plus penalties and interest in each member state. The amnesty period runs from October 1, 2005 through September 30, 2006. In the longer term, use tax compliance can be enhanced to a much greater extent if remote vendors can be required to collect and remit use taxes either because Congress enacts legislation⁶ that creates nexus for remote vendors or because the Supreme Court overturns the Quill Case that established sales tax nexus on a physical presence basis. Tax administrators and analysts generally conclude that mandatory collection by vendors significantly improves revenue performance relative to voluntary collection by either buyers or vendors, so the revenue potential is dramatically enhanced by mandatory compliance.

Findings

Hawaii businesses and people are estimated to make \$9.5 billion in e-commerce and retail mail order purchases in 2006 (see Table 1). Of this amount, an estimated \$5.9 billion is taxable at either the 4.0 or 0.5 percent GET rate, with about \$3.2 billion taxable at the 0.5 percent rate and about \$2.7 billion taxable at the 4.0 percent rate. In total 62.0 percent of e-commerce transactions is taxable. Approximately \$123.6 million in GET revenues is due on these sales, and an estimated \$51.7 million is not being collected either by the vendors or paid in use

⁵ The U.S. Supreme Court in *Quill, Inc. v. North Dakota* ruled that a state can only require firms with physical presence in the state to collect the sales tax. At this point participation in the SSUTA does not alter this Supreme Court determined standard.

⁶ Legislation to require remote vendors to collect the sales tax on behalf of states that conform to the SSUTA was introduced in Congress on December 21, 2005.

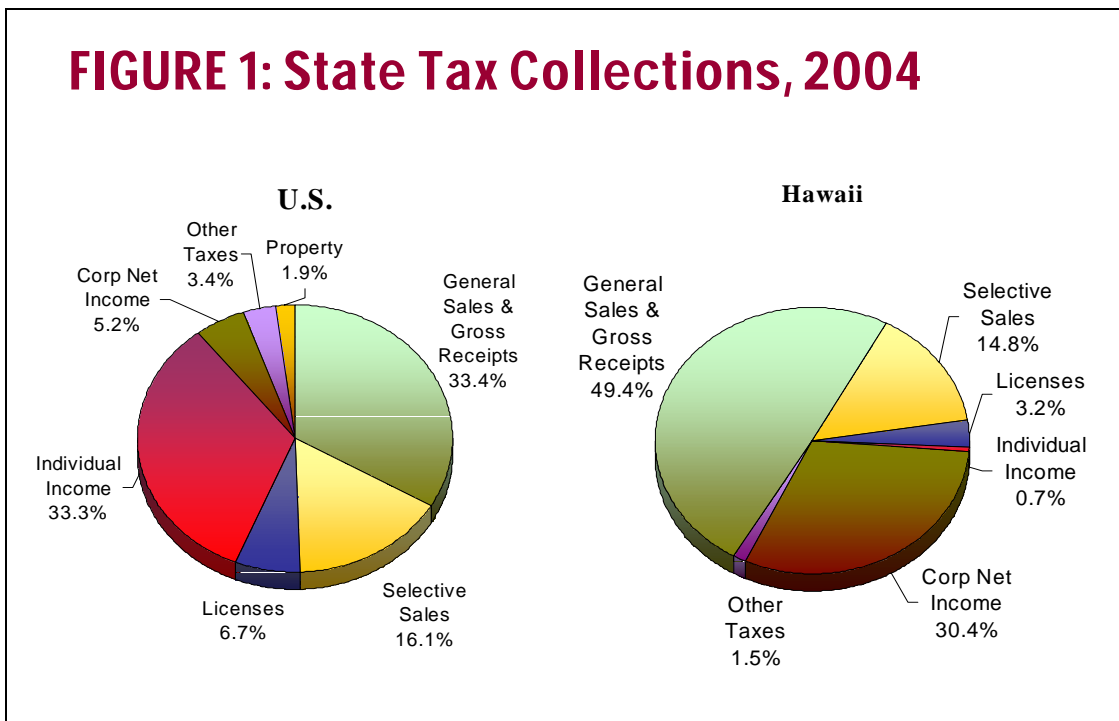
taxes by the purchasers. Hawaii will collect some additional revenue if it joins the SSUTA since 410 firms have already begun voluntarily complying in SSUTA states. Still, voluntary compliance associated with the SSUTA cannot be expected to result in Hawaii receiving most of the currently uncollected revenue. For example, a study by the state of Washington estimated that states could expect to receive about 20 percent of uncollected revenue on a voluntary basis. Hawaii can anticipate about \$10.3 in additional revenue if firms respond according to the Washington study. Congressional legislation requiring remote vendors to comply with the tax or a Supreme Court reversal of the Quill case would result in almost all of the \$51.7 million being collected. The net revenue gain to Hawaii will be lower to the extent that the Capital Goods Excise Tax Credit reduces income tax receipts. Nonetheless, the GET can be easily conformed to the SSUTA and it makes good policy sense to do so.

	Type of Vendor				
	<u>Retailers</u>	<u>Wholesalers</u>	<u>Manufacturers</u>	<u>Services</u>	<u>Total</u>
Estimated Hawaii E-Commerce Purchases	1,047.9	3,170.2	5,102.8	192.6	9,513.5
4.0 Percent Base					
Tax Base	1,047.9	488.2	1,041.0	110.8	2,687.8
Tax Due	41.9	19.5	41.6	4.4	107.5
Current Compliance	19.9	13.1	24.7	2.5	60.1
Uncollected Tax	22.1	6.4	17.0	1.9	47.4
0.5 Percent Base					
Tax Base		1,261.7	1,903.4	47.0	3,212.0
Tax Due		6.3	9.5	0.2	16.1
Current Compliance		4.6	7.0	0.2	11.7
Uncollected Tax		1.7	2.6	0.1	4.3

Source: Author's calculations.

A Thumbnail Sketch of the GET

Hawaii's reliance on the GET is about one-half again greater than the norm across states. Hawaii collected 49.4 percent of its tax revenues from the GET in 2004 and the average state obtained only 33.4 percent of tax revenues from the sales tax (see Figure 1).⁷ Only Washington, Tennessee, Florida, Texas, and South Dakota generate a larger percentage of tax revenues from their sales tax than does Hawaii, and South Dakota is the only one of these other states that also collects a personal income tax.



The Hawaii GET is imposed at four rates: 4.0, 0.5, 0.15 and 0 percent (see section 18-237-13). The zero rate is levied on exempt sales, and the 0.15 percent rate is imposed on insurance producers. The 0.5 percent rate is levied on sales by

⁷ <http://www.taxadmin.org/fta/rate/04taxdis.html>

manufacturers, wholesalers, intermediary services, sugar processing, and pineapple canning. The 4.0 percent rate is imposed on all other taxable sales.⁸ The use tax is imposed at similar rates as the sales tax (see section 18-238-2). The use tax is 4.0 percent on purchases by individuals; by retailers, contractors, and service providers on purchases that are not for resale; and by manufacturers on purchases where the goods do not become component parts of the final product. Purchases for resale or where they become a component part are taxed at 0.5 percent as long as the wholesaler or manufacturer does not act as a retailer.

The standard GET rate (4.0 percent) is low on the standards of other states. Five states, Alaska, Delaware, Montana, New Hampshire, and Oregon, have no state sales tax and therefore a 0 rate. Among sales-taxing states, only Colorado has a lower *state* sales tax rate (2.9 percent) than Hawaii, and six states besides Hawaii have a 4.0 percent state rate. Thirty-four states allow a local sales tax rate.⁹ Hawaii's state and local rate is the lowest among sales-taxing states when the state rate is combined with the maximum local sales tax rate.¹⁰

Hawaii is able to generate a large share of tax revenues from the GET despite the low tax rate because of the broad base. Hawaii's taxation of food and nearly all services and its relatively infrequent granting of exemptions are major reasons for the broad base. Dividing states' tax bases by their respective personal income is one means of comparing the relative breadth of state tax bases.¹¹

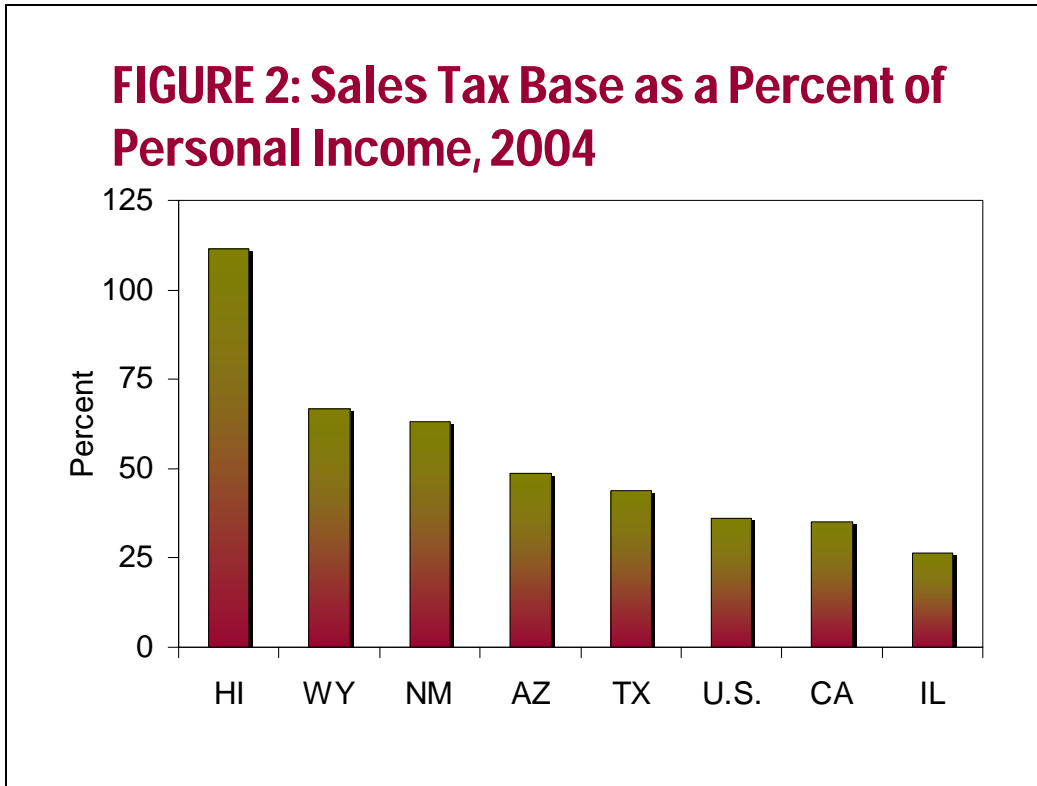
⁸ The GET rate is 4.16 by comparison with the rate levied in many other states. The reason is that the GET is imposed on gross revenues of a business, including any attempt by the vendor to include the GET in the price, while most other states impose the tax on the gross of tax price.

⁹ Alaska has no state sales tax rate but has local tax rates up to 7.0 percent.

¹⁰ See <http://www.taxch.com/STRates.stm>

¹¹ Personal income is a broad measure of a state economy and includes wages and salaries, rents, interest, dividends, earnings of sole proprietors and farmers, and transfer payments.

Hawaii has the broadest base of any state using this standard, with a base equal to 111.37 percent of personal income. Wyoming is second broadest, at 66.59 percent, and the average state tax has a base equal to 36.05 percent of personal income (see Figure 2).



The use tax is responsible for a significant share of Hawaii tax collections for transactions taxed at 0.5 percent, but not for transactions taxed at 4.0 percent. In Fiscal Year 2004-05, approximately 31.2 percent of the \$93.8 million collected from the 0.5 percent base came from the use tax. These use tax collections had declined from Fiscal Year 2003-04, though overall GET receipts were up about 12.4 percent. Use tax collections were only responsible for 1.7 percent of the base that was taxable at 4.0 percent. The low collections for the 4.0 percent base

are suggestive of very weak compliance with the use tax by non-business purchasers.

E-Commerce in the United States

The following sections describe the methodology for estimating the revenue effects of the SSUTA. The general approach involves a number of steps including estimation of:

- the total e-commerce sales for the United States
- the share of e-commerce sales that is attributable to Hawaii
- the GET due on Hawaii-destined transactions
- the GET that is currently being collected on these transactions
- the currently uncollected GET
- the additional GET that would be received under the SSUTA.

This section begins the process by estimating e-commerce transactions for the U.S. Historical data on e-commerce are available from the U.S. Bureau of the Census by type of vendor including for manufacturers, wholesalers, retailers and service providers. These data serve as the beginning point for estimating the effects of the SSUTA on Hawaii GET revenues. Annual data are available from the Census by type of vendor for 1998 through 2003, and quarterly data are provided by the Census for sales by retailers through the second quarter of 2005.¹² Total e-commerce sales exceeded \$1.3 trillion in 2003, and have more than doubled since 1999 (see Table 2 and Figure 3). Manufacturers dominate e-commerce sales, being responsible for 63 percent of sales in 2003 (Table 3), though their share has fallen significantly since 1999 (see Table 3). The declining percentage that manufacturers play in e-commerce can be attributed to three

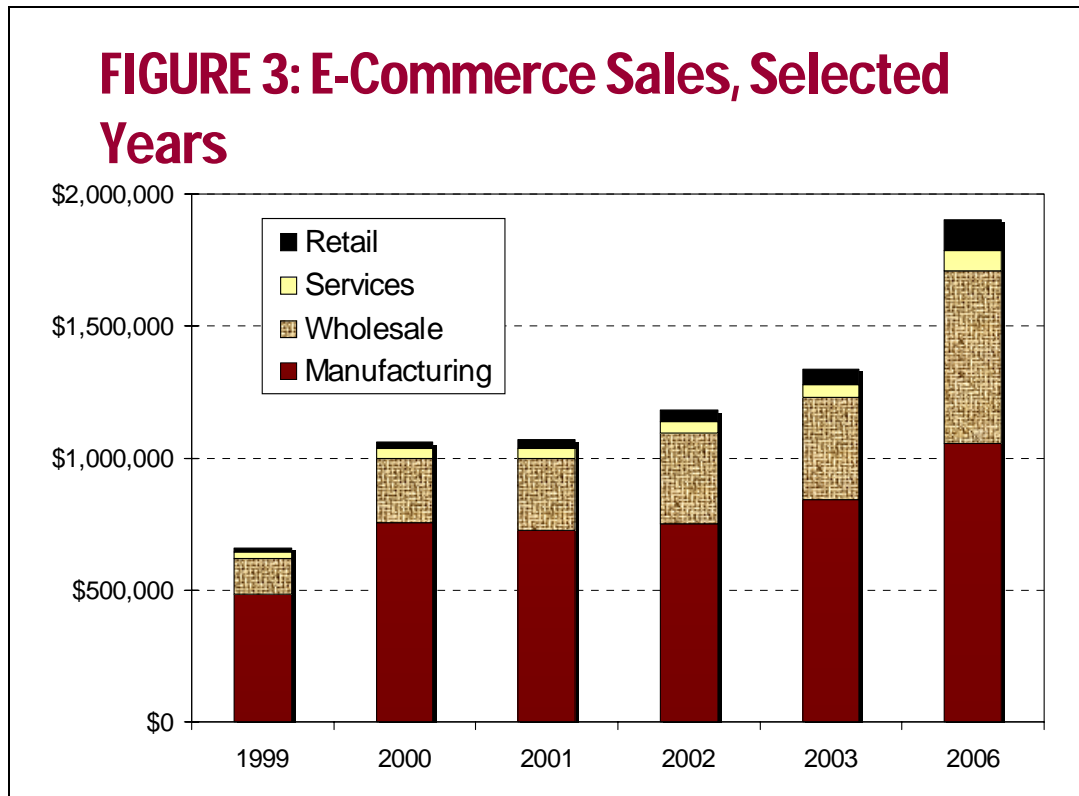
¹² The Census did not report manufacturers' sales for 1998.

factors: slow sales growth by manufacturers, rapid growth in sales by wholesalers and very rapid growth in sales by retailers. However, retailers provide such a small share of e-commerce sales that the rapid growth had a limited influence on the changes in the percentage distribution of transactions by type of vendor. Together, retailers and service providers are responsible for less than 8 percent of total e-commerce sales.

TABLE 2: U.S. E-Commerce Sales, 1998 - 2003, and 2006

Vendor	(Millions \$)						
	1998	1999	2000	2001	2002	2003	2006
Manufacturing		485,283	755,807	725,149	751,985	842,666	1,055,596
Wholesale	108,862	134,432	241,109	272,183	343,327	386,922	655,793
Services	15,316	25,158	37,312	37,261	41,463	49,945	77,508
Retail	5,005	15,354	28,299	34,595	44,706	55,731	113,952
Total	129,183	660,227	1,062,527	1,069,188	1,181,481	1,335,264	1,863,531

Source: U.S. Bureau of the Census and Author's Calculations.



	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2006</u>
Manufacturing	73.50%	71.13%	67.82%	63.65%	63.11%	56.64%
Wholesale	20.36%	22.69%	25.46%	29.06%	28.98%	35.19%
Services	3.81%	3.51%	3.48%	3.51%	3.74%	4.16%
Retail	2.33%	2.66%	3.24%	3.78%	4.17%	6.11%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: U.S. Bureau of the Census and Author's Calculations.

The intent of this report is to estimate potential SSUTA revenues for calendar year 2006, so it was necessary to forecast sales from 2003 through 2006. This was achieved by assuming that the growth rate by type of vendor for 2001 through 2003 was sustained through 2006. This assumption can be defended on several grounds. First, the assumed average annual growth rate of 11.8 percent (actual 2001 through 2003 growth) is much lower than the 19.3 percent annual growth since 1999. Second, 2000 was not used as a baseline because of the recession that occurred during that year. Third, the 26.9 percent growth rate for sales by retailers between 2001 and 2003 is fairly similar to the 24.6 percent growth rate for retailers that is derived by comparing the actual 2003 annual data with the quarterly data for 2004. Sales by manufacturers would continue to fall as a share of total sales if recent historical patterns were to continue through 2006 (See Table 3).

E-Commerce Purchases by People and Firms in Hawaii

The next step is to estimate the portion of national e-commerce transactions where the goods and services will be used in Hawaii. Hawaii's share of e-commerce sales should generally be proportionate to its share of overall national economic activity, though four factors could alter the proportion

attributable to Hawaii. First, Hawaii's low sales tax rate makes Hawaii residents less likely to shop online to avoid paying the use tax that is due than are residents of higher tax rate states (see Goolsbee, 1999). Second, the long distances to the mainland may increase the propensity to shop online because fewer alternatives are available for shopping in neighboring states. Third, four of the top thirty-five e-commerce vendors (Staples, Inc.; Sears, Roebuck & Co.; 1-800-Flowers Inc.; and K-Mart) do not ship to Hawaii. This reduces the online shopping options for Hawaii residents. Finally, higher shipping costs to Hawaii might discourage online purchasing, though the goods still must be shipped if people obtain the goods through some other mechanism. Relatively little research exists on the propensity in different states to shop online, but it is suggestive that Hawaii residents are more likely than average to shop online. A recent study by Scarborough Research indicates that Hawaii Internet users are more likely to make significant purchases than are people in the average state.¹³ As a result, it is assumed that Hawaii residents and businesses make 10 percent more online purchases relative to their personal income than do those in the average state.

Hawaii residents' purchases from retailers and service providers are presumed to be proportionate to the state's share of total capacity to *consume*, and purchases from manufacturers and wholesalers are presumed to be proportionate to the state's share of total *production*. Capacity to consume is proxied by personal income, and Hawaii had 0.42 percent of national personal income in 2004. Production is proxied with gross state product (GSP), and Hawaii had 0.43

¹³ See "Honolulu 3rd in High-Speed Net Access," Honolulu Advertiser, March 14, 2006.

percent of national GSP in 2004.¹⁴ Estimates of mail order purchases by Hawaii businesses and consumers are also included in Table 4 and in the tax base estimates and the tax revenue estimates provided below.¹⁵

TABLE 4: Estimated Hawaiian E-Commerce Purchases By Type of Vendor, 2006	
	(\$ Millions)
Retailers	1,047.9
Wholesalers	3,170.2
Manufacturers	5,102.8
Service	192.6
Total	9,513.5

Source: Author's calculations.

Taxability of E-Commerce Purchases

The estimated e-commerce purchases by Hawaii buyers do not directly translate into tax liabilities because the GET use tax rate depends on the classification of the buyer and how the buyer intends to use the purchased items. As noted above, the GET rate is 4.0 percent for consumer purchases and certain business purchases such as when the item does not become a component part of a manufactured good or constructed unit or when the good is not for resale. The GET rate is 0.5 percent or 0 for other business purchases. The Census e-commerce data from which we derive Hawaii's sales provide information on the sales by various types of business vendors, but do not provide information on who the buyers are or how the goods and services will be used. Thus, the Census

¹⁴ Hawaii's share of personal income and GSP are assumed to grow through 2006 at the same rate that they grew from 1999 to 2004, so that Hawaii is assumed to have 0.43 percent of personal income and 0.44 percent of GSP in 2006. As noted above, these shares were increased by 10 percent to account for the greater propensity to purchase online.

¹⁵ National mail order sales are estimated to be \$106.0 billion in 2006.

classifications do not directly allow the e-commerce data to be translated into the various taxable groupings in Hawaii. This section describes how the data by type of vendor sale are converted into taxable purchases in Hawaii.

Two basic steps are needed to determine the taxability and tax rate for Hawaii e-commerce transactions: the transactions must be divided into sales to individual consumers versus sales to businesses, and the business sales must be divided into those taxable at 4 percent, those at 0.5 percent, and those that are exempt. The 1997 Economic Census for the United States is one source of data to assist in these tasks. The Economic Census includes data for sales by retail, wholesale and service vendors for various types of buyers. These data are eight years old and are for all sales by these vendors not just e-commerce sales. Still, the data can be used to provide some insight into who purchases the sales of various classes of vendors. Nonetheless, purchasing patterns may differ between e-commerce and other types of commerce and may have changed over time, so these data are not accepted totally on face value in this report.

Retail Vendors

The Economic Census data indicate that on average 84.2 percent of retail sales are to final consumers, 4.4 percent are to businesses to use as inputs that become part of the final product and 11.4 percent are to businesses for other uses.¹⁶ The data allow further refinement because the distribution of purchases by category is available for many types of retailers. The data for seven different categories of e-commerce retailers are used here to estimate the distribution of

¹⁶ U.S. Bureau of the Census, U.S. Department of Commerce, 1997 Economic Census, Retail Trade, Table 2, Class of Customer by Kind of Business.

retail trade between the three uses. Mail order sales are assumed to be distributed across consumers, business inputs, and other business uses in the same manner as “other retail purchasers” (one of the categories in the Census data).

Approximately 26.6 percent of “other retail purchases” are by businesses and 73.4 percent are by consumers (Table 5). Hawaii’s share is estimated as described above using personal income to allocate the consumer share and gross state product to allocate the business share.

TABLE 5: Estimated U.S. E-Commerce and Mail Order Purchases by Type of Buyer, 2006	
	(\$Millions)
Consumer	163,596
Business Inputs	420
Other Business	55,933
Total	219,948

Source: Author's estimates.

Wholesale and Manufacturing Vendors and Service Providers

The 1997 United States Economic Census also includes data on the type of buyer and how the goods are used for sales by wholesalers. The Economic Census estimates that 10.4 percent of wholesale purchases are for “business users for consumption and not for resale.” This category appears to exclude both items purchased for resale and items that become a component part of the final product. These data are also disaggregated by type of wholesale vendor. However, the average percentage of purchases for “business users for consumption and not for resale” is used for estimating potentially taxable e-commerce sales by

wholesalers, rather than the disaggregated sales¹⁷ because of the likely differences that exist between the types of sales that were made by traditional wholesalers and e-commerce firms.¹⁸ According to the Census data, another 0.6 percent of wholesale sales are to consumers. Nonetheless, consumers are assumed to purchase 5 percent of wholesale e-commerce sales, because consumers are much better able to buy from remote wholesalers than from traditional wholesalers.

Data are not available in the Economic Census by type of purchaser for manufacturing vendors. Therefore, manufacturers are presumed to sell to business users not for resale and to consumers in the same proportions as e-commerce wholesalers.

Finally, some data are available from the 1997 Census for selected services.¹⁹ For example, consumers purchase 18 percent of accounting services, various business users buy 58 percent, and miscellaneous and government users procure 24 percent. Based on these data for all service sales, individuals are assumed to purchase 25 percent of services sold via e-commerce and businesses are assumed to buy 32.5 percent of services for uses that are taxable at the 4.0 percent tax rate.

GET Revenues and Effects of the SSUTA

This section estimates the tax revenue that is due on remote e-commerce purchases, the degree to which these taxes are already being collected, and the

¹⁷ Use tax revenues from firms paying the 4.0 percent rate would be somewhat smaller if the disaggregated percentages were used.

¹⁸ U.S. Bureau of the Census, U.S. Department of Commerce, 1997 Economic Census, Wholesale Trade, Table 1.

¹⁹ U.S. Bureau of the Census, U.S. Department of Commerce, 1997 Economic Census, Professional, Scientific and Technical Services, Table 2, Receipts by Class of Consumers for Selected Professional, Scientific and Technical Services.

amount that is currently uncollected. Finally, discussion of the potential for collection under the SSUTA is provided. The GET tax base is estimated using the methodology described above to separate sales by each type of vendor into taxable purchases by consumers and businesses. All purchases by consumers are presumed to be taxable at 4.0 percent. It remains necessary to separate business purchases into those taxable at 4.0 percent, those taxable at 0.5 percent, and non-taxable purchases. These generally required assumptions that implicitly presumed what type of business is making the purchase since manufacturing and wholesale purchases generally are either exempt or are taxable at 0.5 percent but many retailer purchases are taxed at 4.0 percent or 0.5 percent.

Table 6 shows estimates of taxable purchases by consumers and businesses at the 4.0 percent GET rate. The combined taxable base for consumers and businesses is \$2687.8 million, which is 28.3 percent of the total estimated value of e-commerce purchases for use in Hawaii. However, there are stark differences between the share of business and consumer purchases that are taxable at the 4.0 percent rate. All consumer purchases are presumed to be taxable, but only 21.9 percent of the estimated \$8,736.0 million in business purchases is estimated to be taxable at 4.0 percent.²⁰ An estimated \$107.5 million in GET is due on these taxable sales.

²⁰ Businesses are estimated to make 92 percent of 2003 e-commerce purchases using the methodology adopted here. This is similar to the business share that has been estimated in other studies (see Bruce and Fox, 2004).

TABLE 6: Estimated GET Use Tax Liability for Transactions Taxed at 4.0 Percent and Uncollected Tax by Type of Vendor, 2006 (\$Millions)

	Type of Vendor				
	<u>Retailers</u>	<u>Wholesalers</u>	<u>Manufacturers</u>	<u>Services</u>	<u>Total</u>
Hawaii Taxable Sales	1,047.9	488.2	1,041.0	110.8	2,687.8
Tax Due	41.9	19.5	41.6	4.4	107.5
Current Compliance	19.9	13.1	24.7	2.5	60.1
Uncollected Tax	22.1	6.4	17.0	1.9	47.4

Source: Author's estimates.

Consumers are only assumed to comply when the vendors through which they purchase collect and remit the GET for Hawaii. The propensity for vendors to collect the tax was estimated by examining the websites of the top 35 e-commerce firms (measured by national sales) to determine whether they include the GET on purchases. Just over 50 percent of the weighted (by e-commerce sales) average of the top 35 firms requires consumers to remit the GET.²¹ This percentage is probably higher than actual compliance because consumers may have means of evading the tax, such as having the products initially shipped to an address outside of Hawaii and then forwarded to Hawaii. Also, smaller e-commerce firms are less likely to collect the tax. Approximately 35 percent of the weighted average of vendors collects the GET if none of the 36th through 100th largest e-commerce firms is presumed to collect the tax. Thus, vendors are assumed to collect 35 percent of the use tax due on consumer purchases.

Businesses will comply in two ways. First, they will comply when the vendor from which they purchase collects and remits the GET. Second, they will comply through the use tax remittance system. The degree of use tax compliance was taken from a study of randomly selected and audited taxpayers prepared by

²¹ Firms that do not ship to Hawaii are omitted.

the State of Washington (2003) in 2003, where compliance was estimated to be 73 percent. Thus, vendors selling to Hawaii firms are assumed to collect 35 percent of the revenue that is due (this assumes that vendors are as likely to collect the tax on businesses as on individuals) and Hawaii firms are assumed to remit 73 percent of the amount not collected and remitted by vendors. In total, compliance is expected to be \$60.1 million.²² This leaves \$47.4 million in GET that is not being collected on e-commerce transactions that are taxable at the 4 percent rate.

Table 7 shows the estimates for business purchases that are taxable at the 0.5 percent rate. The estimate is that \$16.1 million of GET is due on the sales at 0.5 percent. Current compliance is estimated to be \$11.7 million, leaving \$4.3 million uncollected.

	Type of Vendor				Total
	Retailers	Wholesalers	Manufacturers	Services	
Hawaii Taxable Sales		1,261.7	1,903.4	47.0	3,212.0
Tax Due		6.3	9.5	0.2	16.1
Current Compliance		4.6	7.0	0.2	11.7
Uncollected Tax		1.7	2.6	0.1	4.3

Source: Author's estimates.

Overall, 62.0 percent of e-commerce sales is taxable at either the 4.0 or 0.5 percent rate, and the remaining 38.0 percent is exempt. The base taxable at 0.5 percent is 20 percent greater than the base taxable at 4.0 percent though the estimated revenue potential is markedly different for a number of reasons. The

²² The methodology may overestimate business compliance, because it is consistent with nearly half of current use tax collections coming from compliance associated with e-commerce transactions.

higher tax rate is an obvious factor in creating a much higher overall tax liability. On the other hand, businesses are more likely than individuals to comply with the GET, so relatively more of the revenue due at the 0.5 percent rate is collected.

A combined \$123.6 million of GET is due on e-commerce transactions of which \$51.7 million is currently uncollected. This estimate of uncollected revenue is about two-thirds of the revenue loss estimated by Bruce and Fox (2004). Several factors explain the difference. First, the evidence suggests that vendors are more likely to be collecting and remitting the tax than had been assumed by Bruce and Fox in earlier studies. Second, the Bruce and Fox methodology was based on making national estimates and allocating to states. In doing so, the Bruce and Fox methodology did not allow for multiple tax rates, which tended to overstate Hawaii's taxes given that many of the sales are taxable at the lower rate. Finally, this report accepts the Census classifications of vendors and uses of goods and services. It is likely that Hawaii administrative practices categorize more transactions as taxable and classify relatively more transactions as taxable at the 4.0 percent rate. Thus, the estimates provided here are probably on the lower end of the revenues associated with remote purchases and the uncollected extent of these revenues.

It should be noted that the Capital Goods Excise Tax Credit provides income tax credits that could reduce the net additional revenues received by Hawaii. The Capital Goods Excise Tax Credit is allowed for GET paid on eligible, depreciable, personal property. The Credit is not available to taxpayers who elect immediate expensing under IRC Section 179. Receipt of the credit

would reduce total new revenues to Hawaii since lower income tax receipts would offset GET payments as the credit is realized. The Credit is refundable.

Hawaii's participation in the SSUTA will increase compliance in the near term as firms choose to voluntarily comply. The SSUTA reports that 410 firms have already registered to voluntarily comply with states' sales taxes.²³ These appear to be firms that have nexus in two to five SSUTA states and are complying so that they can operate freely across all SSUTA states. If Hawaii were to join the SSUTA, these same firms would comply with the GET and this would generate some additional revenue. At this point, Hawaii's membership in the SSUTA will expand vendor compliance but much of the revenue will still go uncollected. A Washington State study concluded that states could expect about 20 percent of uncollected revenue to be remitted on a voluntary basis. This suggests that Hawaii can anticipate about \$10.3 million in additional receipts, which means conformity with the SSUTA will provide some important revenues. Over the longer term, Hawaii's participation could result in almost all of the estimated \$51.7 million being collected through vendor compliance if either Congress acts to require vendor compliance or the Supreme Court overturns the Quill case. For example, the State of Washington estimated 1.3 percent vendor non-compliance with the sales tax. Nearly all of the uncollected taxes will be obtained if similar compliance can be obtained through mandatory collection by remote vendors.

²³ Based on telephone conversations with SSUTA officials in February 2006.

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