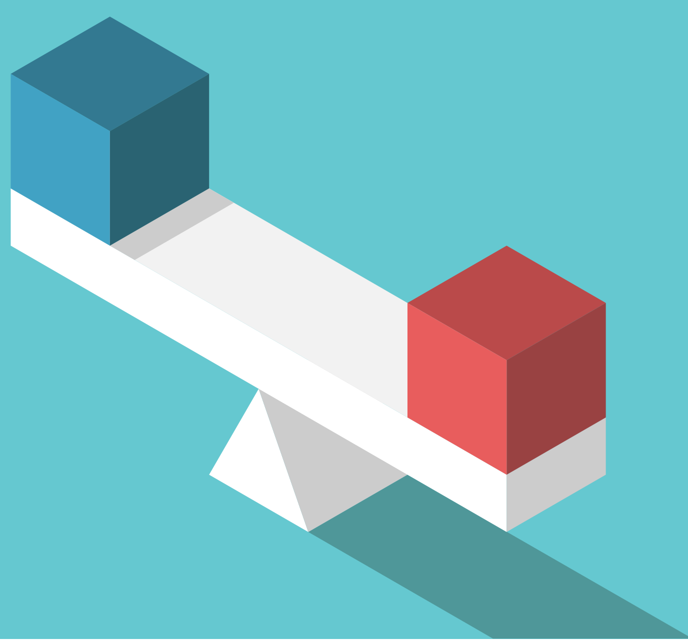
Review of General Excise and Use Tax Exemptions and Exclusions Pursuant to Section 23-73, Hawai‘i Revised Statutes

A Report to the Legislature of the State of Hawai‘i

Report No. 21-07
April 2021



OFFICE OF THE AUDITOR
STATE OF HAWAI‘I

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STATE OF HAWAIʻI

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Foreword

This report assesses certain tax exemptions and exclusions from Hawai‘i’s General Excise 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.

We express our appreciation to the Department of Taxation; Legislative Reference Bureau; Department of Business, Economic Development and Tourism; Maui Economic Opportunity, Inc.; and the Executive Office on Aging for their assistance in providing data and other information for this report.

Leslie H. Kondo
State Auditor

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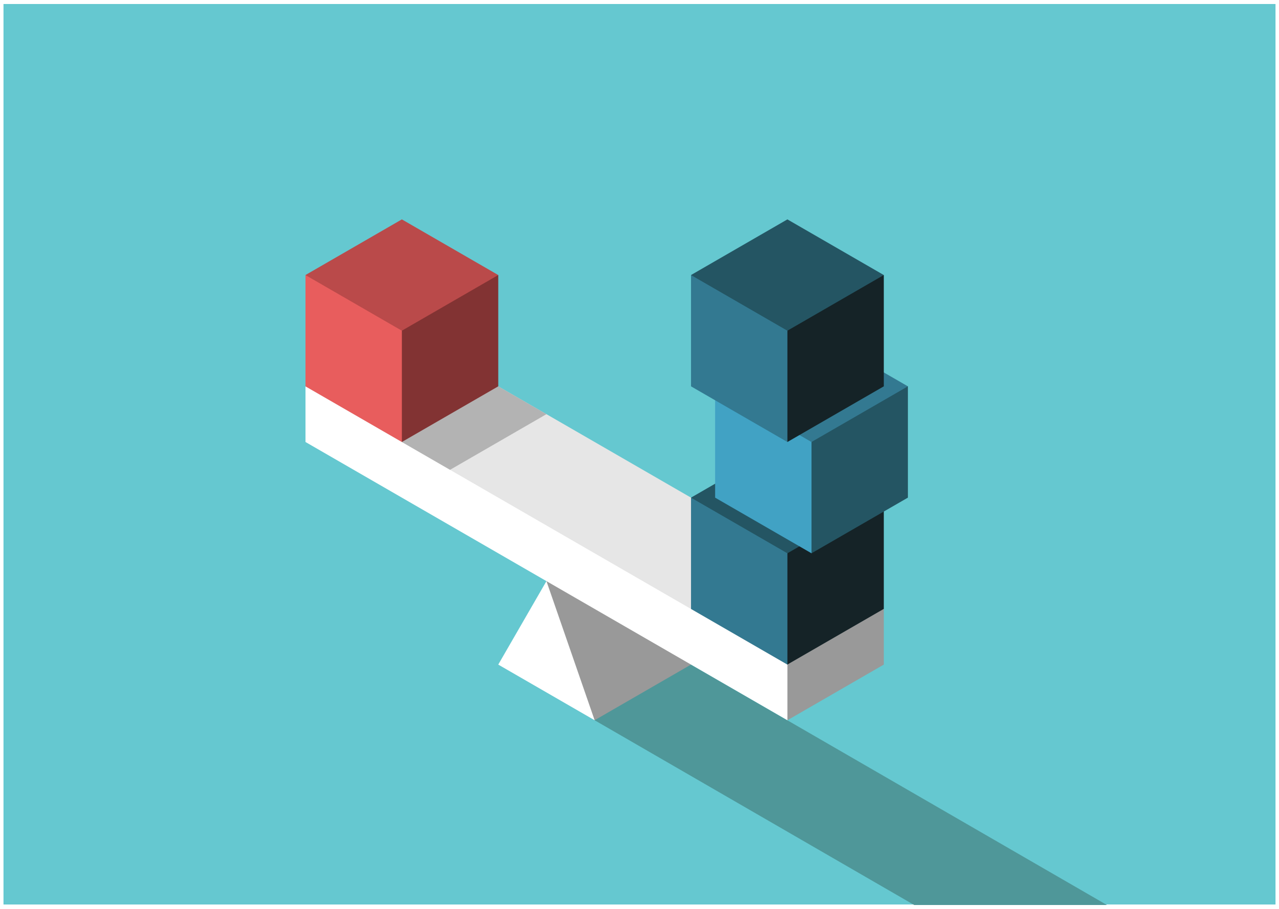


Review of General Excise and Use Tax Exemptions and Exclusions Pursuant to Section 23-73, Hawai‘i Revised Statutes

Introduction

THIS REPORT assesses certain tax exemptions and exclusions from Hawai‘i's General Excise Tax (GET). Section 23-71 et seq., Hawai‘i Revised Statutes (HRS), requires the Auditor to annually review different tax exemptions, exclusions, and credits on a 10-year recurring cycle, including provisions of the Public Service Company Tax and Insurance Premium Tax. Appendix A includes the full list of tax provisions required to be reviewed in upcoming years.

Beginning in 2020, we also annually review credits, exclusions, and deductions provided under the Income Tax and Financial Institutions Tax on a five-year recurring cycle that was established under Section 23-91 et seq., HRS.

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.

About This Report

As described by the Department of Taxation (DoTax), Hawai‘i’s GET and Use Tax, combined, apply to nearly all business activities in the state, resulting in a $112.2 billion tax base. In FY2020, which ended June 30, 2020, GET and Use Tax revenues accounted for $3.36 billion, or 49 percent of the total tax revenue of $6.89 billion. Those amounts predate the current COVID-19 pandemic, which has significantly impacted public health and the State’s economy, while simultaneously resulting in sharp reductions in GET and Use Tax revenue. Lawmakers may often choose to exempt or exclude certain revenues from taxation to promote certain social and economic goals.

Section 1 of Act 261, Session Laws of Hawai‘i (SLH) 2016, which established the annual review of tax exemptions, exclusions, and credits by the State Auditor’s Office, noted that tax expenditures from exemptions, exclusions, and credits reduce revenues to the State.[1] This requires ordinary taxpayers who do not benefit from the exemptions, exclusions, and credits to compensate for the reduced revenues, or alternately, funding for state programs must be curtailed. However, the Legislature also believed that certain tax exemptions, exclusions, and credits are worthy of continuation for equity, efficiency, and economic and social policy.

Accordingly, the Legislature found these reviews are “necessary to promote tax equity and efficiency, adequacy of state revenues, public transparency, and confidence in a fair state government.” 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.

As noted in this report, it was at times difficult to determine the purposes of the tax provisions reviewed. Further, when a purpose was identified, it was often difficult to identify the outcomes that the Legislature intended the tax provision to achieve. And, we had no objective means to assess whether provisions were achieving the outcomes that we were able to identify.

We recommend the Legislature clearly articulate purposes and establish specific metrics for measuring effectiveness when reviewing tax exemptions for extension or amendment, which will permit a more thorough and meaningful analysis of exemptions in the future. We further recommend that both GET *exclusions* we reviewed be removed from the schedule of future reviews. As explained below, these exclusions represent revenue that was never intended to be subject to

[1] We discuss the differences between tax *exemptions* and tax *exclusions* at page 5.

Tax Like an Egyptian:

The wholesale rate, the retail rate, and tax "pyramiding"

HAWAI'I'S GET is applied to the gross receipts or gross income from business activities in the state, including both wholesale and retail transactions. This is in contrast to a sales tax, which is typically taxed only at one level – the point of sale. The imposition of GET on business transactions at all levels results in what is commonly referred to as tax "pyramiding" – essentially a tax on a tax – with tax being imposed at various points on the same goods or services as they move through the chain of production and distribution to the eventual consumer.

Having a tax on a tax results in higher total costs which are often passed on to the ultimate consumer. For example, when a candymaker incorporates macadamia nuts purchased from a local farm into its chocolates, the price of candy sold to a consumer includes GET levied at the wholesale and retail levels. That is because the macadamia nut farmer pays GET on the nuts the farmer sells, and the candymaker pays GET on the candy following sales to a consumer. In many cases, the farm will add its GET liability to the amount it bills the candymaker, and the candymaker will include that cost in the price of its candy. The candymaker's revenue subject to GET includes the GET paid by the farm in the candymaker's price of its candy.

In order to reduce the effects of tax pyramiding, Hawai'i imposes a lower rate – 0.5 percent – on wholesale, or business-to-business, transactions of goods or services intended for resale. The retail rate – 4.0 percent – is generally applied only at the consumer level.

Some of the tax provisions discussed in this report – most notably the seven exemptions – attempt to eliminate tax pyramiding by exempting certain business-to-business transactions from GET.

GET. Taxpayers are generally not required to have a GET license or to file a GET return to benefit from these exclusions. For that reason, DoTax does not compile information about the use of these exclusions.

Hawai'i's General Excise Tax and Use Tax

Hawai'i's GET and Use Tax have broad reach – together, they apply to nearly every business transaction conducted in the state as well as to goods and services imported to Hawai'i. The two taxes are complementary to each other. GET is paid by a person or entity on revenue derived from doing business in the state, while Use Tax is paid by a person or entity importing goods, services, or contracting into the state from sellers who are *not* subject to GET. The Use Tax is intended to level the tax playing field by taxing goods and services that are purchased outside of Hawai'i and imported for use or resale. The Use Tax attempts to remove any tax advantage that businesses outside of the state may have with respect to goods and services used in Hawai'i.

General Excise Tax (Chapter 237, HRS)

While GET is regarded as a tax on gross business income, it resembles a consumption tax or sales tax in that the cost is typically passed along to consumers. However, GET is distinct from a typical sales tax in that it is a tax *on the business*, whereas a sales tax is a tax *on the consumer* that is collected by the business. GET is also distinct in that it is assessed on every business transaction – wholesale and retail – resulting in a broad tax base. By contrast, a typical sales tax generally only applies to retail sales of tangible goods.

For 2020, the most current tax year assessed in this report, Hawai‘i GET rates were:

- 0.15 percent on commissions from insurance sales;
- 0.5 percent primarily on revenue received by manufacturers and wholesalers, as defined by statute; and
- 4.0 percent on revenue received from all other activities including, but not limited to, the retail sale of tangible personal property (goods) or services, construction contracting, rental of personal or real property, business interest income, and royalties.

The terms “exemption” and “exclusion” are not defined in Hawai‘i’s GET law or in Section 23-71, HRS, which mandated this review. However, the sidebar “Exclusions and Exemptions” on the following page explains how tax exemptions and exclusions generally work.

Use Tax (Chapter 238, HRS)

According to DoTax, Hawai‘i imposes an excise tax on property and services imported for use in the state from persons or entities outside of Hawai‘i that are not required to pay GET. Use Tax is assessed to the person or entity importing the goods or services at rates that vary based on whether the imported goods or services are resold or used by the importer. Similar to GET, Use Tax has a wholesale rate of 0.5 percent of the value of goods and services imported to Hawai‘i for resale and a retail rate of 4.0 percent of the value of goods and services imported for the importers’ own use or consumption.

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.

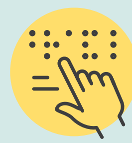
EXCLUSIONS

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 amounts paid to people to foster children excludes such revenue from GET. This revenue does not have to be reported.

EXEMPTIONS

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



Example: The exemption of revenue received by blind, deaf, or totally disabled persons from their business allows qualifying claimants to deduct the first $2,000 in income from their gross revenue, avoiding GET liability on those amounts.

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, moneys 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 moneys that may be available for other state priorities.

County Public Transportation Surcharges (Chapters 237, 238, and 248, HRS)

Since January 2007, a 0.5 percent GET and Use Tax surcharge has been imposed to help fund the City and County of Honolulu's mass transit system. Hawai‘i and Kaua‘i counties have adopted 0.25 percent and 0.5 percent surcharges respectively, both of which took effect in 2019. There is no surcharge collected on activity exempted from GET or Use Tax. Therefore, the revenue implications of GET and Use Tax exemptions are not limited to state tax revenue. For example, the exemption provided for sublease income (discussed below), resulted in $19.5 million in reduced county surcharge revenue in 2019. Overall, the exemptions reviewed in this report resulted in $21.27 million in reduced county surcharge revenue in 2019.

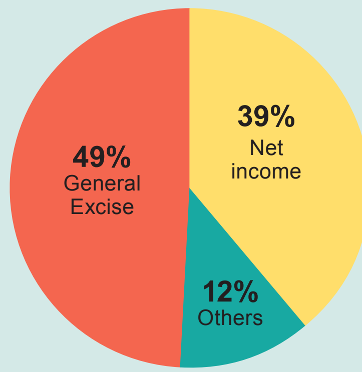
How We Got GET
General Excise Tax in Hawai'i

HAWAIʻI'S GET, like most sales taxes across the country, is a product of the Great Depression. While the Islands did not experience the level of unemployment and economic distress experienced by industrialized areas of the United States, falling land values during the early 1930s led to a drop in real and personal property tax revenue, which were then the mainstays of the Hawaiʻi tax structure. In response, the 1932 Territorial Legislature cut real property tax rates and repealed the levy on personal property. To make up for the lost revenue, the Legislature adopted a business excise tax, which taxed the operating costs of each entity doing business in Hawaiʻi. In 1935, the Legislature replaced the business excise tax with GET, which taxed the gross proceeds of sales of goods and services in Hawaiʻi.

Containing elements of both business and consumption taxation, GET was designed to redistribute the tax burden to different industries and their consumers.[1] Estimates prepared for the 1935 House Finance Committee predicted that the sugar, ranching, and diversified agriculture industries would receive tax relief while the retail industry would experience the greatest tax increase. While the adoption could be viewed as a concession to some of Hawaiʻi's oldest and largest businesses, this change in tax policy may have been prophetic, as the Islands' economy underwent fundamental changes.

Even by 1939, the retailing industry was accounting for the Territory's largest "taxable value," today referred to as the "tax base," at $123.72 million, or 33 percent of the total $376.71 million tax base. At $41.60 million, sugar comprised 11 percent of the tax base, with pineapple close behind at $35.44 million, or 9 percent of the tax base. Meanwhile, the tax base for service industry businesses was just $17 million, or 4.5 percent of the total. By Statehood in 1959, while all industries rose with the favorable economic tides, the gap between business and consumption tax bases grew wider. Retailing's tax base ballooned to $707.53 million (35 percent of the total tax base) while services saw even greater growth at $160.49 million (8 percent of the total). Meanwhile, sugar and pineapple had tax bases of $93.42 million and $98.43 million, respectively, with each comprising about 5 percent of the tax base.

State of Hawaiʻi General and Other Governmental Funds Tax Revenues by Type, FY2020



Note: "Others" includes taxes such as the Transient Accommodations Tax, tobacco and liquor tax, and liquid fuel tax.

Source: FY2020 Comprehensive Annual Financial Report of the State of Hawaiʻi

Today, the retailing and service industries are still the breadwinners for the State when it comes to GET. For FY2019, DoTax reported that retailing had a tax base of $36.8 billion, or 33 percent of the total tax base, with services at $16.93 billion, or 15 percent of the tax base.

In FY2020, the State collected a total of $6.89 billion in tax revenue. Most of that revenue came from two taxes: GET and the individual income tax. The GET is Hawaiʻi's largest tax revenue source, accounting for $3.36 billion, or 49 percent of total tax revenue. At $2.66 billion, the net income tax collections, which are comprised of both individual and corporate income tax revenues, represent Hawaiʻi's second-largest tax revenue source. The Transient Accommodations Tax, or hotel room tax, is the State's third-largest revenue source, accounting for $303.18 million.

[1] Hawaiʻi's General Excise Tax, Report No. 2, 1963, Legislative Reference Bureau, State of Hawaiʻi, p. 8.

Analysis of Reviewed Tax Provisions

This report reviews a total of nine tax provisions – seven GET exemptions and two GET exclusions. While DoTax collects data on seven of these tax provisions, our ability to report information about three of them was restricted by DoTax's policy prohibiting disclosure of information, even in aggregated form. In reporting data for 2019, DoTax revised its disclosure policy, which previously prevented disclosure of data for exemptions claimed by 10 or fewer taxpayers for statewide data. The current policy is to exclude disclosure when there are five or fewer claims for an exemption, or when an individual return represents a large percentage of the tabulation. DoTax did not provide us with the basis for the new policy or the criteria as to what constitutes "a large percentage" of the total amount claimed under a specific tax provision. However, because this new policy was not retroactively applied, in certain cases, this report presents data on certain exemptions for years prior to 2019 which may have been treated differently under the current policy.

Under Section 23-73, HRS, our office was also to analyze Section 237-24(17), HRS, regarding an exemption for amounts received by TRICARE-managed care support contractors. However, Section 237-24(17), HRS, was repealed on December 31, 2018, under Act 164, SLH 2013. We, therefore, did not review that exemption.

We note that Section 237-24(16), HRS, relating to cooperative housing corporations, is related to Section 237-24.3(2), HRS, regarding an exemption for reimbursements to associations of owners of condominium property regimes or nonprofit homeowners or community associations for common expenses, which we are not scheduled to analyze until 2024. However, because DoTax does not segregate data relating to these two exemptions, we report the exemptions' aggregate numbers in this report.

Overall, we found there was insufficient data to determine whether six of the seven exemptions reviewed are meeting their stated or inferred purposes. As we note above, making conclusions as to whether purposes have been met is extremely difficult when amounts claimed are not tracked or where no benchmarks or metrics have been provided. We also found that one exemption for amounts received by a patient-centered community care contractor used to pay third-party health care providers pursuant to a contract with the United States may be erroneously or improperly claimed by some taxpayers.

Assessment Challenges: Lack of Data on Cost, Causation

Many challenges hindered our ability to report information and analyze the exemptions and exclusions as required under Section 23-71, HRS, most significantly, the lack of available data. Prior to 2017, DoTax did not systematically track GET and Use Tax exemptions, meaning there is little, if any, data about the number of taxpayers that claimed each exemption or the amounts they claimed.

While development of the department's Tax Modernization System project has allowed for better data collection, DoTax currently does not have some specific information we need to more meaningfully assess the exemptions from GET and Use Tax. For some provisions, the lack of historical data precluded us from determining "the amount of tax expenditure for the exemption, exclusion, or credit for each of the previous three calendar years," as required by Section 23-71, HRS. The absence of historical data also hindered our ability to estimate the amounts of tax expenditures for the current and next two calendar years. Without that data and the expertise to forecast economic trends, we determined any projection on the future cost of exemptions and exclusions would be too speculative and unreliable to be included in this report. As the data continues to be tracked, we may reach a point in the future where meaningful projections can be made; since DoTax only recently began collecting data, that point is likely to be some years away.

We were further challenged to determine the purpose of some exemptions and exclusions. The legislative acts that created the exemptions and exclusions often lack a clear statement of the intent of the tax preference. Where available, we used other sources, such as committee reports and other legislative history, to infer the purpose of an exemption or exclusion; however, even then, we were unable to assess whether a particular tax provision is meeting its purpose since none of the provisions include specific benchmarks against which the provisions are to be measured

In addition, an analysis of economic or employment benefits compared against forgone tax revenue was hampered by a variety of other factors. Businesses that claim these exclusions and exemptions are not required to provide data beyond the amount claimed to DoTax. Moreover, we were unable to share taxpayer names and other confidential tax return data with the Department of Labor and Industrial Relations to independently identify and verify employment and payroll data for taxpayers claiming exemptions that may be intended to stimulate local employment. Taxpayers do not report to DoTax data on jobs, wages, or certain other economic activities that may have been generated because of a tax provision.

Further, our analysis could not account for a variety of unintended effects. For example, some businesses that claimed an exemption aimed at generating economic activity may have received tax preferences for jobs that would have been created irrespective of the tax preference, while other jobs may have been filled by non-residents. We were likewise unable to assess the disadvantages faced by businesses and industries that were not eligible for the tax preference. As a result of these challenges, we could not make a causal connection between any potential Hawaiʻi employment or economic gains and the use of these exemptions.

Finally, as required by statute, we conducted an analysis of the impact of tax provisions on "low-income residents" using the formula provided in the statute. However, we question whether the calculations represent

Tax Equity and Efficiency: Finding the Balance

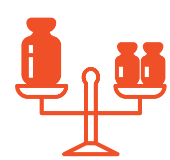
WE ARE REQUIRED to assess tax equity and efficiency as part of our review. However, the Hawaiʻi Revised Statutes do not define these terms. Accordingly, our evaluations were guided by criteria developed by the U.S. Joint Committee on Taxation and from the U.S. Government Accountability Office, as detailed in the Association of International Certified Professional Accountants (AICPA) publication *Guiding Principles of Good Tax Policy: A framework for evaluating tax proposals*. The Joint Committee on Taxation is a nonpartisan committee of the United States Congress that, among other things, investigates the administration, operation, and effects of taxes.

Tax *equity* is the principle of taxing similar taxpayers similarly. The concept of horizontal equity provides that two taxpayers with equal abilities to pay should pay the same amount of tax. In contrast, vertical equity provides that a person with the greater ability to pay should pay more tax.

Tax *efficiency* is the principle that a tax system should not unduly impede or reduce the productive capacity of the economy. All taxes have the capacity to change how a taxpayer may behave; for example, a GET exemption for local dairy farmers could stimulate development of the local dairy industry by lowering the industry's costs, thereby creating a competitive advantage. Under the concept of efficiency, a tax system should avoid hindering economic goals, such as economic growth, capital formation, and competitiveness with other jurisdictions. A separate, but related, concept states that administrative and compliance costs should be kept low to foster effective tax administration. For purposes of this report, we primarily discuss economic efficiency rather than administrative efficiency, but do mention some administrative issues we deemed significant.

Sometimes a tax exemption, designed to increase economic activity in a certain industry or geographic area, will reduce tax equity by providing favorable treatment to these activities. Therefore, lawmakers must carefully balance both principles to optimize tax policy.

The concept of **horizontal equity** provides that two taxpayers with equal abilities to pay should pay the same amount of tax.



In contrast, **vertical equity** provides that a person with the greater ability to pay should pay more tax.

Source: Auditor research

the value that repeal of a particular exemption or exclusion would have for low-income residents. Although money generated from repealing a particular exemption or exclusion likely will increase tax revenues, the impact of the additional funds will not automatically accrue a benefit to low-income residents in particular, but to all residents. Further discussion, as well as our calculations, can be found in Appendix B.

An additional concern is that the term "tax expenditure" is not defined in Hawai'i's GET law or in Section 23-71, HRS, which mandated this review. However, as DoTax notes in its 2019 *Hawai'i General Excise and Use Tax Exemptions* report, tax expenditures are revenue losses attributable to tax exemptions and exclusions. As noted throughout this report, the Auditor and DoTax apply different methodology in arriving at the amounts of the tax expenditures attributed to some exemptions. This report considers a tax expenditure amount to be the amount of revenue forgone as a result of a GET tax exemption. In contrast, DoTax does not necessarily consider forgone revenue to result in an actual tax expenditure, if, in its opinion, the underlying business activity was not meant to be subject to the GET. Additionally, DoTax calculates tax expenditures based on the tax rate at which DoTax believes the activity should be taxed, e.g., taxing all business-to-business activities at the wholesale GET rate even where a taxpayer would have paid GET at a higher rate, but for the exemption. See "Tax Expenditures: At What 'Cost'?" on page 11.

Tax Expenditures: At What “Cost”?

AS DOTAX EXPLAINS in its 2019 *Hawai‘i General Excise and Use Tax Exemptions* report: *“[t]ax expenditures are the implied revenue cost of the deviation from a uniform application of the excise and use tax.”* Determining the true “cost” of a given tax exemption or exclusion is difficult. And, at times, our estimates of tax expenditure amounts differ from the amounts reported in DoTax’s annual GET and Use Tax expenditure reports. As we explain, this is largely because DoTax often applies a lower, uniformly assumed tax rate to the amounts claimed, not the actual rates reported by claimants on GET/Use Tax returns.

The 2019 DoTax report explains that their calculation of tax expenditures requires certain assumptions regarding the appropriate tax rate if the exemption were to be discontinued. Using these assumptions, they use the retail rate of 4.0 percent for exemptions that apply to final sales, the wholesale rate of 0.5 percent for exemptions that apply to business-to-business transactions, and do not apply a rate for exemptions that eliminate the double taxation of exported products or that eliminate the taxation of certain purchases by federal and foreign governments which cannot be taxed.

We take a different approach in arriving at some of the estimated amounts of tax expenditures in our report. While DoTax applies the “wholesale” rate (0.5 percent) to the entire amount claimed under certain exemptions, we use data provided to us by DoTax from the GET and Use Tax returns and apply the tax rate claimed by actual taxpayers in accordance with applicable tax laws; this at times results in the application of the 4.0 percent retail rate. In these cases, this has yielded a “tax expenditure” amount much greater than amounts calculated by DoTax in its *Hawai‘i General Excise and Use Tax Exemptions* reports. There are also some differences in the total amounts claimed for the exemptions; these differences are due to updated DoTax data used in our report.

DoTax acknowledges that their approach to calculating tax expenditure amounts is based on debatable assumptions:

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

Finally, as DoTax’s 2019 *Hawai‘i General Excise and Use Tax Exemptions* report notes, tax expenditures do not equate to the true amount of revenue realized if the exemption were to be repealed:

> **In presenting data on tax exemptions, it is also crucial that a clear distinction be made between tax expenditures and revenue estimates. The data presented in this report provides only the amounts of each exemption claimed and should not be relied on as an estimate of the amount of revenue that may be realized by repealing an exemption. A revenue estimate would have to account for the substitution and behavioral effects of repealing an exemption.**

Although we agree with this statement, we believe that the better measure of a “tax expenditure” applies the *actual* tax rates required by current law, not an assumed tax rate that does not exist in fact.

Exemption of gross income of real property lessees received from sublessees (Section 237-16.5, HRS)

Exemption at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$175.5 million	546	$7.02 million	$14.58	Unable to determine

Source: Data based on DoTax data as of September 8, 2020 and Auditor calculation.

History of the Exemption

1997
The Legislature established a deduction for a lessee who subleases all or a portion of the leased real property to reduce the amount of gross income[2] subject to GET that the lessee receives from the sublease by seven-eighths (87.5 percent). This effectively subjects the sublease revenue to a GET rate of 0.5 percent instead of 4.0 percent.

2011
GET and Use Tax exemptions, including the tax exemption on written real property subleases, were temporarily suspended for FY2012 and FY2013.

What does this exemption do?

Lessor

Lessee/Sublessor subleases same or part of same property to another

Sublessee

The section allows a lessee who subleases the property to deduct 87.5 percent (seven-eighths) of the gross proceeds or gross income received from a sublessee. However, the deduction is limited to the lease amount paid by the lessee to its landlord. By allowing a deduction of seven-eighths of gross proceeds, the effective result is that sublease revenue is taxed at the 0.5 percent wholesale GET rate, rather than the 4.0 percent retail rate (as 0.5 is one-eighth of 4.0).

A lessee claiming the deduction on its sublease revenue must report the name and Hawai‘i Tax ID number of the lessor on Schedule GE. Deductions are only allowed for written leases and subleases relating to the same, or portions of the same, real property. In addition, the lessee is required to obtain from its lessor a certificate, Form G-71, certifying that the lessor is subject to GET on the gross income received from the lessee. The lessee retains that form for its records, and it is not filed with DoTax.

[2] Section 237-3, HRS, has a common definition for “gross proceeds of sale” and “gross income.” For purposes of this report we use the term gross income for consistency and conciseness.

How does this exemption work?

ABC Corp. leases a property to XYZ Corp. for $1 million a year. ABC pays GET at 4.0 percent on its revenue from this lease, or $40,000. XYZ in turn subleases the property to John Smith, a seller of aloha shirts, for $1.5 million a year. The exemption allows XYZ to reduce the amount of its sublease revenue subject to GET. Specifically, XYZ can deduct 87.5 percent of the revenue from its sublease up to the amount of its lease, i.e., up to $1 million. Instead of paying GET on the sublease revenue of $1.5 million, XYZ can deduct $875,000 of that revenue. XYZ would pay GET on the remaining $625,000 at the rate of 4.0 percent, which reduces XYZ's GET obligation by $35,000. GET costs are often passed along in subsequent transactions. If XYZ adds the amount of its GET obligation to the sublease, the sublease rent would be lower than in the absence of the exemption. In turn, the lower lease rate could allow Smith the flexibility to hire more employees, expand operations, increase profits, or charge less for shirts.

What is the purpose of this exemption?

According to Act 353, SLH 1997, the purpose of this exemption is to reduce the pyramiding of GET on lease and sublease transactions, seen as the result of "certain structural problems existing in the Hawai'i economy which add to the high cost of living in Hawai'i and the overall cost of doing business." Under then-existing law, GET was imposed on the leasing and subleasing of the same parcel of real property, each level paying the 4.0 percent GET rate on its respective gross proceeds from leasing activity. One legislative committee report noted that, in situations when a property is the subject of multiple layers of subleases, the multiple levels of taxes would be passed on to consumers.

The Legislature found that economic activity in Hawai'i, which at the time was at one of its lowest levels, needed stimulus. Money saved by reducing GET imposed on multiple levels of leases of the same property was expected to boost family discretionary spending in Hawai'i or assist in business growth by reducing the overall transactional costs normally passed on the consumers. In turn, that added economic activity was expected to generate tax revenues that would reduce or eliminate any revenue loss from the exemption.

Is this exemption meeting its purpose?

We were unable to determine whether the exemption is meeting its ultimate purpose – to encourage economic activity. Although the exemption does reduce GET pyramiding, we were unable to determine whether such tax savings are passed along to consumers or resulted in an increase in discretionary spending and business growth.

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure*
2019	546	$175.5 million	$7.02 million	$0
2018	571	$174.89 million	$6.99 million	$0
2017	575	$149.5 million	$5.96 million	$0

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. 2019 figures based on DoTax GET data as of September 8, 2020. Tax expenditure amounts based on Auditor calculation.

*DoTax does not consider this provision applicable to an activity subject to the GET.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

DoTax provided information on the top 50 claimants for this exemption. These claimants included major hotels, a major shopping mall, a major mixed-use property of office buildings and restaurants, a national restaurant chain, and a convenience store chain.

In its 2019 *Hawai'i General Excise and Use Tax Exemptions* report, DoTax calculated that the GET exemption for real property leases resulted in $175.5 million in exemptions but no tax expenditure. DoTax presumes that the exemption does not increase or decrease the amount of tax paid relative to a "normal" market transaction, e.g., one involving a wholesaler and a retailer. DoTax considers the lessor to be akin to the retailer and the lessee that subleases the property akin to the wholesaler. According to DoTax, the fact that the sublease deduction is the cost of the primary lease multiplied by 87.5 percent ensures that the 0.5 percent wholesale rate is still paid.

Our estimate of the tax expenditure resulting from this exemption differs from DoTax. Our estimate of the tax expenditure is based on the revenue implications that could result if the exemption did not exist. We calculate the tax expenditure for these exemptions to be the value of the claim multiplied by the associated tax rate that taxpayers claiming the exemptions actually reported on their GET returns and Use Tax returns (see sidebar "Tax Expenditures: At What 'Cost'?" on page 11). Therefore, we calculate the 2019 tax expenditure for this exemption to be $7.02 million, which equates to the amount claimed multiplied by the applicable tax rate of 4.0 percent, 0.5 percent, or 0.15 percent. In 2019, nearly all claimants applied this exemption at the 4.0 percent rate.

Is the exemption necessary to promote or preserve tax equity or efficiency?

This exemption creates a bias in favor of one class of taxpayer (sublessors of real property) and is not necessary to promote or preserve tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exemption?

We cannot determine whether any economic or employment benefits resulted from the exemption or whether those benefits offset the cost. DoTax does not require claimants to report the impacts or benefits of this exemption; as we note in this report, such data could assist in assessing the exemption's effectiveness. Additionally, we determined that the primary purpose is not to target any specific economic or employment benefit, but rather, to generally provide GET relief that would boost family discretionary spending or assist in business growth. Metrics for evaluating effectiveness could assist in determining whether the provision has resulted in an economic or employment benefit and whether the benefit outweighs the cost.

Should the exemption be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exemption should be retained, amended, or repealed.

Issues of concern

As noted above, DoTax does not require taxpayers claiming this exemption to file Form G-71, which is the lessor's certification that the lessor will be subject to GET on the gross proceeds or gross income received from the lessee/sublessor. Requiring the certification to be filed would likely improve compliance with the requirement that lessors furnish a completed Form G-71 and assist verification when necessary.

We also note the 2015 and 2019 versions of the instructions for this exemption contained errors wherein claimants were told to provide lessor information on an incorrect section of the GET form. DoTax said this should not have impacted the validity of the claims and that the incorrect reference would be corrected.

Exemption of value or gross income of nonprofit organizations from conventions, conferences, trade shows, and display spaces (Section 237-16.8, HRS)

Exemptions at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$17.5 million	24	$699,930	$1.45	Unable to determine

Source: Data based on DoTax data as of September 8, 2020 and Auditor calculation.

History of the Exemption

2004
The Legislature established the exemption.

2011
GET and Use Tax exemptions, including the exemption of certain convention, conference, and trade show fees, were temporarily suspended for FY2012 and FY2013.

What does this exemption do?

It exempts the gross income received by a fraternal benefit, religious, charitable, scientific, educational, or other nonprofit organization from fees for convention, conference, or trade show exhibit or display spaces from GET, provided that the gross proceeds of sales by a vendor using the exhibit or display spaces shall be subject to GET. According to DoTax, non-profit income is usually not exempt from GET if the primary purpose is to fundraise. Therefore, the exemption provided under Section 237-16.8, HRS, expressly removes any ambiguity over whether the income generated by non-profits is subject to GET.

How does this exemption work?

A nonprofit national trade association held its annual convention at the Hawai‘i Convention Center. Fees charged for booth space at a related expo generated $1 million in revenue for the trade association. If those fees were subject to GET, the organization would owe $40,000, or 4.0 percent of $1 million. The exemption results in a $40,000 reduction in GET for the association. However, GET must still be paid by vendors at the expo, whose gross income is subject to GET at the 4.0 percent retail rate.

What is the purpose of this exemption?

A 2004 legislative conference committee report noted that the Hawai‘i Convention Center played a vital role in fueling the State’s primary economic engine – tourism. However, the report pointed out that the Hawai‘i Convention Center may lose potential convention bookings due to the pyramiding effect of the GET on nonprofit organizations. According to another legislative committee report, the exemption was meant to address the issue by eliminating the pyramiding impact on nonprofit organizations for fees collected for exhibit or display space.

We note that although the committee report referenced the "pyramiding impact" of imposing GET on such fees, it is questionable whether assessing GET on the fees from exhibition space sales and on revenues earned by the entities using the space results in any pyramiding of GET (see "Tax Like an Egyptian" on page 3). These fees are separate one-level, or retail, transactions, which do not result in pyramiding. However, this does not change what we infer the purpose of this exemption to be, which is to exempt this revenue from GET liability to encourage Hawai'i Convention Center bookings. We note that the exemption is not exclusive to the Hawai'i Convention Center but would also apply to such revenue at other venues.

Is this exemption meeting its purpose?

The exemption, in theory, may encourage business opportunities for the Hawai'i Convention Center and other convention venues by exempting GET on revenues generated by conventions, conferences, and trade shows from the sale of exhibition and display space. However, we are unable to determine whether there were any increased convention or trade show business activities directly resulting from the exemption, nor can we determine whether venues other than the Hawai'i Convention Center have benefitted from the exemption.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

DoTax calculated the amount of the tax expenditure associated with this exemption by multiplying the total amount claimed by the wholesale rate (0.5 percent), considering these to be business-to-business transactions. We disagree with this characterization. Rather, we calculate the tax expenditure for these exemptions to be the value of the claim multiplied by the associated tax rate that taxpayers claiming the exemptions actually reported on their GET and Use Tax returns (see sidebar "Tax Expenditures: At What 'Cost'?" on page 11).

Based on our review of data compiled by DoTax from the returns filed by the taxpayers claiming the exemptions, nearly all deductions were made at the retail rate (4.0 percent), not the wholesale rate (0.5 percent), and the total at both rates was $17.5 million in 2019.

Using this methodology, we estimate the tax expenditures for 2017, 2018, and 2019 for this exemption as follows:

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure
2019	24	$17.5 million	$699,930	$87,000
2018	36	$18.68 million	$746,506	$93,389
2017	27	$14.21 million	$568,342	$71,066

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. 2019 figures based on DoTax GET data as of September 8, 2020. Tax expenditure amounts based on Auditor calculation.

Is the exemption necessary to promote or preserve tax equity or efficiency?

By its nature, the exemption creates a bias in favor of one class of taxpayer (fraternal benefit, religious, charitable, scientific, educational, or other nonprofit organizations that generate revenue from exhibit or display space at the organization's conference, convention, or trade show) and is therefore not necessary to promote tax equity.

Is there an economic or employment benefit and if so, does the benefit outweigh the cost of the exemption?

We were unable to determine if the exemption has directly resulted in any economic or employment benefit. DoTax does not require reporting of associated impacts or benefits when claiming the exemption. Therefore, our cost versus benefit review of this exemption was hampered by an inability to identify its impact on convention bookings or how they affected the ability of the Hawai'i Convention Center (or other applicable venues) to fuel economic growth.

Should the exemption be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exemption should be retained, amended, or repealed.

Issue of concern

DoTax does not automatically verify that taxpayers claiming this exemption are nonprofit organizations under section 501(c)(3) of the U.S. Internal Revenue Code of 1986, as amended, which is a qualification for use of this exemption.

Exclusion of proceeds earned from annual senior citizen's fairs (Section 349-10, HRS)

Exclusion at a Glance (2019)

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	No data available	Unable to determine

What does this exclusion do?

Under this exclusion, proceeds earned from annual senior citizen's fairs are deemed to be proceeds earned from "casual sales." As defined in Chapter 237, HRS, casual sales are "an occasional or isolated sale or transaction involving…tangible personal property" by a person not required to have a GET license. Casual sales are excluded from the definition of "business" in Chapter 237 and therefore not subject to GET.

How does this exclusion work?

An economic development organization holds an annual senior citizen's fair via a grant provided by the county. The economic development organization collects booth fees from vendors, which are used to supplement the county grant. Under this exclusion, gross income received by vendors and the booth fees collected by the organization are considered "casual sales" and therefore not subject to GET.

What is the purpose of this exclusion?

According to a 1976 legislative conference committee report on the bill that enacted the exemption, an Executive Office on Aging was needed to eliminate the fragmentation of service delivery to the elderly. The provision establishing an annual senior citizen's fair and the treatment of fair proceeds as casual sales were part of the legislation to improve the coordination and delivery of programs and services to the elderly. Therefore, we infer that the exclusion of annual senior citizen's fair income from the GET was meant to encourage the utilization of annual fairs as a means of improving delivery of services to seniors.

History of the Exclusion

1976
The Legislature established, within the Office of the Governor, an Executive Office on Aging and, at the county level, county offices of elderly affairs. The Legislature also established an annual senior citizen's fair to be held by each county policy council for elderly affairs. Proceeds earned from such fairs are deemed to be proceeds earned from casual sales as defined in Section 237-1, HRS.

1979
The Legislature amended this section to state that the county shall be responsible for the planning, organizing, and coordinating of the fair in every respect. The state policy advisory board for elderly affairs may assist the county in any aspect upon request. The county shall distribute such proceeds to the various senior citizen organizations and individuals who participate in the fair in accordance with appropriate methods of distribution as determined by the county.

Is the exclusion meeting its purpose?

The exclusion appears to be utilized to organize fairs intended to improve the delivery of services for the elderly. It is unclear to what extent such activity is occurring or if the exclusion has any impact on delivery of services. DoTax does not track the occurrence of such fairs and the Executive Office on Aging, which is the State's lead agency in the coordination of a statewide system of aging and caregiver support services, had little information regarding the frequency of such fairs.

What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2017-2019?

DoTax does not consider this exclusion to be a tax expenditure, since senior citizen's fair sales are deemed to be "casual sales," which are excluded from the scope of GET. Therefore, DoTax considers that there is no associated forgone tax revenue. Additionally, DoTax does not require reporting of gross proceeds from annual senior citizen's fairs that benefit from the exclusion. Accordingly, DoTax has no data on the number of claimants, the total amount claimed, or the amount of tax expenditure.

Is the exclusion necessary to promote or preserve tax equity or efficiency?

By its nature this exclusion provides a tax preference to a certain type of economic activity (senior citizen's fairs) and thus is not necessary to promote tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exclusion?

We are unable to determine whether the exclusion has directly resulted in any economic or employment benefit, but its primary purpose does not appear to be to create such benefits. DoTax does not require reporting of the impacts or benefits of this exclusion.

Should the exclusion be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exclusion should be retained, amended, or repealed.

Issues of concern

DoTax should attempt to identify whether and to what extent this exclusion is being claimed to determine whether it achieves its purpose. In addition, the statute does not clearly define what constitutes "proceeds earned from this fair." For example, it is not clear if proceeds earned by vendors that sell goods, food and drink, or services are included. Some guidance, via a Tax Information Release or other bulletin, would be advisable, especially since this exclusion is not required to be reported to DoTax and therefore is not tracked. If the exclusion is meant to apply to vendor revenue, DoTax should consider requiring vendors to claim these amounts on Schedule GE in order to track usage and to discourage abuse.

During our review, we were told by an organizer of an annual senior citizen's fair on Maui that not all booth fees were excluded from GET by the fair organizer, which was funded under a county grant. However, under Section 349-10, HRS, it appears all booth revenue, including that of vendors, are treated as casual sales and therefore should be excluded from GET. Again, DoTax guidance on how this exclusion should be utilized would clarify this issue.

Exemption for amounts received from common payments of related entities (Section 237-23.5, HRS)

Exemption at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
Confidential*	Confidential*	Confidential*	Cannot be calculated	Unable to determine

* According to DoTax, specific claimant data for 2019 could not be publicly disclosed for taxpayer confidentiality reasons.

History of the Exemption

1988
The Legislature established the exemption.

1999
Act 165 clarified the definition of "related entities" for purposes of the General Excise Tax.

What does this exemption do?

It exempts intercompany transfers of funds for services, and overhead associated with such services, as well as transfers to a "common paymaster." A common paymaster under this exemption is any member of a group of related corporations that disburses remuneration to employees of two or more of those corporations on their behalf and is responsible for keeping books and records for the payroll with respect to those employees. The provision exempts amounts received, charged, or attributable to services furnished by one related entity to another related entity, or to interest attributable to loans, advances, or use of capital between related entities.

How does this exemption work?

ABC Corp. provides payroll and administrative services for related affiliate XYZ Inc. and charges $100,000 for these services. ABC can claim an exemption for the $100,000 in revenue received from XYZ, reducing ABC's gross receipts subject to GET by $100,000. This results in a $4,000 reduction in GET liability for ABC.

What is the purpose of this exemption?

According to a 1988 legislative committee report on the bill that resulted in the exemption, the purpose of the exemption was to provide a GET exemption for certain transactions between related entities and for common paymaster operations. The committee noted parent companies typically charge subsidiaries for expenses for managerial, administrative, legal, or accounting services. The subsidiary, in turn, reflects payments for such services to the parent. Although under income tax law, no income tax is imposed, such transactions would be subject to GET but for this exemption. The committee found the exemption would assist the development of business in Hawai‘i and promote a positive business climate.

Is the exemption meeting its purpose?

Although the exemption appears to provide an exemption from GET liability for intercompany transfers and common paymaster transactions, we are unable to determine whether there were any increased business opportunities or improvement in the business climate directly resulting from the exemption.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017-2019?

DoTax calculated the amount of the tax expenditure associated with this exemption by multiplying the total amount claimed by the wholesale rate (0.5 percent), considering transactions between related entities to be business-to-business transactions. We disagree with this characterization and instead calculate the tax expenditure for these exemptions by multiplying the amounts claimed by the associated tax rate that claimants actually reported on their GET and Use Tax returns (see sidebar “Tax Expenditures: At What ‘Cost’?” on page 11).

Based on our review of data compiled by DoTax from the returns filed by the taxpayers claiming the exemptions, most deductions were made at the retail rate (4.0 percent), not the wholesale rate (0.5 percent). Using this methodology, we estimate the tax expenditures for 2017, 2018, and 2019 as follows:

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure
2019	Confidential*	Confidential*	Cannot be calculated	$0
2018	22	$18.98 million	$730,885	$94,892
2017	32	$19.84 million	$760,001	$99,210

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. 2019 figures based on DoTax GET data as of September 8, 2020. Tax expenditure amounts based on Auditor calculation.

*DoTax changed its data suppression methodology such that specific claimant data for 2019 for this exemption could not be publicly disclosed for taxpayer confidentiality reasons.

Is the exemption necessary to promote or preserve tax equity or efficiency?

By its nature the exemption applies to a certain class of taxpayer and therefore is not necessary to promote tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exemption?

We are unable to determine the extent that the exemption has directly resulted in any economic or employment benefit. DoTax does not require reporting of the impacts or benefits of this exemption when beneficiaries claim the exemption. Therefore, our cost versus benefit review of this exemption was hampered by an inability to determine whether the exemption affected business development and ultimately the extent it promoted a positive business climate.

Should the exemption be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exemption should be retained, amended, or repealed.

Issues of concern

None noted.

Exemption of amounts received by blind, deaf, or totally disabled persons from their business (Section 237-24(13))

Exemption at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$1.89 million	772	$18,530	4 cents	Yes

Source: Data based on DoTax data as of September 8, 2020 and Auditor calculation.

What does this exemption do?

Gross income received by any blind, deaf, or totally disabled person doing business within the state, up to $2,000 a year, is not subject to GET. The exemption also applies to gross income received by a corporation wholly owned by an individual or individuals who are blind, deaf, or totally disabled; a general, limited, or limited liability partnership, all of whose partners are blind, deaf, or totally disabled; or a limited liability company, all of whose members are blind, deaf, or totally disabled. To be considered blind, deaf, or totally disabled, a claimant must obtain both an applicable medical professional's certification and a letter of approval of disability exemption on forms provided by DoTax. A related provision under Section 237-17, HRS, establishes that GET assessed on a business or other activities of individuals who are blind, deaf, or totally disabled shall not exceed 0.5 percent of receipts.

How does this exemption work?

Taxpayer is a corporation licensed to do business in Hawai‘i. One hundred percent of taxpayer's shares are owned by a person who is totally disabled and who has furnished the necessary certification to DoTax. The first $2,000 in gross income to the corporation is exempt from GET, which reduces the corporation's GET liability by $10 at the wholesale rate of 0.5 percent, as established under Section 237-17 HRS.

History of the Exemption

1947
The Legislature established a $2,000 per year exemption for income received by any blind person engaging, or continuing, within the territory, in any business, trade, activity, occupation, or calling.

1966
The Legislature established that the tax levied, assessed, and collected on business or other activities of individuals who are blind, or corporations, all of whose outstanding shares are owned by individuals who are blind, shall not exceed 0.5 percent of the proceeds, sales, income, or other receipts subject to tax.

1973
The Legislature revised Section 237-17, HRS, so that persons with impaired sight, hearing, or who are totally disabled, would qualify for the GET exemption available to the blind.

2002
The Legislature revised Section 237-24, HRS, to provide the same GET benefits to persons with impaired sight, hearing, or who are totally disabled, regardless of the type of entity in which they choose to do business.

What is the purpose of this exemption?

The exemption was aimed at supporting those with disabilities.

Is the exemption meeting its purpose?

By reducing GET liability, the exemption appears to be meeting its purpose of supporting those with disabilities. However, the value of the exemption is small – 0.5 percent of $2,000, or $10.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

DoTax calculated the amount of the tax expenditure associated with this exemption by multiplying the total amount claimed by the retail rate (4.0 percent). Unlike tax expenditures at the wholesale rate, DoTax does not consider these to be business-to-business transactions, but transactions between businesses and final consumers or the equivalent thereof. That is because the department anticipates that most claimants are small retail businesses rather than wholesalers. However, based on our review of data compiled by DoTax from the returns filed by the taxpayers claiming the exemptions, nearly all deductions were made at the wholesale rate (0.5 percent), not the retail rate (4.0 percent). That is because Section 237-17, HRS, establishes that GET assessed on a business or other activities of individuals who are blind, deaf, or totally disabled, shall not exceed 0.5 percent of receipts. Therefore, we calculate the tax expenditure for this exemption to be the value of the claim multiplied by the associated tax rate that taxpayers claiming the exemptions actually reported on their GET and Use Tax returns (see sidebar "Tax Expenditures: At What 'Cost'?" on page 11).

Using this methodology, we estimate the tax expenditures for 2017, 2018, and 2019 for this exemption as follows:

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure
2019	772	$1.89 million	$18,530	$76,000
2018	919	$2.18 million	$24,415	$87,398
2017	927	$2.16 million	$23,571	$86,974

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. 2019 figures based on DoTax GET data as of September 8, 2020. Tax expenditure amounts based on Auditor calculation.

Is the exemption necessary to promote or preserve tax equity or efficiency?

By its nature the exemption creates a bias in favor of one class of taxpayer (individuals who are blind, deaf, or totally disabled) and therefore is not necessary to promote tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exemption?

DoTax does not require reporting of the impacts or benefits of this exemption when beneficiaries claim the exemption. Therefore, we are unable to determine whether the exemption has directly resulted in any economic or employment benefit, but the primary purpose appears to be social rather than economic.

Should the exemption be retained without modification, amended, or repealed?

Section 237-17, HRS, which establishes that GET assessed on a business or other activities of individuals who are blind, deaf, or totally disabled shall not exceed 0.5 percent of receipts, appears to provide more meaningful tax relief for intended beneficiaries. In fact, that provision essentially ensures that this exemption should be claimed at the 0.5 percent rate, which results in negligible tax relief. If the Legislature wants to retain this exemption, it should consider whether exempted income should be limited to just the first $2,000 as that cap was established in 1947, and reduces GET by only ten dollars.

Issues of concern

DoTax does not automatically verify that claimants meet qualifications for eligibility. However, according to DoTax, the department is in the process of configuring its computer system to do automated enforcement; we recommend they complete and implement this process.

Section 237-17, HRS, which establishes that GET assessed on a business or other activities of individuals who are blind, deaf, or totally disabled shall not exceed 0.5 percent of receipts, appears to provide more meaningful tax relief for intended beneficiaries. In fact, that provision essentially ensures that this exemption should be claimed at the 0.5 percent rate, which results in negligible tax relief. If the Legislature wants to retain this exemption, it should consider whether exempted income should be limited to just the first $2,000 as that cap was established in 1947, which reduces GET by only $10.

Separate from our review of the GET and Use Tax filings, we note that some claims made under this exemption were for improper (non-disabled) business activity categories, some of which were taxable at the higher 4.0 percent retail GET rate. DoTax should review the appropriateness of such claims, as it appears these taxpayers may be erroneously claiming the exemption or claiming the exemption at the wrong rate. Some guidance, via a Tax Information Release or other bulletin might be advisable given these apparent issues.

Exemption of amounts received by independent cane farmers who are sugarcane producers (Section 237-24(14))

Exemption at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
Confidential*	Confidential*	Confidential*	Cannot be calculated	Yes

* According to DoTax policy, specific claimant data could not be publicly disclosed for taxpayer confidentiality reasons as there were fewer than five claimants.

History of the Exemption

1935
In establishing a new excise tax structure, or GET, the Legislature provided a deduction for a sugar refiner that purchased sugarcane from a grower. The deduction applied to purchases from a grower that had already been taxed. The purchaser was allowed to deduct the amount paid for the sugarcane from the value used for computing the tax on the refined product.

1953
The Legislature added additional language providing that amounts received by a sugarcane producer from the manufacturer purchasing the sugarcane are exempt from GET where (1) the producer is an independent cane farmer; (2) the value of the sugar and its by-products are later taxed against the manufacturer; (3) the producer's gross proceeds are dependent upon the actual value of the manufactured products; and (4) the producer's gross proceeds are reduced by the tax paid by the manufacturer.

2011
GET and Use Tax exemptions, including for amounts received by a producer of sugarcane from the manufacturer to whom the producer sells the sugarcane, were temporarily suspended for FY2012 and FY2013.

What does this exemption do?

Under this exemption, amounts received by a sugarcane grower from sales to a product manufacturer are not subject to GET. The exemption is only allowed if the grower is an "independent" sugarcane farmer and the manufacturer pays GET on the value of the sugarcane incorporated into the manufacturer's products.

The term "producer" is defined in Section 147-1, HRS and means any person engaged within the state in the growing or production for market of any agricultural commodity or any cooperative association of such persons.

How does this exemption work?

The exemption reduces the tax liability of a sugarcane grower, so long as the raw sugar purchaser (manufacturer of refined products) pays GET based on product prices that are based on the value of the sugar grower's sales. XYZ Farms is an independent grower of sugarcane in Hawai‘i that meets the conditions defined in the statute. XYZ Farms sells $100,000 in sugarcane to ABC Spirits, an alcohol manufacturer. ABC Spirits refines and uses the sugar in products sold for $200,000, which is a price that includes the value of the sugarcane purchased from XYZ Farms. ABC Spirits pays GET on the $200,000. XYZ Farms can exempt the $100,000 in sales to ABC Spirits from its GET liability, reducing XYZ Farms' GET by $500.

What is the purpose of this exemption?

Neither Act 141 of 1935 nor accompanying committee reports provided a rationale for the deduction afforded to sugarcane producers. However, according to Senate Committee Report No. 85 on the bill that became Act 141, SLH 1935, the intent of the broad-sweeping legislation in which the Legislature enacted GET was "to result in the necessary shifting of the tax burdens so as to insure a measure of equality and fairness which is not existent under the present taxation structure."

Senate Committee Report No. 546 on the bill that became Act 229, SLH 1953, stated its purpose was to "correct a situation of double taxation" existing from taxes applied against plantations, or growers and producers of sugar products and further defined the items of produce that were exempt from taxation to accomplish that desired objective.

Is the exemption meeting its purpose?

The exemption appears to be achieving its purpose to the extent that it is utilized to eliminate double taxation in these situations.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

According to DoTax, fewer than 10 entities claimed this exemption in 2018 and 2017, and fewer than 5 entities claimed this exemption in 2019. To protect confidential taxpayer information, DoTax's policy did not allow disclosure of specific claimant data.

Is the exemption necessary to promote or preserve tax equity or efficiency?

By its nature the exemption creates a bias in favor of one class of taxpayer (independent sugarcane producers) and is therefore not necessary to promote tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exemption?

We are unable to determine whether the exemption has directly resulted in any economic or employment benefit. DoTax does not require reporting of the impacts or benefits of this exemption when beneficiaries claim the exemption. Additionally, exemption data was suppressed by DoTax to avoid potential disclosure of confidential taxpayer information. However, sugar production is no longer a large part of Hawai'i's economy. According to the Department of Business, Economic Development and Tourism, Hawaiʻi's last major sugar operation ended in late 2016. In 2017 there were only nine farms producing some sugarcane on only a total of 30 acres.

Should the exemption be retained without modification, amended, or repealed?

We are unable to determine whether this exemption should be retained without data on economic impact; it does appear to achieve the purpose of eliminating double taxation. However, given the industry's limited economic impact, limited number of claimants, and small industry sales, the Legislature should consider whether sugarcane cultivation is still an industry that should be targeted for tax relief.

Issues of concern

The available exemption data, though limited, suggests that the exemption may have minimal economic impact at this point, and it may be advisable to reevaluate whether this exemption continues to promote Hawaiʻi's policy goals in this area. In addition, the exemption lacks definitions and is difficult to understand, which makes it challenging to assess and monitor compliance. For example, the statute requires that "[t]he value or gross proceeds of sale of the sugar...is included in the measure of the tax levied on the manufacturer…", and "[t]he producer's gross proceeds of sales are reduced by reason of the tax on the value or sale of the manufactured products."

Exclusion of amounts received by foster parents (Section 237-24(15))

Exclusion at a Glance (2019)

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	No data available	Yes

What does this exclusion do?

It excludes from GET the money paid by the State or eleemosynary child-placing organizations to foster parents for their care of foster children in their homes.

How does this exclusion work?

The Smith family cares for two foster children. The State pays the Smiths $15,000 a year for their care of the children. Those payments are exempt from GET. The Smiths receive a tax benefit equivalent to $600 for which they would liable if not for the exclusion.

What is the purpose of this exclusion?

According to a 1964 committee report on the bill that resulted in the exclusion, the purpose of the underlying bill was to exempt from GET money paid by the State or child-placing organization to foster boarding parents.

Is the exclusion meeting its purpose?

We found it meets its purpose to the extent it eliminates GET liability for foster parents. However, as DoTax does not require reporting of excluded amounts, we are unable to determine whether all foster parents are using the exclusion.

What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2017–2019?

No specific data is available from DoTax on number of claimants, total amount claimed, or tax expenditure. These amounts are not required to be reported to DoTax. Additionally, DoTax does not consider that this exclusion results in a tax expenditure because according to DoTax, the

History of the Exclusion

- **1964**
  The Legislature established the exclusion because it was unclear whether foster boarding parents who care for children for the state and eleemosynary child-placing organizations were operating a business subject to GET. Among other things, eleemosynary means "of or relating to alms, charity, or charitable donations; charitable."

Legislature never intended payments to foster parents to be included in the GET base. Accordingly there is no associated forgone tax revenue.

Is the exclusion necessary to promote or preserve tax equity or efficiency?

By its nature the exclusion creates a bias in favor of one class of taxpayer (foster parents) and thus is not necessary to promote tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exclusion?

As the purpose of this exclusion is to ease the tax burden on foster parents and ostensibly encourage foster parenting, the exclusion does not appear to be intended to promote any particular economic or employment benefits from such activity.

Should the exclusion be retained without modification, amended, or repealed?

We are unable to determine whether this exclusion should be retained, amended, or repealed. However, this exclusion appears to be grounded in social policy, which is beyond the scope of this review.

Issues of concern

None noted.

Exemption for reimbursements to cooperative housing corporations for operating and maintenance expenses (Section 237-24(16))

Exemption at a Glance (2019)

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$1.42 billion	2,135	$56.83 million	$118.02	Unable to determine

Source: Data based on DoTax data as of September 8, 2020 and Auditor calculation.

Note: DoTax does not segregate the data relating only to this exemption and combines this data with a related exemption from GET for maintenance fees for condominiums and nonprofit homeowners associations contained in Section 237-24.3(2), HRS. Therefore, the above figures and those in the table later in this section contain consolidated amounts for both exemptions. We are scheduled to analyze Section 237-24.3(2), HRS, in 2024.

What does this exemption do?

It exempts proceeds received by cooperative housing corporations[3] for reimbursement of amounts paid for the maintenance and upkeep of cooperatively owned buildings and grounds.

As discussed above, the exemption is comparable to the exemptions provided in Section 237-24.3(2), HRS, exempting amounts received by condominium associations and nonprofit homeowners or community associations for amounts in reimbursement of sums paid for common expenses.

How does this exemption work?

Members of a cooperative housing corporation, XYZ Apartments, pay $1 million in maintenance fees each year to reimburse XYZ Apartments for costs the corporation incurred for maintenance and other related

[3] A cooperative housing corporation is defined in Section 421I-1, HRS, as a corporation that:

(1) Has one and only one class of stock outstanding;

(2) Allows each tenant shareholder to occupy a dwelling unit for dwelling purposes solely by reason of the tenant shareholder's ownership of stock in the corporation;

(3) Does not allow a shareholder to receive, either conditionally or unconditionally, any distributions from the corporation except when there is a complete or partial liquidation of the corporation; provided that this paragraph does not apply to earnings and profits of the corporation; and

(4) Has eighty percent or more of the gross income for the taxable year in which taxes are paid or incurred pursuant to 26 United States Code Section 216(A) derived from tenant shareholders.

History of the Exemption

1965
The Legislature created an exemption for amounts received by a cooperative housing corporation from its shareholders or members in reimbursement of funds paid for the maintenance and upkeep of the cooperative housing building and the premises.

1967
The Legislature amended the statute with language intended to ensure uniform, equitable, and unambiguous application and enforcement.

1968
The Legislature clarified that the original intent of the provision was to exempt from GET revenues received by cooperative housing corporations organized with the sole objective of permitting their stockholders to share in the cost of purchasing, operating, and maintaining land and improvements for residential purposes.

upkeep of common areas. XYZ can exempt this $1 million from GET liability, resulting in a tax savings of $40,000.

What is the purpose of this exemption?

According to a committee report on the underlying bill in 1965 that included several other tax measures, general purposes were to (1) render more efficient the administration of the tax laws of the State; (2) eliminate certain inequities and inconsistencies existing in our tax structure; (3) provide tax relief to certain taxpayers which will stimulate economic development; and (4) secure other social and economic goals enunciated in the "New Hawai'i" program.

A committee report relating to Act 297, SLH 1967, which amended the exemption, clarified the purpose as: "to ensure the uniform and equitable application of the general excise tax law to monies received as reimbursements for costs and advances." It was the intent of the bill that payments made by one person through another without monetary gain to the latter shall not create a taxable incident under the general excise tax law. The bill was intended to place owners of cooperatives and condominiums on a parity with owners of other types of real property interests.

Is the exemption meeting its purpose?

The exemption appears to achieve its purpose of treating property owners under a cooperative housing corporation the same as condominium association members and other real property owners regarding maintenance and common expenses. The exemption also achieves its purpose of precluding GET liability for payments made to cooperative housing corporations by property owners for reimbursement of certain expenses without monetary gain to the latter.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

DoTax does not segregate the data relating to this exemption but rather combines this data with the exemptions for maintenance fees for condominiums in Section 237-24.3(2), HRS. Therefore, the following numbers contain total amounts for both exemptions. Although the data are not segregated, we note that in 2019 there were 1,560 condominium associations, representing 156,352 apartments, registered with the State of Hawai'i, according to the Department of Business, Economic Development and Tourism.

DoTax calculated the amount of the tax expenditure associated with this exemption by multiplying the total amount claimed by the wholesale rate (0.5 percent), considering these to be business-to-business transactions. We calculate the tax expenditure for these exemptions to be the value of the claim multiplied by the associated tax rate that taxpayers claiming the exemptions actually reported on their GET and Use Tax returns (see sidebar "Tax Expenditures: At What 'Cost'?" on page 11).

Based on our review of data compiled by DoTax from the returns filed by the taxpayers claiming the exemptions, most deductions were made at the retail rate (4.0 percent), not the wholesale rate (0.5 percent). Using this methodology, we estimate the tax expenditures for 2017, 2018, and 2019 for this exemption as follows:

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure
2019	2,135	$1.42 billion	$56.83 million	$7.1 million
2018	2,155	$2.57 billion	$102.94 million	$12.88 million
2017	2,000	$1.20 billion	$47.96 million	$6.02 million

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. 2019 figures based on DoTax GET data as of September 8, 2020. Tax expenditure amounts based on Auditor calculation.

Is the exemption necessary to promote or preserve tax equity or efficiency?

This exemption is designed to provide a tax preference to a certain type of ownership structure in an attempt to create equity between cooperative housing corporations and condominium associations and other owners of real property interests, and thus promotes tax equity.

Is there an economic or employment benefit and, if so, does the benefit outweigh the cost of the exemption?

The exemption benefits co-op members by alleviating a tax on their homeowner's association. However, we are unable to determine the extent to which the exemption has directly resulted in any economic or employment benefit to the state. DoTax does not require reporting of the impacts or benefits of this exemption when taxpayers claim the exemption.

Should the exemption be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exemption should be retained, amended, or repealed on economic grounds but as designed it does appear to address the perceived unequal treatment of property owners under a cooperative housing corporation.

Issue of concern

DoTax does not segregate the exemption amounts from condominium and homeowner's associations, which precludes our ability to assess this exemption separately from the related exemption applied to condominium and homeowners' associations. If the Legislature decides that the amounts for cooperative housing corporations should be tracked separately, DoTax would have to implement a mechanism for doing so (e.g., creating separate exemption codes and entries in Schedule GE and the GET return forms).

Exemption for amounts received by Patient-Centered Community Care program contractors (Section 237-24(17))

Exemption at a Glance (2018)

Amount claimed	Number of Unique Claimants	Tax Expenditure	Meeting its Purpose?
$1.28 million	12	$51,334	Unable to determine

Source: DoTax report based on GET data as of June 26, 2020 and Auditor calculation.

Note: In 2019, DoTax began suppressing details regarding the utilization of this exemption.

What does this exemption do?

It exempts amounts received by a Patient-Centered Community Care (PCCC) program contractor used to pay third-party health care providers pursuant to a contract with the federal government. According to DoTax and the U.S. Department of Veterans Affairs, TriWest Healthcare Alliance Corp. (TriWest Alliance) is Hawai'i's PCCC contractor.

How does this exemption work?

Hypothetically, TriWest Alliance received $1 million from the U.S. Department of Veterans Affairs, which was used to pay a local hospital for medical services provided to U.S. military veterans under the PCCC program. TriWest Alliance can exempt $1 million of revenue from its GET liability, resulting in a tax savings of $40,000. This exemption does not allow the hospital, the third-party health care provider, to exempt payments received from TriWest Alliance under this program from GET.

• History of the Exemption

2014
The act established that amounts received by a contractor of the Patient-Centered Community Care program established by the United States Department of Veterans Affairs (VA) pursuant to Title 38, United States Code, are exempt from GET.

Under Title 38, section 8153, United States Code, the VA established a new initiative in September 2013 titled Patient-Centered Community Care. Under this program, VA medical centers will have the ability to purchase non-VA medical care for veterans through contracted medical providers when they cannot readily provide the needed care due to geographic inaccessibility or limited capacity. The purpose and mission of the Patient-Centered Community Care program is to ensure access to high-quality, low-cost health care services for veterans. The program will also help provide VA medical centers with standardized health care quality metrics, timely return of medical documentation, cost avoidance with fixed rates for services across the board, guaranteed access to care, and enhanced tracking and reporting of non-VA medical care expenditures over traditional non-VA medical care services.

Note: This exemption was originally contained in section 237-24(18), HRS; former section 237-24(17), HRS, was repealed pursuant to Act 164, Section 2 (SLH 2013).

What is the purpose of this exemption?

The purpose of Act 143 of 2014 was to increase veterans' access to quality health care by establishing an exemption for amounts received by a contractor of the PCCC program for the costs or advancements to third-party health care providers to avoid increasing the costs of health care services delivered through the PCCC program.

Is the exemption meeting its purpose?

We were unable to determine whether the exemption is meeting its purpose. There were 12 claimants for the exemption in 2018, including several medical offices. However, because TriWest Alliance is the sole PCCC in Hawai'i and this exemption does not apply to or allow third-party health care providers to exempt payments received from TriWest Alliance, the exemption appears to be either mistakenly or improperly claimed by all taxpayers other than TriWest Alliance. We believe additional discussion with and review by DoTax is warranted to examine whether this exemption is being claimed properly.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2017–2019?

DoTax calculated the amount of the tax expenditure associated with this exemption by multiplying the total amount claimed by the wholesale rate (0.5 percent), considering these to be business-to-business transactions. Based on our review of data compiled by DoTax from the returns filed by the taxpayers claiming the exemption for 2018, all exemptions were claimed at the retail rate (4.0 percent), not the wholesale rate. Therefore, we calculate the tax expenditure for these exemptions to be the value of the claim multiplied by the associated tax rate that taxpayers claiming the exemptions actually reported on their GET and Use Tax returns (see sidebar "Tax Expenditures: At What 'Cost'?" on page 11). Using this methodology, we estimate the tax expenditures for 2017 and 2018 for this exemption as follows:

Year	Number of Claims	Amount Claimed	Tax Expenditure	DoTax Tax Expenditure
2019	Confidential*	Confidential*	Cannot be calculated	Confidential*
2018	12	$1.28 million	$51,334	$6,417
2017	18	$931,432	$33,372	$4,657

Source: 2017 and 2018 figures based on DoTax GET data as of June 26, 2020. Tax expenditure amounts based on Auditor calculation.

*For 2019, DoTax changed its data suppression methodology such that specific claimant data for 2019 for this exemption could not be publicly disclosed for taxpayer confidentiality reasons.

Is the exemption necessary to promote or preserve tax equity or efficiency?

By its nature the exemption creates a bias in favor of one class of taxpayer (contractors of the PCCC program) and therefore is not necessary to promote tax equity.

Is there an economic or employment benefit and if so, does the benefit outweigh the cost of the exemption?

We are unable to determine whether the exemption has directly resulted in any economic or employment benefit. DoTax does not require reporting of the impacts or benefits of this exemption when beneficiaries claim the exemption.

Should the exemption be retained without modification, amended, or repealed?

There is insufficient data to determine whether this exemption should be retained, amended, or repealed.

Issues of concern

Only one contractor, TriWest Alliance, is the Hawai‘i PCCC, and as such is the only taxpayer entitled to claim the exemption. The fact that there are multiple claimants for the exemption suggests that the exemption may be erroneously or improperly used by any taxpayer other than TriWest Alliance.

Additionally, DoTax's instructions for claiming the exemption refer to Section 237-24(18) as the underlying statute rather than Section 237-24(17). The section cited no longer exists. In response to our inquiries, DoTax acknowledged the discrepancy and said the incorrect reference should not impact claim validity. However, as the instructions may cause confusion and uncertainty as to whether the exemption is allowed, a correction should be made.

Recommendations

1. For new tax credits, exemptions, and exclusions, the Legislature should include (1) a clear statement of the purpose of the tax provision and (2) objective criteria to determine whether the tax preference is meeting that purpose. As part of our reviews, we are to determine, among other things, whether the tax provision "has achieved and continues to achieve the purpose for which it was engaged by the Legislature." Without a statement of legislative intent for each tax provision, as well as specific metrics to assess whether the provision is meeting the intended purpose, we will not be able to report important information for many provisions and likely cannot assess whether the benefit outweighs the cost of the preference.

   A similar approach has been taken by the State of Washington, whose legislature has noted this type of additional detail, such as demographics to be used to measure effectiveness, is important to facilitating future reviews of its tax preferences.

2. For the same reasons, the Legislature should amend current tax credits, exemptions, and exclusions to include (1) a clear statement of the purpose of the tax provision and (2) objective criteria to determine whether the tax preference is meeting that purpose.

3. Taxpayers claiming an exemption from GET or Use Tax should be required to provide specific data as part of any filing to demonstrate how the tax preference supports business growth. For example, businesses could be required to attest to and provide documentation on the number of jobs, the total amount in wages, or other metrics directly related to a preference that is intended to provide an economic or employment benefit to the State. Such information would yield important data we need to provide more meaningful information about the actual benefits associated with a particular tax preference that the Legislature can consider as it evaluates whether to retain, modify, or repeal the provision.

4. Exemption of gross income of real property lessees received from sublessees (Section 237-16.5, HRS):

   As noted above, DoTax does not require taxpayers claiming this exemption to file Form G-71, which is the lessor's certification that the lessor will be subject to GET on the gross proceeds or gross income received from the lessee/sublessor. Requiring the certification to be filed would likely improve compliance with the requirement that lessors furnish a completed Form G-71 and assist verification when necessary.

We also note the 2015 and 2019 versions of the instructions for this exemption contained errors wherein claimants were told to provide lessor information on an incorrect section of the GET form. DoTax said this should not have impacted the validity of the claims and that the incorrect reference would be corrected.

5. Exemption of value or gross income of nonprofit organizations from conventions, conferences, trade shows, and display spaces (Section 237-16.8, HRS):

   DoTax does not automatically verify that taxpayers claiming this exemption are nonprofit organizations under section 501(c)(3) of the U.S. Internal Revenue Code of 1986, as amended, which is a qualification for use of this exemption. We recommend that taxpayers claiming this exemption be required to provide verification of nonprofit status.

6. Exclusion of proceeds earned from annual senior citizen's fairs (Section 349-10, HRS):

   DoTax should attempt to identify whether and to what extent this exclusion is being claimed to determine whether it achieves its purpose. In addition, the statute does not clearly define what constitutes "proceeds earned from this fair." For example, it is not clear if proceeds earned by vendors that sell goods, food and drink, or services are included. Some guidance, via a Tax Information Release or other bulletin, would be advisable, especially since this exclusion is not required to be reported to DoTax and therefore is not tracked. If the exemption is meant to apply to vendor revenue, DoTax should consider requiring vendors to claim these amounts on Schedule GE in order to track usage and to discourage abuse.

   During our review, we were told by an organizer of an annual senior citizen's fair on Maui that not all booth fees were excluded from GET by the fair organizer, which was funded under a county grant. However, under Section 349-10, HRS, it appears all booth revenue, including that of vendors, are treated as casual sales and therefore should be excluded from GET. Again, DoTax guidance on how this exclusion should be utilized would clarify this issue.

7. Exemption of amounts received by blind, deaf, or totally disabled persons from their business (Section 237-24(13), HRS):

   DoTax does not automatically verify that claimants meet qualifications for eligibility. However, according to DoTax, the department is in the process of configuring its computer system to do automated enforcement; we recommend they complete and implement this process.

Section 237-17, HRS, which establishes that GET assessed on a business or other activities of individuals who are blind, deaf, or totally disabled shall not exceed 0.5 percent of receipts, appears to provide more meaningful tax relief for intended beneficiaries. In fact, that provision essentially ensures that this exemption should be claimed at the 0.5 percent rate, which results in negligible tax relief. If the Legislature wants to retain this exemption, it should consider whether exempted income should be limited to just the first $2,000 as that cap was established in 1947, and reduces GET by only ten dollars.

Separate from our review of the GET and Use Tax filings, we note that some claims made under this exemption were for improper (non-disabled) business activity categories, some of which were taxable at the higher 4.0 percent retail GET rate. DoTax should review the appropriateness of such claims, as it appears these taxpayers may be erroneously claiming the exemption or claiming the exemption at the wrong rate. Some guidance, via a Tax Information Release or other bulletin might be advisable given these apparent issues.

8. Exemption of amounts received by independent cane farmers who are sugarcane producers (Section 237-24(14), HRS):

   The available exemption data, though limited, suggests that the exemption may have minimal economic impact at this point, and it may be advisable to reevaluate whether this exemption continues to promote Hawai‘i’s policy goals in this area. In addition, the exemption lacks definitions and is difficult to understand, which makes it challenging to assess and monitor compliance. For example, the statute requires that “[t]he value or gross proceeds of sale of the sugar...is included in the measure of the tax levied on the manufacturer…”, and “[t]he producer’s gross proceeds of sales are reduced by reason of the tax on the value or sale of the manufactured products.” We recommend that the statute be reviewed and revised for clarity.

9. Exemption for reimbursements to cooperative housing corporations for operating and maintenance expenses (Section 237-24(16), HRS):

   DoTax does not segregate the exemption amounts from condominium and homeowner’s associations, which precludes our ability to assess this exemption separately from the related exemption applied to condominium and homeowners’ associations. If the Legislature decides that the amounts for cooperative housing corporations should be tracked separately, DoTax would have to implement a mechanism for doing so (e.g., creating separate exemption codes and entries in Schedule GE and the GET return forms).

10. Exemption for amounts received by Patient-Centered Community Care program contractors (Section 237-24(17), HRS):

    Only one contractor, TriWest Alliance, is the Hawai‘i PCCC, and as such is the only taxpayer entitled to claim the exemption. The fact that there are multiple claimants for the exemption suggests that the exemption may be erroneously or improperly used by any taxpayer other than TriWest Alliance.

    Additionally, DoTax's instructions for claiming the exemption refer to Section 237-24(18) as the underlying statute rather than Section 237-24(17). The section cited no longer exists. In response to our inquiries, DoTax acknowledged the discrepancy and said the incorrect reference should not impact claim validity. However, as the instructions may cause confusion and uncertainty as to whether the exemption is allowed, a correction should be made.

11. Finally, we recommend that the following exclusions be removed from future review, pursuant to Section 23-71(c), HRS:

    a. Exclusion of proceeds earned from annual senior citizen's fairs (Section 349-10, HRS); and

    b. Exclusion of amounts received by foster parents (Section 237-24(15), HRS).

    These exclusions eliminate taxes on activities the Legislature did not intend to include in the broad GET base. As a result, these tax provisions do not have an associated "tax expenditure" cost. In addition, DoTax does not require claimants to file GET returns or other documents to exclude revenue from those activities. Because revenues excluded are not reported, there is no data upon which to assess these provisions. Therefore, unless DoTax requires claimants to report the revenues they are excluding under these provisions, future review of these provisions is not warranted. If, however, the Legislature determines that it would like these provisions to be assessed, the Legislature should direct DoTax to report and track data associated with the use of the exclusions.

Appendix A

Schedule of Tax Statutes for Review

Sections 71-81, HRS
Sections 91-96, HRS

Deadline	HRS Ref.	Statute to be reviewed	Notes
2021 Sess.	23-73	237-16.5	Gross income of real property lessees from sublessees
		237-16.8	Value or gross income of nonprofit organizations from conventions, conferences, trade shows, and display spaces
		349-10	Proceeds earned from annual senior citizen's fairs
		237-23.5	Amounts received from common payments of related entities
		237-24(13)	Amounts received by blind, deaf, or totally disabled persons from their business
		237-24(14)	Amounts received by independent cane farmers who are sugarcane producers
		237-24(15)	Amounts received by foster parents
		237-24(16)	Reimbursements to cooperative housing corporations for operating and maintenance expenses
		237-24(17)*	Amounts received by TRICARE managed care support contractors
		237-24(18)	Amounts received by Patient-Centered Community Care program contractors
	23-92	235-12.5	Credit for renewable energy technology system installed and placed in service in the State. For the purpose of section 23-91(b)(5), this credit shall be deemed to have been enacted for an economic benefit
		241-4.6	Credit for renewable energy technology system installed and placed in service in the State. For the purpose of section 23-91(b)(5), this credit shall be deemed to have been enacted for an economic benefit
		235-17	Credit for qualified production costs incurred for a qualified motion picture, digital media, or film production

* This exemption was not reviewed because this section was repealed on Dec. 1, 2018 under Act 164, SLH 2013

Report Date	HRS Ref.	Statute to be reviewed	Notes
2022 Sess.	23-74	239-2, paragraph (5)	Definition of "gross income" – Gross income of home service providers of mobile telecommunications services
		239-2	Exclusions under the definition of "gross income" – Dividends paid by one member to another member of an affiliated public service company group or gross income from the sale or transfer of materials and supplies, interest on loans, and provision of services among members of an affiliated public service company group
		237-3(b)	Gross receipts from the sale or transfer of materials and supplies, interest on loans, and provision of services among members of an affiliated public service company group
		239-5.5	Gross income of utilities from monthly surcharges
		239-6.5	Tax credit for lifeline telephone service subsidies
		269-172	Green infrastructure charges received by electric utilities
		237-29.7	Gross income or gross proceeds received by insurance companies
		431:7-207	Tax credit to facilitate regulatory oversight
		432:1-403	Exemption for nonprofit medical indemnity or hospital service associations or societies specifically from the general excise tax, public service company tax, or insurance premium tax
		432:2-503	Exemption for fraternal benefit societies specifically from the general excise tax, public service company tax, or insurance premium tax
	23-93	235-7.3	Exclusion of royalties and other income derived from a patent, copyright, or trade secret of a qualified high technology business
		235-9.5	Exclusion for income and proceeds from stock options or stocks of a qualified high technology business or a holding company for a qualified high technology business
		235-17.5	Credit for capital infrastructure costs
		241-4.4	Credit for capital infrastructure costs
		235-110.7	Credit for capital goods used by a trade or business
		241-4.5	Credit for capital goods used by a trade or business
		235-110.91	Credit for research activity
		235-110.3	Credit for ethanol facility
		241-3.5	Deduction for adjusted eligible net income of an international banking facility

Report Date	HRS Ref.	Statute to be reviewed	Notes
2023 Sess.	23-75	237-24.3(1)	Amounts received from loading, transporting, and unloading agricultural commodities shipped interisland
		237-24.3(3)(A)	Amounts received from cargo loading or unloading
		237-24.3(3)(B)	Amounts received from tugboat and towage services
		237-24.3(3)(C)	Amounts received from the transportation of pilots or government officials and other maritime-related services
		238-1, paragraph (7)	Definition of "use" – The value of oceangoing vehicles for transportation from one point to another in the State
		238-3(g)	The value of imported intoxicating liquor and cigarettes and tobacco products for sale to persons or common carriers in interstate commerce
		238-3(h)	The value of vessels constructed under section 189-25, relating to commercial fishing vessel loans, prior to July 1, 1969
		237-28.1	Gross proceeds from shipbuilding and ship repair
	23-94	235-4.5(a)	Exclusion of intangible income earned by a trust sited in this State
		235-4.5(b)	Exclusion of intangible income of a foreign corporation owned by a trust sited in this State
		235-4.5(c)	Credit to a resident beneficiary of a trust for income taxes paid by the trust to another state
		235-55	Credit for income taxes paid by a resident taxpayer to another jurisdiction
		235-129	Credit for income taxes paid by a resident taxpayer to another jurisdiction
		235-71(c)	Credit for a regulated investment company shareholder for the capital gains tax paid by the company
		235-110.6	Credit for fuel taxes paid by a commercial fisher
		235-110.93	Credit for important agricultural land qualified agricultural cost
		235-110.94	Credit for organically produced agricultural products
		235-129(b)	Credit to a shareholder of an S corporation for the shareholder's pro rata share of the tax credit earned by the S corporation in this State
		209E-10	Credit for a qualified business in an enterprise zone; provided that the review of this credit pursuant to this part shall be limited in scope to income tax credits

Report Date	HRS Ref.	Statute to be reviewed	Notes
2024 Sess.	23-76	237-24.3(4)	Amounts received by employment benefit plans and amounts received by nonprofit organizations or offices for the administration of employee benefit plans
		237-24.3(5)	Amounts received from food coupons under the federal food stamp program or vouchers under the Special Supplemental Foods Program for Women, Infants and Children
		237-24.3(6)	Amounts received from the sale of prescription drugs or prosthetic devices
		237-24.3(8)	Amounts received as dues by unincorporated merchants associations for advertising or promotion
		237-24.3(9)	Amounts received by labor organizations from real property leases
		237-24.75(2)	Reimbursements to the Hawaii convention center operator from the Hawaii Tourism Authority
		237-24.75(3)	Reimbursements to professional employer organizations from client companies for employee wages and fringe benefits
		209E-11	Amounts received by qualified businesses in enterprise zones
	23-95	235-5.5	Deduction for individual housing account deposit
		235-7(f)	Deduction of property loss due to a natural disaster
		235-16.5	Credit for cesspool upgrade, conversion, or connection
		235-19	Deduction for maintenance of an exceptional tree
		235-55.91	Credit for the employment of a vocational rehabilitation referral
		235-110.2	Credit for in-kind services contribution for public school repair and maintenance
		235-110.8	Credit for ownership of a qualified low-income housing building
		241-4.7	Credit for ownership of a qualified low-income housing building
2025 Sess.	23-77	237-24.3(2)	Reimbursements to associations of owners of condominium property regimes or nonprofit homeowners or community associations for common expenses
		237-24.5**	Amounts received by exchanges or exchange members
		237-25(a)(3)	Gross income received from tangible personal property sales to state-chartered credit unions
		237-24.8	Amounts received by financial institutions, trust companies, trust departments, or financial corporations acting as interbank brokers
		237-26	Gross proceeds of scientific contractors and subcontractors
		238-3(j)	The value of property or services exempted by section 237-26, relating to scientific contracts
		237-27	Amounts received by petroleum product refiners from other refiners
	23-96	235-15	Credit for purchase of child passenger restraint system
		235-55.6	Credit for employment-related expenses for household and dependent care services
		235-55.7	Credit for a low-income household renter
		235-55.85	Credit for food and excise tax

** This exemption was reviewed in the report to the 2020 Legislature

Report Date	HRS Ref.	Statute to be reviewed	Notes
2026 Sess.	23-78	237-24.7(1)	Amounts received by hotel operators and hotel suboperators for employee wages and fringe benefits
		237-24.7(2)	Amounts received by a county transportation system operator under a contract with the county
		237-24.7(4)	Amounts received by orchard property operators for employee wages and fringe benefits
		237-24.7(6)	Amounts received from insurers for damage or loss of inventory of businesses located in a natural disaster area
		237-24.7(7)	Amounts received by community organizations, school booster clubs, and nonprofit organizations for precinct and other election-related activities
		237-24.7(8)	Interest received by persons domiciled outside the State from trust companies acting as payment agents or trustees on behalf of issuers or payees of interest-bearing instruments or obligations
		237-24.7(9)	Amounts received by management companies from related entities engaged in interstate or foreign common carrier telecommunications services for employee wages and fringe benefits
		237-24.7(10)	Amounts received from high technology research and development grants
	23-92	235-12.5	Credit for renewable energy technology system installed and placed in service in the State. For the purpose of section 23-91(b)(5), this credit shall be deemed to have been enacted for an economic benefit
		241-4.6	Credit for renewable energy technology system installed and placed in service in the State. For the purpose of section 23-91(b)(5), this credit shall be deemed to have been enacted for an economic benefit
		235-17	Credit for qualified production costs incurred for a qualified motion picture, digital media, or film production

Report Date	HRS Ref.	Statute to be reviewed	Notes
2027 Sess.	23-79	237-27.5	Gross proceeds from air pollution control facility construction, reconstruction, operation, use, maintenance, or furnishing
		238-3(k)	The value of air pollution control facilities
		237-27.6	Amounts received by solid waste processing, disposal, and electric generating facility operators under sale and leaseback transactions with political subdivisions that involve the facilities
		237-29	Gross income of qualified persons or firms or nonprofits or limited distribution mortgagors for certified or approved low-income housing projects
		238-3(j)	The value of property, services, or contracting exempted by Section 237-29, relating to certified or approved housing projects
		431:7-208	Credit for low-income housing
		46-15.1(a)	Gross income from county low-income housing projects
		346-369	Compensation received by provider agencies for homeless services or homeless facility management
	23-93	235-7.3	Exclusion of royalties and other income derived from a patent, copyright, or trade secret of a qualified high technology business
		235-9.5	Exclusion for income and proceeds from stock options or stocks of a qualified high technology business or a holding company for a qualified high technology business
		235-17.5	Credit for capital infrastructure costs
		241-4.4	Credit for capital infrastructure costs
		235-110.7	Credit for capital goods used by a trade or business
		241-4.5	Credit for capital goods used by a trade or business
		235-110.91	Credit for research activity
		235-110.3	Credit for ethanol facility
		241-3.5	Deduction for adjusted eligible net income of an international banking facility

Report Date	HRS Ref.	Statute to be reviewed	Notes
2028 Sess.	23-80	237-29.5	Value or gross proceeds from tangible personal property shipped out of State
		237-29.53	Value or gross income from contracting or services performed for use outside the State
		238-1, paragraph (9)	Definition of "use" – The value of services or contracting imported for resale, consumption, or use outside the State
		237-29.55	Gross proceeds or gross income from the sale of tangible personal property imported into the State for subsequent resale
	23-94	235-4.5(a)	Exclusion of intangible income earned by a trust sited in this State
		235-4.5(b)	Exclusion of intangible income of a foreign corporation owned by a trust sited in this State
		235-4.5(c)	Credit to a resident beneficiary of a trust for income taxes paid by the trust to another state
		235-55	Credit for income taxes paid by a resident taxpayer to another jurisdiction
		235-129	Credit for income taxes paid by a resident taxpayer to another jurisdiction
		235-71(c)	Credit for a regulated investment company shareholder for the capital gains tax paid by the company
		235-110.6	Credit for fuel taxes paid by a commercial fisher
		235-110.93	Credit for important agricultural land qualified agricultural cost
		235-110.94	Credit for organically produced agricultural products
		235-129(b)	Credit to a shareholder of an S corporation for the shareholder's pro rata share of the tax credit earned by the S corporation in this State
		209E-10	Credit for a qualified business in an enterprise zone; provided that the review of this credit pursuant to this part shall be limited in scope to income tax credits

Report Date	HRS Ref.	Statute to be reviewed	Notes
2029 Sess.	23-81	237-23(a)(3)	Fraternal benefit societies, orders, or associations for the payment of benefits to members
		237-23(a)(4)	Corporations, associations, trusts, or societies: (A) Organized and operated exclusively for religious, charitable, scientific, or educational purposes; (B) Operating senior citizens housing facilities qualifying for loans under the United States Housing Act of 1959, as amended; (C) Operating legal service plans; or (D) Operating or managing homeless facilities or other programs for the homeless
		237-23(a)(5)	Business leagues, chambers of commerce, boards of trade, civic leagues, agricultural and horticultural organizations, and organizations operated exclusively for the benefit of the community or promotion of social welfare, including legal service plans
		237-23(a)(6)	Hospitals, infirmaries, and sanitaria
		237-23(a)(7)	Tax-exempt potable water companies serving residential communities lacking access to public utility water services
		237-23(a)(8)	Agricultural cooperative associations incorporated under state or federal law
		237-23(a)(9)	Persons affected with Hansen's disease and kokuas with respect to business within the county of Kalawao
		237-23(a)(10)	Corporations, companies, associations, or trusts organized for cemeteries
		237-23(a)(11)	Nonprofit shippers
	23-95	235-15	Credit for purchase of child passenger restraint system
		235-55.6	Credit for employment-related expenses for household and dependent care services
		235-55.7	Credit for a low-income household renter
		235-55.85	Credit for food and excise tax

Report Date	HRS Ref.	Statute to be reviewed	Notes
2030 Sess.	23-72	237-3(b)	Gross receipts from the following: (A) Sales of securities; (B) Sales of commodity futures; (C) Sales of evidences of indebtedness; (D) Fee simple sales of improved or unimproved land; (E) Dividends; and (F) Sales or transfers of materials and supplies, interest on loans, and provision of services among members of an affiliated public service company group
		237-13(3)(B)	Gross income of contractors from subcontractors
		237-13(3)(C)	Reimbursements to federal cost-plus contractors
		237-13(6)(D)(i),(ii), (iii), and (iv)	Gross receipts of home service providers acting as service carriers
		237-24.3(11)	Amounts received from aircraft and aircraft engine rental or leasing
		237-24.9	Amounts received from aircraft servicing and maintenance and aircraft service and maintenance facility construction
		238-1, paragraph (6)	Definition of “use” – The value of aircraft leases or rental and acquired or imported aircrafts and aircraft engines
		238-1, paragraph (8)	Definition of “use” – The value of material, parts, or tools for aircraft service and maintenance and aircraft service and maintenance facility construction

Appendix B

Impact on "Low-Income Residents"

Section 23-71, HRS, also requires us to estimate the "annual cost of the exemption [or] exclusion... per low-income resident of the State." The statute defines "low-income resident" as a state resident who is (1) the only member of a family of one and has an income of not more than 80 percent of the area median income for a family of one; or (2) part of a family with an income of not more than 80 percent of the area median income for a family of the same size. Applying this definition, there were an estimated 481,524 "low-income residents" statewide in 2018 based on data provided by the Department of Business, Economic Development and Tourism.

The results of this evaluation follow and only include costs for the tax provisions with reportable data.

Cost of Exemptions and Exclusions per "Low-Income Resident"

Statute	Tax Incentive	2019 Cost	Cost per "Low-Income Resident"
Section 237-16.5	Gross income of real property lessees from sublessees	$ 7,020,155	$ 14.58
Section 237-16.8	Value or gross income of nonprofit organizations from conventions, conferences, trade shows, and display spaces	$ 699,930	$ 1.45
Section 237-23.5	Amounts received from common payments of related entities	Confidential	Cannot be calculated
Section 237-24(13)	Amounts received by blind, deaf, or totally disabled persons from their business	$ 18,530	$ .04
Section 237-24(16)	Reimbursements to cooperative housing corporations for operating and maintenance expenses	$ 56,827,950	$ 118.02
Section 237-24(18)	Amounts received by Patient-Centered Community Care program contractors	Confidential	Cannot be calculated

Source: Office of the Auditor

Although we conducted this analysis using the formula set forth by statute, we question whether the results above represent the value to "low-income residents" of repeal of a particular exemption or exclusion. Although money generated from repealing a particular exemption or exclusion will likely increase tax revenues, the impact of the additional funds will not automatically accrue a benefit to "low-income residents," in particular, but to all residents. Therefore, to the extent that the Legislature considers a tax credit or rebate to low-income residents to offset this cost, a more accurate representation of impact may be to divide the amount of cost by all residents, not just low-income residents. The amount of the cost per resident will impact lower-income residents more than higher-income residents.

The following table contrasts 2019 GET data with Hawai‘i’s total 2018 population of 1,420,491 people.

Cost of Exemptions per Hawai‘i Resident

Statute	Tax Incentive	2019 Cost	Cost per Hawai‘i resident
Section 237-16.5	Gross income of real property lessees from sublessees	$ 7,020,155	$ 4.94
Section 237-16.8	Value or gross income of nonprofit organizations from conventions, conferences, trade shows, and display spaces	$ 699,930	$ 0.49
Section 237-23.5	Amounts received from common payments of related entities	Confidential	Cannot be calculated
Section 237-24(13)	Amounts received by blind, deaf, or totally disabled persons from their business	$ 18,530	$ .01
Section 237-24(16)	Reimbursements to cooperative housing corporations for operating and maintenance expenses	$ 56,827,950	$ 40.01
Section 237-24(18)	Amounts received by Patient-Centered Community Care program contractors	Confidential	Cannot be calculated

Source: Office of the Auditor

Department of Taxation's Response to Draft Copy of Report

ON MARCH 15, 2021, we transmitted a draft of this report to the Department of Taxation and did not receive a response. A copy of the transmittal letter is included as Attachment 1.

STATE OF HAWAI‘I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai‘i 96813-2917

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State Auditor

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March 15, 2021

VIA EMAIL ONLY **(Tax.Directors.Office@hawaii.gov)**

The Honorable Isaac W. Choy
Interim Director, Department of Taxation
Princess Ruth Ke‘elikōlani Building
830 Punchbowl Street, Room 221
Honolulu, Hawai‘i 96813

Re: DRAFT copy of (1) *Review of General Excise and Use Tax Exemptions and Exclusions* and (2) *Review of Income and Financial Institutions Tax Credits*

Dear Director Choy:

Attached for your review is a draft copy of the Auditor's:

1. *Review of General Excise and Use Tax Exemptions and Exclusions Pursuant to Section 23-73, Hawai‘i Revised Statutes*; and

2. *Review of Income and Financial Institutions Tax Credits Pursuant to Section 23-92, Hawai‘i Revised Statutes*.

Please let us know by March 19, 2021 whether your department plans to provide comments on one or both of the draft reports, and if so, provide such comments by **March 23, 2021**. We would appreciate separate comments for each report.

As these are draft reports, we request that these reports be kept confidential within your department. Also, please let us know by **March 19, 2021** whether or not you or your staff would like to schedule a teleconference to discuss the drafts. If so, we will be glad to set something up.

If you have any questions, please feel free to contact project supervisor Chuck Narikiyo via email at chuck.narikiyo@hawaii.gov.

Thank you for your consideration.

Very truly yours,

Leslie H. Kondo
State Auditor

CTN:SLH:emo
Attachments
cc/attach: Seth S. Colby, Tax Research and Planning Officer (Seth.S.Colby@hawaii.gov)
Ted Shiraishi, Rules Officer (ted.s.shiraishi@hawaii.gov)