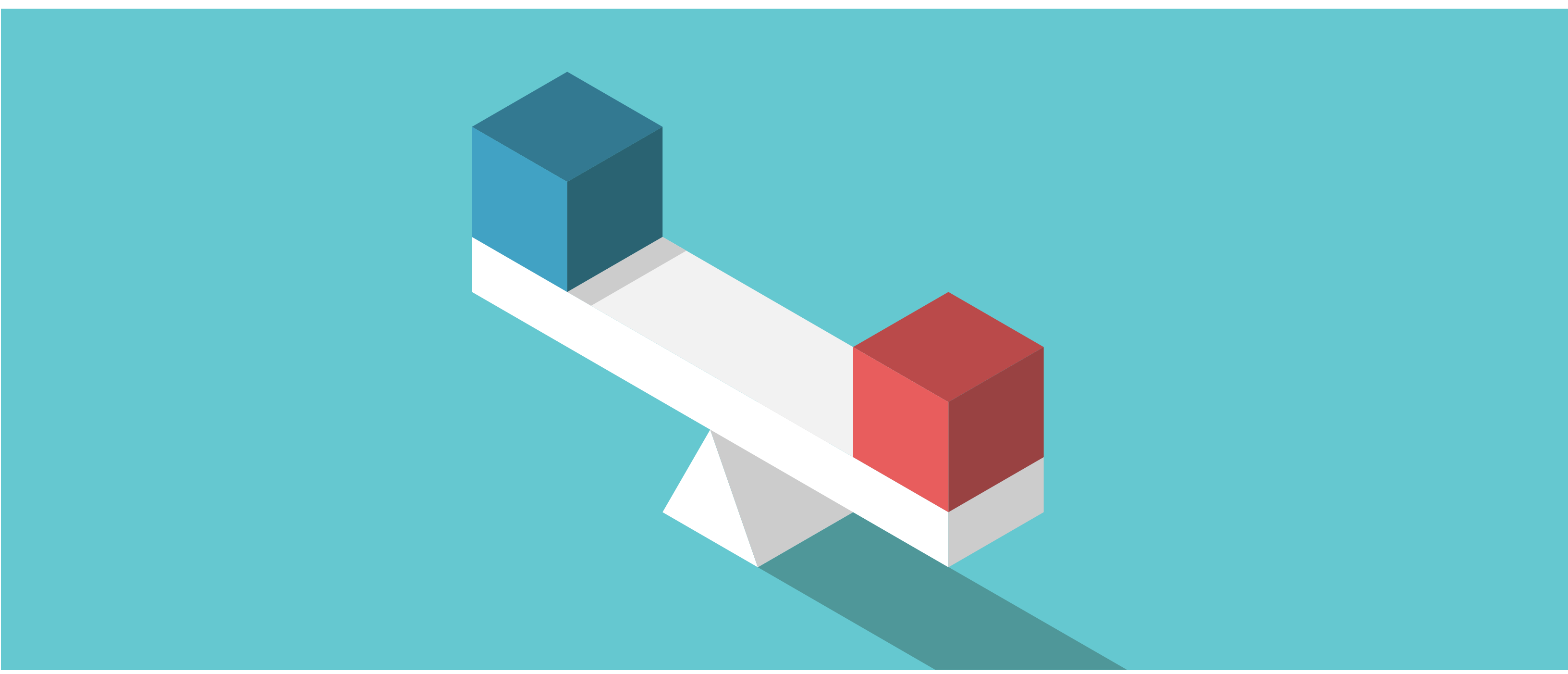
Review of Tax Provisions Pursuant to Section 23-74, Hawai‘i Revised Statutes

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

Report No. 22-06
June 2022



OFFICE OF THE AUDITOR
STATE OF HAWAI‘I

OFFICE OF THE AUDITOR
STATE OF HAWAIʻI

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawaiʻi State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor's position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawaiʻi Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

Our Mission

To improve government through independent and objective analyses.

We provide independent, objective, and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management, and expenditure of public funds.

Our Work

We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

Additionally, we perform procurement audits, sunrise analyses and sunset evaluations of proposed regulatory programs, analyses of proposals to mandate health insurance benefits, analyses of proposed special and revolving funds, analyses of existing special, revolving and trust funds, and special studies requested by the Legislature.

We report our findings and make recommendations to the governor and the Legislature to help them make informed decisions.

For more information on the Office of the Auditor, visit our website:
https://auditor.hawaii.gov

Foreword

This report assesses certain Hawai‘i tax exemptions, exclusions, and credits under the General Excise Tax, Use Tax, Public Service Company Tax, and Insurance Premium Tax. Section 23-71 et seq., Hawai‘i Revised Statutes, requires the Auditor to annually review tax provisions on a 10-year recurring cycle.

We express our appreciation to the Department of Taxation; Legislative Reference Bureau; Department of Business, Economic Development and Tourism; Public Utilities Commission; and the Department of Commerce and Consumer Affairs for their assistance in providing data and other information for this report.

Leslie H. Kondo
State Auditor

Table of Contents

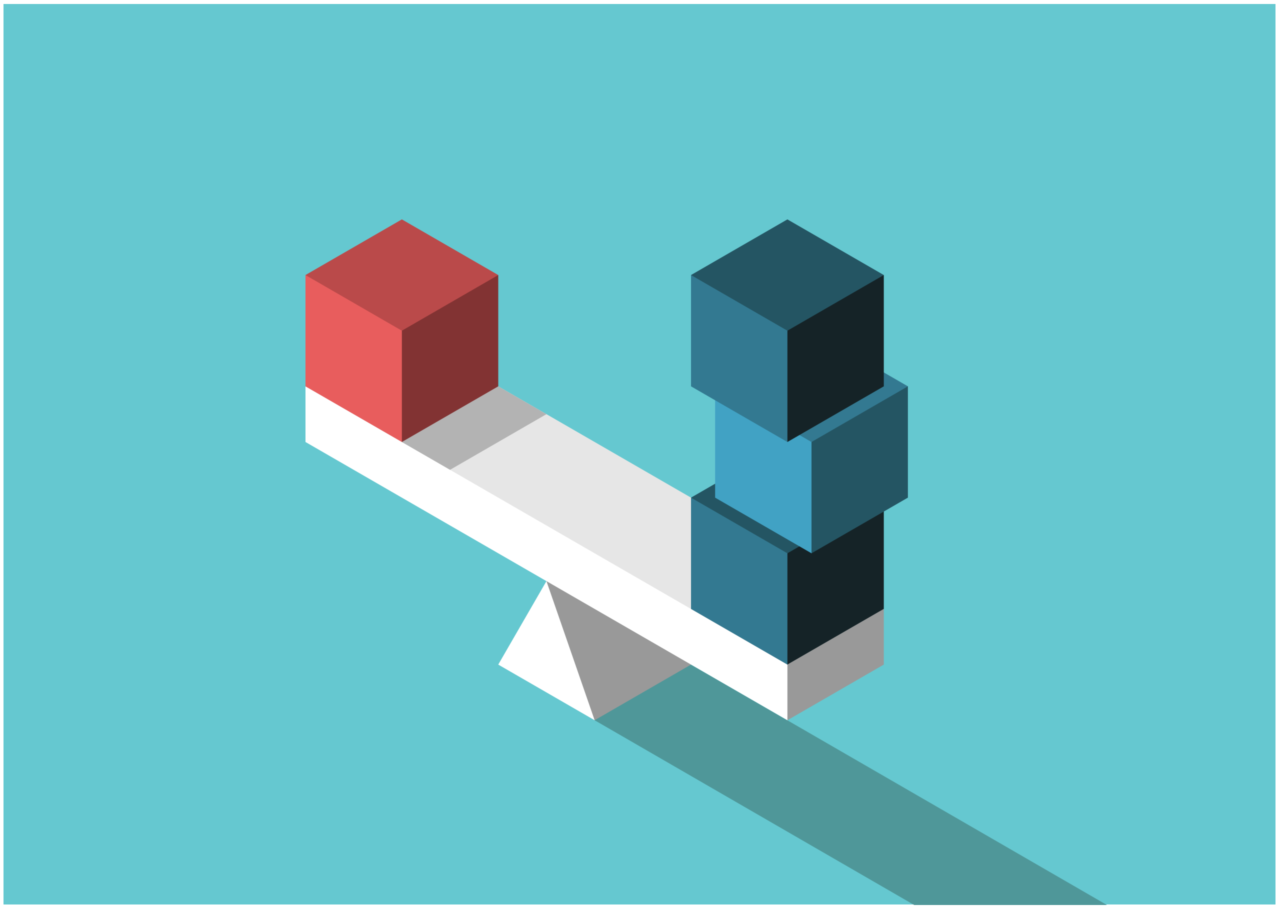


ILLUSTRATION: ISTOCK.COM

Review of Tax Provisions Pursuant to Section 23-74, Hawai‘i Revised Statutes

Introduction

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

In 2020, we also began annually reviewing credits, exclusions, and deductions provided under the Income Tax and Financial Institutions Tax on a five-year recurring cycle established under section 23-91 et seq., HRS.

The analysis and recommendations in this report aim to inform policymakers about the purposes, costs, and benefits of various tax provisions to allow for improved policymaking.

The analysis and recommendations in this report aim to inform policymakers about the purposes, costs, and benefits of various 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, taken in concert, apply to nearly all business activities in Hawai‘i. In fiscal year (FY) 2021, which ended June 30, 2021, GET and Use Tax revenues accounted for $3.08 billion, or nearly 38 percent of the total tax revenue of $8.17 billion.

Lawmakers often choose to exempt or exclude certain revenues from taxation to promote social and economic goals, or for tax efficiency or equity purposes. 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 Auditor, noted that tax exemptions, exclusions, and credits reduce revenue to the state. This requires all taxpayers, including those who do not directly benefit from the exemptions, exclusions, and credits, to compensate for the reduced revenue or, alternatively, 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 the Auditor's reviews "necessary to promote tax equity and efficiency, adequacy of state revenues, public transparency, and confidence in a fair state government."

As an initial comment, we note that it was difficult to determine the purposes of the tax provisions reviewed and what outcomes the Legislature intended the tax provisions to achieve without any clear indication by the Legislature in the statute, the bills that created the provisions, or the laws' legislative histories.

Therefore, we recommend the Legislature clearly articulate the purpose of each tax provision and establish specific metrics to measure the provision's effectiveness, which will permit a more thorough and meaningful analysis when we review these provisions in the future. We further recommend that the following three exclusions be removed from the schedule of future reviews:

1. Exclusion on Gross Receipts of Home Service Providers Acting as Service Carriers (Section 239-2, paragraph (5) of the definition of "gross income", HRS);

2. Exclusion for Dividends 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 (Utility) Service Company Group (Section 239-2, HRS); and

3. Exclusion for Green Infrastructure Charges Received by Electric Utilities (Section 269-172, HRS).

As explained below, DoTax considers these exclusions to represent revenue that is not meant to be subject to taxation and therefore should not be considered a "tax expenditure."[1] Taxpayers are not required to report excluded amounts to DoTax. For that reason, DoTax does not compile information about the use of these three 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 for use in Hawai'i from other states and foreign countries. The two taxes are complementary: GET is paid by a person or entity that receives revenue from business activity conducted in the state, while Use Tax is paid by a person or entity importing goods, services, or contracting into the state from a seller that is *not* subject to GET. The Use Tax is intended to remove any tax advantage that businesses outside of the state may have with respect to goods and services used in Hawai'i by taxing goods and services that are purchased outside of Hawai'i and imported for use or resale.

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 FY2021, 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 on revenue received primarily 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, renting

[1] See sidebar, "Tax Expenditures: At What Cost?" on page 12 for a detailed explanation of tax expenditures.

Tax Pyramiding

The wholesale rate, the retail rate, and tax “pyramiding”

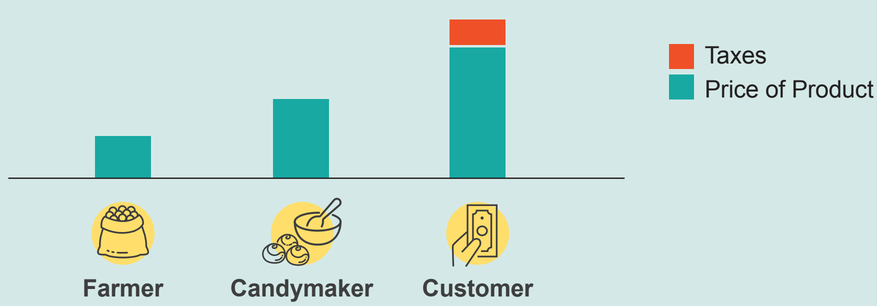
HAWAI‘I’S GET is applied to the receipts or income from business activities in the state, including both wholesale and retail transactions. GET is imposed on goods or services of each separate entity involved in the chain of production and distribution starting with revenue from the sale of the raw materials and ending in the eventual sale to the retail consumer. This is in contrast to a sales tax, which is typically levied only at the retail level. The imposition of tax at multiple levels results in a “tax on a tax,” commonly referred to as tax pyramiding.

Having a tax on a tax often results in higher total costs to the consumer. For example, when a farmer sells macadamia nuts to a candymaker, the farmer’s revenue from the sale is subject to GET. The farmer will often include the amount of its GET liability in the price of the macadamia nuts. The candymaker incorporates the macadamia nuts in its candy and is subject to GET on the revenues from the sale of the candy to customers. The retail price of the candy will often include the cost of the macadamia nuts, which includes the farmer’s GET liability, as well as the amount the candymaker must pay in GET on the revenue from the sale of the candy.

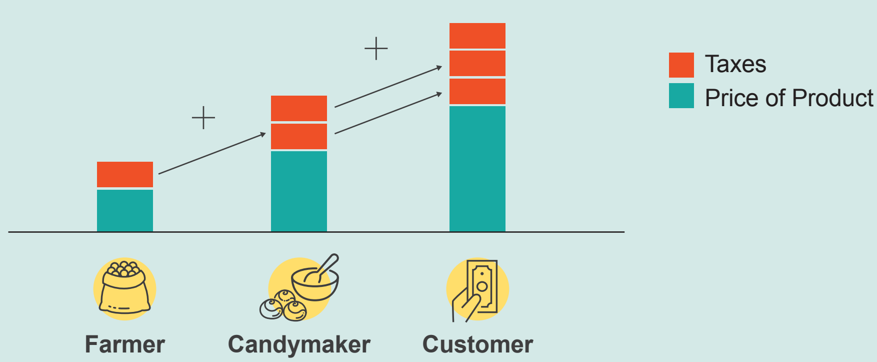
In order to reduce the effects of tax pyramiding, Hawai‘i imposes a lower GET rate (0.5 percent) on wholesale, or business-to-business, transactions of goods or services intended for resale. The retail GET rate (4.0 percent) is generally applied only at the consumer level.

The Effect of Pyramiding Under a General Excise Tax

Sales Tax on Final Consumption



General Excise Tax



or leasing real or personal property, business interest income, commissions (except insurance commissions), theaters and amusements.

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 page 11 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 that are purchased from persons or entities outside Hawai‘i (who are not required to pay GET) and imported for use or resale in the state.

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 importer’s own use or consumption.

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

Since January 2007, the City and County of Honolulu has imposed a 0.5 percent GET and Use Tax surcharge to help fund its mass transit system. Hawai‘i and Kaua‘i counties have adopted 0.25 percent and 0.5 percent surcharges on revenue from business activities in their respective counties, both of which took effect in 2019. There is no surcharge on revenues from activity exempted from GET or Use Tax. Therefore, in addition to reducing state tax revenue, exemptions and exclusions from GET and Use Tax also reduce the amount of taxes collected by those counties that have imposed a surcharge.

Other Taxes Referenced in this Report

Insurance Premium Tax (Section 431:7-202, HRS)

The Insurance Premium Tax is a tax on insurance companies authorized to do business in Hawai‘i, based on premiums written from risks to property or residents situated or located in the state. As explained by DoTax, this tax is paid in lieu of all taxes except real property tax and taxes on the purchase, use, or ownership of tangible personal property. The tax rate varies from 2.75 percent for life insurance policies to 4.265 percent for certain other lines of insurance.

The Insurance Premium Tax is administered and collected by the State Insurance Commissioner, who is required to remit and report amounts of all taxes collected to DoTax. In FY2021, the State collected $185.34 million in Insurance Premium Tax.

Public Service Company Tax (Chapter 239, HRS)

The Public Service Company Tax is based on a percentage of a public utility's income earned during the preceding taxable year. The tax is imposed at different rates depending upon the source of the income, ranging from 0.5 percent to 5.35 percent. The Public Service Company Tax is administered by DoTax and is in lieu of all other taxes except income tax, county vehicular tax, public utility franchise taxes, use or consumption taxes, and employment taxes. During FY2021, the State collected $125.2 million in Public Service Company Tax. Public utilities are also subject to a separate public utility fee that is administered by the Public Utilities Commission (PUC).

Tax Credits

Tax credits reduce a taxpayer's tax liability and can apply to various taxes including, as discussed in this report, income taxes, taxes on insurance premiums, and taxes on income earned by public utilities. Hawai'i's first tax credit was established in 1957 to avoid double taxation of income. Since then, numerous tax credits have been enacted. Most of them are designed to promote social welfare or to encourage development of certain industries or economic activities.

Because tax credits are direct reductions from tax liability, they are considered more valuable to taxpayers than ordinary deductions, which reduce taxable income. Tax credits may be refundable or nonrefundable. If a tax credit is nonrefundable, it can provide a tax benefit only to the extent that the taxpayer has a tax liability, reducing the liability by the amount of the credit. If the amount of the credit exceeds the filer's tax liability in a particular year, the unused portion of nonrefundable credits generally can be carried forward and applied to future years' taxes. In contrast, the taxpayer is assured of receiving the full amount of a refundable tax credit in the year it is claimed, because if the tax credit exceeds the tax liability, the state pays the taxpayer the difference. Neither of the tax credits reviewed in this report are refundable.

How We Got GET: General Excise Tax in Hawai'i

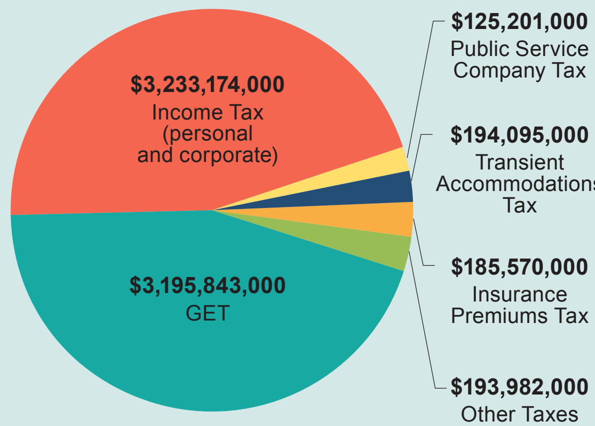
HAWAI'I'S GET, like most sales taxes across the country, is a product of the Great Depression. While the Territory of Hawai'i did not experience the level of unemployment and economic distress experienced by industrialized areas of the United States, falling land values during the early 1930s led to a drop in real and personal property tax revenue, which were then the mainstays of the Hawai'i 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 Hawai'i. In 1935, the Legislature replaced the business excise tax with GET, which taxed the proceeds of sales of goods and services in Hawai'i.

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. Although the adoption could be viewed as a concession to some of Hawai'i'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," or "tax base," at $123.72 million, or 33 percent of the Territory's 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),

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

State of Hawai'i General and Other Governmental Funds Tax Revenues by Type, FY2021



Source: 2021 Audit of the Annual Comprehensive Financial Report of the State of Hawai'i

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.

Today, the retailing and service industries are still the breadwinners for the state when it comes to GET. For FY2021, DoTax reported that retailing had a tax base of $33.7 billion, or 34 percent of the total tax base, with services at $15.34 billion, or 16 percent of the tax base.

In FY2021, the State General Fund, which is the State's chief operating fund, realized a total of $7.13 billion in tax revenue. Most of that revenue came from two taxes: GET and net income tax. The net income tax collections, which are comprised of both individual and corporate income tax revenues, represent Hawai'i's largest tax revenue source and accounted for $3.23 billion. GET, the fund's second largest tax revenue source, accounted for $3.2 billion, or 45 percent of total general fund tax revenue. The Transient Accommodations Tax, or hotel room tax, the State's third-largest revenue source, accounted for $194.1 million.

Analysis of Reviewed Tax Provisions

What did we review?

This report reviews a total of nine tax provisions, which include four exemptions, three exclusions from GET, and two tax credits. We obtained data on total aggregated amounts claimed for the two tax credits; however, according to DoTax, data regarding the number of claims was not available.

Under section 23-74, HRS, we also were to analyze the exclusion for 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 under section 237-3(b), HRS. We previously reviewed that exclusion in Report No. 20-09, *Review of General Excise and Use Tax Exemptions and Exclusions*, issued in June 2020.

What did we find?

We could not determine whether three GET exemptions and one tax credit were achieving their purpose. We also determined that one exemption, three exclusions, and one tax credit were at least partially meeting their stated or inferred purposes. As we note above, making conclusions as to whether purposes are being met is extremely challenging (and often impossible) when amounts claimed are not tracked or where no benchmarks or metrics are set forth in statute to assess whether a provision is achieving its intended purpose.

Assessment Challenges: Lack of Data on Cost, Causation

Many challenges hindered our ability to report information and analyze the exemptions, exclusions, and tax credits in the manner 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. Additionally, DoTax generally does not track exemptions or tax credits applied against the Public Service Company Tax or the Insurance Premium Tax.

While the department’s Tax System Modernization project has allowed for better data collection, DoTax currently does not capture additional specific information we need to more meaningfully assess the exemptions from GET and Use Tax, the Public Service Company Tax, and the Insurance Premium 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

Tax Equity and Efficiency: Finding the Balance

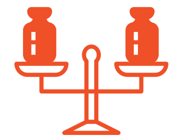
WE ARE REQUIRED to assess whether the tax provisions reviewed are necessary to promote or preserve tax equity or efficiency, however, Hawai'i Revised Statutes do not define these terms. Rather, our analysis was informed by criteria developed by the U.S. Joint Committee on Taxation and from the U.S. Government Accountability Office, as detailed in the Association of International Certified Professional Accountants publication *Guiding Principles of Good Tax Policy: A framework for evaluating tax proposals.*

According to that framework, tax *efficiency* is the principle that a tax system should not unduly impede or reduce the productive capacity of the economy.

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, while the concept of vertical equity provides that a person with the greater ability to pay should pay more tax.

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. However, a tax provision meant to improve tax efficiency for one group of taxpayers can result in less equitable treatment of other taxpayers. For example, an exemption designed to increase economic activity in a certain industry or geographic area will reduce tax equity by providing favorable tax treatment to these activities. Therefore, lawmakers must carefully balance both principles to optimize tax policy.

As there is no standard definition for the terms "tax equity" or "tax efficiency," and because section 23-91, HRS does not define those terms, the Auditor's ability to determine whether reviewed tax provisions were necessary to promote tax equity or efficiency was a challenge. Further, the statutes establishing the framework of the Auditor's tax provision reviews do not establish the perspective from which a tax provision impacts on tax equity and efficiency should be evaluated. Accordingly, our analysis did not specifically address questions of either "equity" or "efficiency."



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

also hindered our ability to estimate the amounts of tax expenditures for the current and next two calendar years. Without that data and the specialized training and knowledge to forecast economic trends, we determined any projection on the future cost of exemptions and credits would be too speculative and unreliable to be included in this report. As data continues to be collected, we may reach a point in the future where meaningful projections can be made; because DoTax only recently began collecting data, that point is likely to be some years away.

We were further challenged to determine the purpose or intent of some exemptions and exclusions. The legislative acts that created the exemptions and exclusions often lack a clear statement of the purpose or intent of the provisions, or the desired outcomes that could be used to measure achievement of the intended purpose. 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 or other criteria against which effectiveness of the provisions are to be measured.

In addition, an analysis of economic or employment benefits compared against forgone tax revenue, or cost-benefit analysis, was hampered by a variety of other factors. Businesses that benefit from these exclusions, exemptions, and credits at most are required to provide amounts claimed to DoTax, if at all. Moreover, we were unable to share taxpayer names and other confidential tax return data with other relevant state agencies to, for example, independently identify and verify employment and payroll data for taxpayers claiming exemptions that may be intended to stimulate local employment. Taxpayers do not otherwise report to DoTax data on jobs, wages, or 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 benefits 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 Hawai‘i employment or economic gains and the use of these exemptions.

Finally, we conducted an analysis of the impact of the tax provisions on “low-income residents” using the formula provided in the statute. However, we question whether the calculations represent 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 confer a benefit upon low-income residents, in particular, but to all residents. Further discussion, as well as our calculations, can be found in Appendix B.

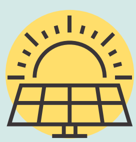
An additional concern is that the term tax expenditure is not defined in Hawai‘i’s tax laws or in section 23-71, HRS, which mandated this review. The side bar on the following page explains how tax exemptions and exclusions generally work. However, as noted in previous reports, the

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 according to DoTax 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 therefore not subject to taxation.



For example, the exclusion on green infrastructure charges received by electric utilities (Section 269-172, HRS) excludes green infrastructure charges collected by an electric public utility from the definition of revenue for purposes of GET, the Public Service Company Tax, the Public Utility Fee, and the Public Utility Franchise Tax. The green infrastructure charge refers to a fee paid to a state loan program that helps eligible customers reduce electricity costs by installing approved energy improvements such as solar photovoltaic (PV) systems, solar hot water systems and/or commercial energy efficiency retrofits, which are repaid through the customer's electric bill. Green infrastructure charges received for the use and services of the loan program, including the repayment of loans made under the loan program, are not kept by the utilities and instead are passed on to the state and deposited into the Hawai'i Green Infrastructure Special Fund. The exclusion ensures that green infrastructure charges collected by electric utilities, acting merely as collection agents on behalf of the state, are not subject to taxation.

EXEMPTIONS

Exemptions refer to revenues from taxable activities or goods that, for policy purposes, are not subject to taxation. Tax exemptions often, but not always, have associated tax expenditures.

For example, contractors can deduct payments made to subcontractors from their gross revenue and avoid GET liability on those amounts. The exemption for amounts paid by contractors to subcontractors shifts payment of GET at the 4 percent retail rate on those amounts to the subcontractor, effectively eliminating the pyramiding of GET. The Legislature hoped that the reduced taxes paid by general contractors would lower the cost of housing. Our Report No. 20-09 issued in June 2020 estimated that in 2018 the exemption resulted in a nearly $21 million tax expenditure.

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

Auditor and DoTax have different interpretations of what constitutes a tax expenditure. This report considers a tax expenditure to be the amount of tax revenue forgone as a result of a tax provision. See “Tax Expenditures: At What ‘Cost’?” below. However, the issue does not directly impact this report, as the tax expenditure figures available for this report are in the nature of tax credits, not exclusions or exemptions.

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.”* However, determining the true “cost” of a given tax exemption or exclusion is difficult.

The 2019 DoTax report lists exemptions that DoTax categorizes as tax expenditures at the wholesale rate (0.5%) and the retail rate (4.0%), and also lists exemptions that DoTax does not consider to be tax expenditures, but may represent forgone opportunities to shift the tax burden to non-Hawai‘i residents.

Additionally, DoTax does not consider certain provisions to result in “tax expenditures” and therefore does not include them in their report. For example, the exclusion on receipts of home service providers acting as service carriers (Section 239-2, paragraph (5) of the definition of “gross income”, HRS) excludes certain revenue to align with a federal framework for taxing mobile communications based on a customer’s home service area. Therefore, DoTax does not consider the amounts excluded under this provision to be tax expenditures.

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.*

Exclusion on Gross Receipts of Home Service Providers Acting as Service Carriers (Section 239-2, paragraph (5) of the definition of "gross income", HRS)

Exclusion at a Glance

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	Cannot be calculated	Yes

Relevant Legislative History

2002
Act 209, SLH 2002, excluded revenue from wholesale sales of mobile telecommunication services made between home service providers from both the Public Service Company Tax and GET and conformed the state tax code to the federal Mobile Telecommunications Sourcing Act of 2000, which mandated a new method of sourcing revenue received by wireless telecommunications companies in order to create a uniform method of taxing such communications across taxing jurisdictions. Under the new rules, calls are sourced to a customer's business or residential address, whichever is the customer's place of primary use. The Act was intended to simplify filing and reporting for home service providers.

What does this exclusion do?

Wireless telecommunication companies are licensed by the Federal Communications Commission (FCC) to provide services in specific geographic areas, referred to as licensed "home service areas." "Home service provider" refers to the wireless telecommunication company that serves customers within a specific home service area. When a customer uses services outside of these home service areas, the home service provider must purchase service from a company licensed in those service areas (known as a "service carrier") in order to connect the call. The home service provider for that call is, and only is, the one in which the customer primarily uses services (i.e., the home service area), regardless of whatever jurisdiction the call originates, terminates, or passes through.

The exclusion on gross receipts of home service providers acting as service carriers essentially works in reciprocal situations to this example by allowing Hawai‘i wireless telecommunications companies to avoid paying the Public Service Company Tax and GET on revenue from wholesale sales of mobile telecommunication services to wireless companies whose home service areas are outside of the state and whose customers make calls in Hawai‘i. Hawai‘i adopted the Public Service Company Tax and GET exclusions to accommodate the new federal mobile communications tax framework created by the Mobile Telecommunications Sourcing Act.

How does this exclusion work?

Aloha Telephone, a hypothetical Hawai‘i-based mobile telecommunication provider, sells telephone services to CalTelcom, a hypothetical company licensed by the FCC to provide mobile telecommunication services in California, to connect a wireless telephone call from a CalTelcom customer visiting Hawai‘i. Aloha Telephone's revenue for acting as a service carrier, (i.e., the revenue from selling the wireless services to CalTelcom), is not subject to either the Public Service Company Tax or GET. Because of the exclusion, Aloha Telephone does not report revenue from the sale of services to CalTelcom for purposes of the Public Service Company Tax or GET.

However, when a Aloha Telephone customer makes a call while outside Hawaiʻi, Aloha Telephone must purchase time from another carrier, one licensed by the FCC to provide services in the area where the call is originating, to complete the call. The customer pays Aloha Telephone for the call, and that revenue is subject to GET.

What is the purpose of this exclusion?

The legislative history of the exclusion indicates the purpose is to simplify filing and reporting of long-distance wireless calls to conform Hawaiʻi law to the federal Mobile Telecommunications Sourcing Act of 2000, which mandated a method of taxing the revenue received by wireless telecommunications companies and clarified state taxing authority of the wireless telecommunications industry.

Is the exclusion meeting its purpose?

Because DoTax does not require taxpayers claiming this exclusion to report the amount of the excluded revenue on tax filings, there is no data regarding the provision's utilization. However, given that Hawaiʻi had an average of 188,348 visitors a day during the second quarter of 2021, according to Department of Business, Economic Development and Tourism, coupled with the relatively common and widespread use of wireless telephones, the exclusion appears to be meeting its purpose by conforming taxation of such calls to a national framework for taxing mobile communication services.

What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2018-2020?

As a result of this exclusion, Hawaiʻi mobile telecommunication providers are not required to report the revenue derived from selling services to non-Hawaiʻi wireless communication providers. Therefore, there is no associated data available as to the number of Hawaiʻi mobile telecommunication providers that claim the exclusion or total amount excluded. DoTax does not consider the amounts excluded under this provision to be tax expenditures.

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

We determined that the primary purpose is not for any specific economic or employment benefit. Rather, the exclusion aligns Hawaiʻi tax law to the federal mobile communications tax framework.

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

Because the exclusion appears to conform Hawai‘i tax law to the federal mobile telecommunications tax law, we recommend this exclusion be retained. Without the exclusion, Hawai‘i's tax law would conflict with federal law.

Exclusion for Dividends 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 (Utility) Service Company Group (Section 239-2, HRS)

Exclusion at a Glance

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	Cannot be calculated	Yes

Relevant Legislative History

1977
Act 26, SLH 1977, amended the definition of “gross income” and “gross proceeds of sales” to exclude dividends paid and gross receipts from various sales and transfers by one member of an “affiliated public service company group” to another member of the same group.

What does this exclusion do?

This exclusion allows public service companies that are members of the same affiliated public service company group to exclude revenue from dividends and certain intercompany transactions from the Public Service Company Tax. “Affiliated public service company group” is defined as an affiliated group of domestic corporations in which all of the members are public service companies (e.g., public utilities).

How does this exclusion work?

Aloha Electric Company and Mahalo Power, Inc., two fictional Hawai‘i companies, provide electrical service to Kāne‘ohe and Ko Olina, respectively. Both are public utilities, as defined under Hawai‘i law, and subject to the Public Service Company Tax. Mahalo Power, Inc. is a subsidiary of Aloha Electric Company and purchases 10 transformers from Aloha Electric Company for $50,000. Aloha Electric Company’s revenue from the sale of the transformers ($50,000) is not subject to the Public Service Company Tax or GET.

What is the purpose of this exclusion?

According to a committee report on the bill that created this exclusion, the purpose is to eliminate the taxation of certain intercompany transactions between affiliated public utility companies. Before Act 26, DoTax had interpreted the law to require public utilities to pay the Public Service Company Tax on dividends received from an affiliated public utility company. As a result, affiliated public utilities were the only corporations in the state required to pay a tax on the dividends received from affiliated companies. In addition to dividends, transactions between a parent utility and a subsidiary were also subject to the Public Service Company Tax. Prior to Act 26, taxes on intercompany transactions could be avoided by eliminating the legal status of the subsidiary companies and operating them as divisions of the parent company. However, the Legislature felt, as expressed by the House Committee on Consumer Protection and Commerce, that public utilities and their consumers should not be penalized merely because of the corporate structure of the companies.

Is the exclusion meeting its purpose?

Public utilities claiming the exclusion are not required to report the amount of revenues from dividends and certain intercompany transactions excluded from the Public Service Company Tax. For that reason, we do not know whether the exclusion is used. However, to the extent that it is used, we believe the exclusion achieves the Legislature's intent.

What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2018-2020?

As noted above, public utilities claiming the exclusion are not required to report the amount of dividends or other revenue from transactions with affiliated public service companies on their Public Service Company Tax or GET filings. As such, DoTax has no data as to the number of public utilities using the exclusion or the amount those companies have excluded from revenues subject to the Public Service Company Tax. DoTax does not consider the amounts excluded under this provision to be tax expenditures.

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

We determined that the primary purpose of this exclusion is not for any specific economic or employment benefit. Further, we are unable to quantify what tax savings resulted from the exclusion, or whether any such savings resulted in any reduction of costs to the customers of public utility companies.

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

Given its purpose and that the provision serves to exclude from taxation the types of revenue from intercompany transactions that all other non-utility companies enjoy, we recommend this exclusion be retained.

Exemption for Monthly Surcharge Assessments Collected by a Utility from Ratepayers in Emergency Situations (Section 239-5.5, HRS)

Exemption at a Glance

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	Cannot be calculated	Unable to determine

Relevant Legislative History

1993
Act 337, SLH 1993, created the exemption for surcharge assessments collected by one utility for another utility in response to the impacts of Hurricane Iniki, which devastated Kaua'i but left the rest of the Hawaiian islands relatively unharmed. The Legislature found that damages sustained during state-declared emergency situations such as natural disasters may affect different regions of the state more harshly than others. To more equitably share the costs of reparations in direct response to Hurricane Iniki, and in consideration of the potential for future disasters, the Legislature found that there was a compelling need for all of Hawai'i's people to assist Kaua'i's electric and telephone utility ratepayers in the cost to rebuild Kaua'i's electric and telephone infrastructure.

What does this exemption do?

Under section 269-16.3, HRS, any public utility that sustains damage to its facilities as a result of a state of emergency and incurs costs related to the restoration and repair of its facilities may seek PUC approval to recover the costs through a monthly surcharge that is assessed on a *statewide* basis.

The exemption applies to the public utilities that did not sustain damage to their facilities but collect the surcharge from their customers for the utility that sustained damage. The surcharge assessments received by a public utility serving only as a collector are not considered "gross income" and are exempt from the Public Service Company Tax. Any amounts retained by a utility for collection or other costs are not included in the exemption.

How does this exemption work?

Kaua'i Power, a hypothetical public electric utility serving the island of Kaua'i, experiences damage to its power grid as a result of a tsunami. The PUC approves the utility's request to recover the restoration and repair costs through a monthly surcharge from the customers of all electric utilities in the state. Public electric utilities on O'ahu, Maui, and Hawai'i Island collect a monthly surcharge of $1 on their customers for Kaua'i Power, generating revenues of $300,000, $100,000, and $90,000, respectively. Under section 239-5.5, HRS, the surcharge revenues collected by the O'ahu, Maui, and Hawai'i utilities and transmitted to Kaua'i Power are not subject to the Public Service Company Tax.

What is the purpose of this exemption?

The legislative history underlying the surcharge assessments notes the purpose of the assessments is to distribute the cost to restore and repair public utility-owned equipment incurred as a result of a state-declared emergency among all the public utility customers on a statewide basis. We infer that this exemption was aimed to facilitate the collection of any surcharges by exempting from taxation the monies collected by a utility that are simply passed on to another utility whose equipment was damaged by an emergency.

Is the exemption meeting its purpose?

According to the PUC, no utility has used section 269-16.3, HRS, to recover the costs to restore and repair facilities damaged during a natural disaster or other emergency since its adoption 29 years ago. According to the PUC, there have been only two times that a public utility could have sought approval to assess the surcharge – once by water carrier Young Brothers, LLC, which sought some post-COVID-19 pandemic rate relief, and once when Kaua‘i Electric applied for post-Hurricane Iniki relief. With regard to post-Hurricane Iniki damage, the affected utility did not qualify to charge the surcharge, according to the PUC. With regard to Young Brothers, the PUC approved a temporary rate increase for the company instead.

While the exemption has not been used to date, it does appear that the exemption would facilitate the collection of any surcharge assessed to utility customers statewide to help defray the cost to repair damage incurred by another public utility from state-declared emergencies if the need were to arise, which is its purpose.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2018-2020?

According to the PUC, this exemption has never been utilized.

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

We determined that the exemption potentially would provide an economic benefit for customers of a utility that collects monthly surcharge assessments by eliminating taxes on the pass-through revenue. Those taxes likely would be calculated into future rates charged to customers in non-affected areas.

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

We determined the exemption should be retained. However, because no utility has utilized the exemption, we cannot determine whether the exemption should be modified. We do recognize that, by exempting the surcharge revenue from the Public Service Company Tax, the provision does allow public utilities that are acting only as the collection agent for the affected public utility to forward all the surcharge revenues to the utility to fund the recovery efforts caused by a state-declared emergency without incurring any associated Public Service Company Tax liability, which appears to be the legislative intent.

Tax Credit for Lifeline Telephone Service Subsidies (Section 239-6.5, HRS)

Tax Credit at a Glance (2019)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$27,000	Data not available*	$27,000	5.7 cents**	Yes

* Note: DoTax stated that claims data was unavailable.
** The number of low-income residents used is 472,574 per Department of Business, Economic Development and Tourism data.

Relevant Legislative History

1986
Act 116, SLH 1986, created the tax credit for Lifeline Telephone Service Subsidies. The credit was to be equal to the Lifeline Telephone Service costs incurred by the utility.

Hawai‘i’s Lifeline Assistance Program (Lifeline Program) provides elderly and disabled residential telephone subscribers whose annual income is less than $10,000 a discount on their monthly service charges for basic landline telephone or internet services provided by Hawai‘i providers designated by the PUC as Eligible Telecommunications Carriers. The Lifeline Program can be used to subsidize either phone or internet service, but not both at once.

Hawai‘i’s Lifeline Program is distinct from a federal Lifeline Program established by the Federal Communications Commission and supported by the Universal Service Fund in 1985. The federal Lifeline Program was originally designed to assist eligible low-income households to subsidize monthly voice telephone service charges, but in 2005 the program was modified to cover either a fixed line or a mobile/wireless service. In 2016 the federal Lifeline Program was further expanded to support mobile and fixed broadband Internet access services on a stand-alone basis or with a bundled voice service.

What does this tax credit do?

Section 239-6.5, HRS, provides a non-refundable tax credit to an Eligible Telecommunications Carrier (ETC) authorized to establish a Lifeline Program service rate. The tax credit reduces the Public Service Company Tax that an ETC must otherwise pay by the amount of the forgone revenues and the administrative costs of providing the discounted service.

The tax credit is claimed on the ETCs’ Public Service Company Tax Return, and the amount of the credit is certified by the PUC. When we first asked the PUC for details on their certification process, the agency responded that it did not have an established, uniform process in place. In response to our inquiries about certification of these claims, the PUC subsequently adopted a standardized certification form to be filled out annually by ETCs claiming the credit. The PUC reviews and certifies the amount of the credit, then forwards the completed form to DoTax as proof of certification. According to the PUC, the credit reflects (1) forgone revenues based on Lifeline Program credits issued to qualified customers, and (2) administrative costs for processing Lifeline Program renewal applications, postage, and portions of annual federal and state Lifeline Program newspaper advertisements aimed at promoting customer awareness of the program.

Six Hawai‘i ETCs are authorized to provide Lifeline Program services, according to the PUC.

What is the purpose of this tax credit?

The purpose of this credit is to provide a means for funding Lifeline Program services by allowing telephone public utilities a tax credit, equal to their respective Lifeline Program subsidized service costs, which is then to be applied against the ETC's Public Service Company Tax liability. According to a conference committee report on the bill that created the credit, the committee found that many people with low and limited incomes are significantly dependent on telephone service to maintain communication with public agencies and providers of medical care, as well as to retain necessary social contacts in the community. The committee found the concept of Lifeline Program services to be highly commendable and that it should be made available to persons with low and limited incomes in the face of rising telephone service costs. However, the committee decided that Lifeline Program services should be limited, and the law identifies "the elderly with limited income and the handicapped with limited income."

Is the tax credit meeting its purpose?

According to DoTax, the tax credit was claimed by PUC-approved ETCs for Lifeline Program services provided to 1,130 customers as of the end of calendar year 2019, and the cumulative amount claimed by these ETCs was $27,000. While some ETCs appear to be providing Lifeline Program services and therefore the credit is to that extent meeting its purpose of subsidizing the provision of Lifeline Program services, we did not make a determination as to the extent to which the tax credit has had any effect on the use of Lifeline Program services among those eligible to receive them.

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

Year	Number of Claims	Amount Claimed	Tax Expenditure
2019	Data not available*	$27,000	$27,000
2018	Data not available*	$34,000	$34,000
2017	Data not available*	$43,000	$43,000

* Note: DoTax stated that claims data was unavailable.

Source: DoTax report based on net income tax, Insurance Premium Tax, and the Public Utilities Tax filing data as of September 2021

Although the number of claimants for the credit is unavailable, DoTax reported that the tax credit was claimed on behalf of 1,130 subscribers as of the end of calendar year 2019. Claims for the credit and associated subscriber numbers have steadily fallen since 2000 when claims were about $170,000 and there were about 8,500 subscribers. According to DoTax, the decline was explained by the fact that the Lifeline Program's eligible income level never increased despite increasing inflation and resident income.

Apart from the Hawai‘i Lifeline Program, the federal Lifeline Program for eligible low-income households had 8,301 Hawai‘i subscribers as of January 2022. That equated to 7 percent of the estimated 121,135 households eligible for the subsidy.

Is there an economic or employment benefit to Hawai‘i and if so, does the benefit outweigh the cost of the credit?

We determined that this provision is not for any specific economic or employment benefit, but to assist and support implementation of a social program.

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

Based on the total amount of the tax credit claimed in 2017, 2018, and 2019, the number of customers who are receiving Lifeline Program services appears to be modest, at best. In fact, according to DoTax, Hawai‘i Lifeline Program subscriber numbers have fallen from more than 8,000 in 2000 to less than 2,000 in 2019, primarily because eligible income levels have not changed.

The Legislature or the PUC may wish to consider whether the tax credit or public awareness efforts should be changed in order to better achieve the purpose of subsidizing services for the elderly and the handicapped with low or limited income, and to consider the effect of increased use of wireless phone services since 1986. Additionally, the Legislature should consider increasing the eligibility income level above the current $10,000 maximum and provide Lifeline Program services to more people who the Legislature may determine to be low-income and in need of assistance for these services.

Exclusion for Green Infrastructure Charges Received by Electric Utilities (Section 269-172, HRS)

Exclusion at a Glance

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	Cannot be calculated	Yes

Relevant Legislative History

2013
Act 211, SLH 2013 created a Hawai‘i Green Infrastructure Authority to administer, among other things, a Green Infrastructure Financing Program to help electricity ratepayers adopt clean energy technology. The Act included this exclusion on green infrastructure charges, which are the on-bill charges associated with the loan program.

What does this exclusion do?

The exclusion for Green Infrastructure Charges Received from Electric Utilities excludes green infrastructure charges collected by an electric public utility from the definition of revenue for purposes of GET, the Public Service Company Tax, the Public Utility Fee, and the Public Utility Franchise Tax. The green infrastructure charge refers to the on-bill charges associated with a loan program that provides eligible electric utility customers State-provided loans. Customers that receive such loans then hire private companies to install approved energy improvements such as solar PV systems, solar hot water systems, and/or commercial energy efficiency retrofits, which are repaid through the customer’s electric bill. The loans and other related costs are repaid to the State through charges on the customers’ utility bills.

The Hawai‘i Green Infrastructure Authority (Authority) administers the loan program, which is known as the Green Energy Money $aver (GEM$) on-bill program. The loan program was created to provide financing options to renters, homeowners, nonprofits and small business owners who may not meet requirements for traditional financing but want to install solar PV, solar hot water systems, or energy efficiency retrofits.

Hawai‘i’s electric public utilities serve as the billing and collection agents for the green infrastructure charge. Currently, there are three public utilities (Hawaiian Electric Company, Hawai‘i Electric Light Company, and Maui Electric Company) that bill and collect green infrastructure charges. The loan program is not yet available to Kauai Island Utility Cooperative customers. Green infrastructure charges are deposited into the Hawai‘i Green Infrastructure Special Fund administered by the Authority.

How does this exclusion work?

Hawaiian Electric Company and its subsidiaries collect green infrastructure charges from customers on behalf of the Authority, according to the PUC. Hawaiian Electric Company and its subsidiaries act as pass-through entities and transfer the charges they collect to the Hawai‘i Green Infrastructure Special Fund created under section 196-65, HRS. Under the exclusion the charges collected are not subject to taxation.

What is the purpose of this exclusion?

The primary purpose of the Act was to establish a regulatory financing structure to authorize low-cost financing through a program that would make green infrastructure installations accessible and affordable in order to achieve measurable cost savings, and meet Hawai‘i’s clean energy goals. The exclusion ensures that the green infrastructure charges collected by electric utilities from their customers on behalf of the Authority are not subject to taxation. According to the Authority, as of September 30, 2019, it has committed more than $90 million in GEM$ capital towards the program.

Is the exclusion meeting its purpose?

We determined that the exclusion is meeting its purpose by excluding from taxation amounts collected on behalf of the Authority and passed through to the special fund. We did not assess the loan program, including whether the loan program is meeting its purposes.

What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2018-2020?

We note that there are only three public utilities (Hawaiian Electric Company, Hawai‘i Electric Light Company, and Maui Electric Company) eligible to claim this exclusion. These utilities are not required to report the amount of green infrastructure charges they collect from utility customers on behalf of the Authority. We note that, in FY2019, the special fund had $4.52 million in revenue and an ending balance of $114.59 million. Special fund revenues include loan fees, contractor application fees, late charges on loans, and interest on bank deposits.

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

We determined that the primary purpose is not for any specific economic or employment benefit.

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

As this exclusion prevents taxation of revenues that are collected by the electric utilities on behalf of the Authority and passed through to the state, we determined the exclusion should be retained.

Exemption of Gross Income or Gross Proceeds Received by Insurance Companies (Section 237-29.7, HRS)

Exemption at a Glance

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
No data available	No data available	No data available	Cannot be calculated	Yes

Relevant Legislative History

1935
Act 141, SLH 1935, generally exempted insurance companies from the Gross Income Tax because they were already subject to a separate tax on premiums. The Gross Income Tax is now known as GET.

1991
Act 286, SLH 1991, specifically exempted the gross income or gross proceeds received by insurance companies from GET as part of an overhaul of taxation laws relating to insurance companies. The legislation made rents from investments in real property in the state ineligible for the Insurance Premium Tax exemption.

What does this exemption do?

Although Section 237-29.7, HRS, describes this provision as an exemption, it actually excludes insurance company revenue from GET. The provision does not exclude income derived from rents from insurance companies' investments in real property in the state.

How does this exemption work?

Mahalo Insurance, a hypothetical Hawai‘i insurance company, collects $5 million in insurance policy premiums. That revenue (i.e., the premiums) is exempt from GET (but is subject to the Insurance Premium Tax).

Mahalo Insurance also receives $1 million in annual lease rent revenue from tenants of its building on Bishop Street. The lease rent revenue is subject to GET.

What is the purpose of this exemption?

The purpose of the exemption is to generally exclude insurance company revenues from GET since those revenues are subject to a tax specifically applicable to insurance policy premiums, (i.e., the Insurance Premium Tax). The 1991 amendment specified the exemption does not apply to rental income earned by insurance companies from their investments in real property. The Legislature found the GET exemption for income from real property rentals that insurance companies had enjoyed prior to the 1991 amendment was unwarranted and that revenue should be taxed in the same manner as revenue from similar business activities by other entities in the state.

Is the exemption meeting its purpose?

Based on the Legislature's intent underlying the exemption, we believe the exemption is meeting its purpose of exempting insurance company premium revenue from GET. In doing so, the provision recognizes that premium revenue is subject to a separate Insurance Premium Tax and that revenue from rental income, which is not subject to Insurance Premium Tax, is still subject to other taxes.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2018-2020?

We are unable to determine the number of claimants, total amount claimed, or the amount of tax expenditures associated with this exemption. Insurance companies do not file a GET return to claim the exemption of revenue from insurance premiums, and DoTax does not consider that this exemption results in lost tax revenue. However, according to DoTax, Insurance Premium Tax collections increased 4 percent in FY2020 to $180.8 million.

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

We determined that the primary purpose is not for any specific economic or employment benefit.

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

The exemption is meeting its purpose of eliminating the double taxation of insurance premium revenue by excluding that revenue from GET while ensuring that insurance companies are liable for GET on revenue earned from their real property investments, which are not subject to the Insurance Premium Tax. Based on our understanding of the Legislature's intent, we recommend the exemption be retained.

Tax Credit to Facilitate Regulatory Oversight (Section 431:7-207, HRS)

Tax Credit at a Glance (2020)

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$10.5 million	28	$10.5 million	$22.22*	Unable to determine

* Source: Department of Commerce and Consumer Affairs, Insurance Division

Relevant Legislative History

1992
Act 236, SLH 1992, created the Tax Credit to Facilitate Regulatory Oversight.

What does this tax credit do?

The Tax Credit to Facilitate Regulatory Oversight provides a one percent tax credit against Insurance Premium Tax,[2] if an insurance company:

- Maintains, in Hawai‘i, books and records required by the Insurance Commissioner sufficient to conduct the examinations authorized by section 431:2-302, HRS;
- Employs, in Hawai‘i, personnel knowledgeable about the insurer’s financial operations, who are authorized to represent the insurer in all matters pertaining to examination; and
- Maintains, in Hawai‘i, a customer service center with employees authorized to promptly adjust, settle, and pay claims and to promptly answer all questions from customers regarding their insurance policies.

---

[2] Section 431:7-202(a), HRS, establishes that each insurer, except with respect to all life insurance contracts, ocean marine insurance contracts, and real property title insurance contracts, shall annually pay a 4.265 percent tax on the gross premiums written from all risks or property in Hawai‘i.

Section 431:7-202(b), HRS, establishes that each insurer, with respect to life insurance contracts, shall annually pay, through the Insurance Commissioner, a 2.75 percent tax on the gross premiums received from all risks resident, situated, or located within Hawai‘i. The tax also applies to premiums for insurance written on individuals residing outside the state unless the direct writing insurer shall show the payment of a comparable tax to another appropriate taxing authority.

As such, the credit does not appear to be applicable to ocean marine insurance contracts and real property title insurance contracts.

According to the Hawaiʻi Department of Commerce and Consumer Affairs, Insurance Division (Insurance Division), the credit is claimed on the Annual Premium Tax Statement, on which insurance premium revenue is reported for Insurance Premium Tax purposes.

What is the purpose of this tax credit?

The credit was created as part of an act aimed at improving state regulation of the insurance industry by encouraging insurers to "maintain in Hawaiʻi the records and personnel necessary to provide less costly, more effective, and more timely state regulation," and help to ensure that insurance companies "promptly service their customers."

Is the tax credit meeting its purpose?

Although the credit does provide a financial incentive to insurers to maintain records and contacts in the state, we are unable to determine whether the tax credit is meeting its purpose. We were unable to make a connection between the credit and any improvement in regulation of the insurance industry and were unable to quantify the value of any corresponding benefits. The Insurance Division, which administers the credit, is better positioned to make such an assessment. However, the Insurance Commissioner said the Insurance Division's Financial Surveillance and Examination Branch, which, among other things reviews all filings from companies applying for Certificates of Authority to transact the business of insurance, has not assessed whether the tax credit has resulted in better regulation and that type of assessment is beyond the scope of the branch.

What were the number of claimants, total amount claimed, and tax expenditures for this tax credit from 2018-2020?

Year	Number of Claims	Amount Claimed	Tax Expenditure
2018	26	$10.78 million	$10.78 million
2019	25	$10.88 million	$10.88 million
2020	26	$10.5 million	$10.5 million

Source: Department of Commerce and Consumer Affairs, Insurance Division

Is there an economic or employment benefit to Hawaiʻi and if so, does the benefit outweigh the cost of the tax credit?

We determined that the primary purpose of the tax credit is not for any specific economic or employment benefit.

Should the tax credit be retained without modification, amended, or repealed?

Based on the available data, we are unable to determine whether this tax credit should be retained, amended, or repealed.

Issues of concern

From 2018 to 2020, Hawaiʻi insurers were provided more than $32 million under this tax credit. However, the Insurance Division, which administers the credit, has not evaluated whether the credit is achieving its intended purposes, which include raising revenue; encouraging insurers to maintain in Hawaiʻi the records and personnel necessary to provide less costly, more effective, and more timely state regulation; and ensuring that insurance companies promptly service their customers. As these purposes include aiding the division's regulation of insurers by incentivizing the maintenance of records and employees in Hawaiʻi, the division is best situated to evaluate whether the credit is achieving such intent.

Exemption for Nonprofit Medical Indemnity or Hospital Service Associations or Societies Specifically from General Excise Tax, Public Service Company Tax, and Insurance Premium Tax (Section 432:1-403, HRS)

Exemption at a Glance

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
Not available	Not available	Not available	Cannot be calculated	Unable to determine

Relevant Legislative History

1935
Act 141, SLH 1935, generally exempted hospitals, infirmaries, and sanitaria from the Gross Income Tax without providing explicit justification. The Gross Income Tax is now known as GET.

1941
Act 145, SLH 1941, created a specific exemption for nonprofit medical, and hospital indemnity associations and societies from every territorial, county and municipal tax, except unemployment compensation tax. According to a Finance Committee report, the purpose of the underlying bill was to exempt associations and societies organized solely as non-profit, medical, indemnity, or hospital service institutions from territorial, county, and municipal taxes.

1987
Act 347, SLH 1987, among other things, reorganized the Hawai‘i Insurance Code and this tax exemption.

What does this exemption do?

The Exemption for Nonprofit Medical Indemnity or Hospital Service Associations or Societies exempts revenues of nonprofit medical indemnity and hospital service associations and societies from all state, county, and municipal taxes, including GET, the Public Service Company Tax, and the Insurance Premium Tax. However, these organizations are not exempt from unemployment compensation tax. Nonprofit medical indemnity and hospital service associations are considered to be “Mutual Benefit Societies” under Chapter 432, HRS. Without the exemption, premiums for accident, health or sickness, and other insurance paid to these organizations, which are not considered core program income, would be subject to GET and other applicable taxes.

What is the purpose of this exemption?

Neither Act 145 of 1941 nor a related legislative committee report articulated the Legislature’s rationale for excluding nonprofit medical indemnity and hospital service associations or societies from all taxes except unemployment compensation tax and real property taxes.

Is the exemption meeting its purpose?

Because we are uncertain as to the Legislature’s purpose for exempting the revenues of nonprofit medical indemnity and hospital service associations or societies from all state, county, and municipal taxes except unemployment compensation tax, we are unable to determine whether the exemption is meeting its purpose.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2018-2020?

Mutual benefit societies, which include nonprofit medical indemnity or hospital service associations or societies, must register with the Department of Commerce and Consumer Affairs (DCCA) and obtain a DCCA-issued Certificate of Authority before doing business in Hawaiʻi. As of May 2021, there were five such mutual benefit societies registered with DCCA and authorized to do business in Hawaiʻi, according to the department's Insurance Division, These were:

- Hawaiʻi Management Alliance Association;
- Hawaiʻi Medical Service Association;
- Mutual Benefit Association of Hawaiʻi;
- University Health Alliance; and
- The Voluntary Employee's Benefit Association of Hawaiʻi.

Those organizations are not required to file tax returns relating to the Public Service Company Tax or the Insurance Premium Tax; however, section 237-9.3, HRS, requires that beneficiaries of GET benefits, including the exemption for Nonprofit Medical Indemnity or Hospital Service Associations or Societies,[3] file a GET return on which those organizations must verify that they qualify for the exemption.

However, DoTax has no data specific to this GET exemption. According to DoTax, data specific to this exemption is consolidated within the exemption claims filed by all nonprofit organizations, not only those of nonprofit medical indemnity or hospital service associations or societies. DoTax stated that it is unable to separate or filter the data to identify the claims for this exemption.

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

As we cannot identify the purpose of this exemption, we cannot determine whether the primary purpose is for any specific economic or employment benefit.

[3] Under section 237-9.3, HRS, a GET benefit means any tax exemption, exclusion of a taxable amount, a reduction from the measure of a tax imposed, a tax deduction, a tax credit, a lower rate of tax, a segregation or division of taxable amounts between multiple taxpayers involved in the same transaction, or any income splitting allowed under the chapter.

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

The Legislature should consider articulating the purpose of this exemption along with specific outcomes that are to be achieved, in order to facilitate future reviews.

Issues of concern

As with other data that it currently tracks only in aggregate, DoTax should report on exemptions claimed by nonprofit medical indemnity or hospital service associations or societies on a discrete basis, rather than together with all other nonprofit organizations, to foster better evaluation of costs and claims on a forward-going basis.

Exemption for Fraternal Benefit Societies Specifically from General Excise Tax, Public Service Company Tax, and Insurance Premium Tax (Section 432:2-503, HRS)

Exemption at a Glance

Amount claimed	Number of Unique Claimants	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
Not available	Not available	Not available	Cannot be calculated	Unable to determine

Relevant Legislative History

1935
Act 141, SLH 1935, exempted fraternal benefit societies, orders or associations operating under the lodge system or for the exclusive benefit of the members of the fraternity itself from the Gross Income Tax without providing explicit justification. The Gross Income Tax is now known as GET.

1961
Act 174, SLH 1961, created an exemption for fraternal benefit societies including orders and lodges operated for the benefit of its members from every territorial, county and municipal tax, except real property taxes and unemployment compensation tax.

1987
Act 347, SLH 1987, among other things, reorganized the Hawai'i Insurance Code, including the fraternal benefit society exemption.

What does this exemption do?

The Exemption for Fraternal Benefit Societies Specifically from General Excise Tax, Public Service Company Tax, and Insurance Premium Tax exempts revenues of fraternal benefit societies from all state, county, and municipal taxes, except for real property taxes and unemployment compensation tax. A fraternal benefit society is defined as "any incorporated society, order, or supreme lodge, without capital stock… whether incorporated or not, that is conducted solely for the benefit of its members and their beneficiaries and not for profit, is operated on a lodge system with ritualistic form of work, having a representative form of government, and which provides benefits," including death, endowment, annuity, and medical benefits. Fraternal benefit societies include groups such as Freemasons and Shriners International.

What is the purpose of this exemption?

The purpose of the bill underlying Act 174 of 1961 was to adopt the "Uniform Fraternal Code," which permitted fraternal benefit societies to issue life insurance, as a nonprofit activity, upon the lives of their members, according to a Senate committee report. Such societies were considered charitable and benevolent, and as nonprofit organizations their funds are exempt from most state income and corporate taxes.

Is the exemption meeting its purpose?

Although no data was available as to indicate whether any Hawai'i fraternal organizations benefitted from the exemption, we determine the exclusion is meeting its purpose to the extent that it is excluding revenue from taxation. Without the exemption, premiums paid to the fraternal organization, which are not considered core program income, would be subject to GET.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2018-2020?

According to the 2020 Hawai'i Data Book, there were 11 mutual and membership benefit organizations statewide in 2010, which was the most recent date for which data was available.

Under section 237-9.3, HRS, which requires that beneficiaries of GET benefits file a GET return, fraternal benefit societies are required to file a GET return and claim the exemption. However, DoTax has no claims data specific to this exemption as it is either utilized without being explicitly claimed or such claims are aggregated with claims for all non-profits, which precludes identification of those claims that just relate to fraternal benefit societies.

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

We determined that the primary purpose is not for any specific economic or employment benefit.

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

We are unable to determine whether this tax credit should be retained, amended, or repealed.

Issues of concern

DoTax should track exemptions claimed by fraternal benefit societies on a discrete basis, rather than together with all nonprofit organizations, to foster better evaluation of costs and claims on a forward-going basis.

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 their filings 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 needed to provide more meaningful information about the actual benefits associated with a particular tax preference for the Legislature to consider as it evaluates whether to retain, modify, or repeal the provision.

4. From 2018 to 2020 Hawai‘i insurers were provided $32 million in tax credits under section 431:7-207, HRS. However, the DCCA, which administers the credit, has not evaluated whether the credit is achieving its intended purposes, which include encouraging insurers to maintain in Hawai‘i the records and personnel necessary to provide less costly, more effective, and more timely state regulation; and ensuring that insurance companies promptly service their customers. The Legislature should consider requiring the DCCA to evaluate whether the credit is achieving its purpose.

5. Regarding section 239-6.5, HRS, based on the total amount of the tax credit claimed in 2017, 2018, and 2019, the number of low- or limited-income elderly and handicapped individuals utilizing the Lifeline Program appears to be small. The Legislature may wish to consider whether the tax credit should be changed in order to better achieve the purpose of providing a subsidy to ensure that such services are available to "the elderly with limited income and the handicapped with limited income." The Legislature or the PUC may wish to consider whether the tax credit or public awareness efforts should be changed in order to better achieve the purpose of subsidizing services for the elderly and the handicapped with low or limited income, and to consider the effect of increased use of wireless phone services since 1986. Additionally, the Legislature should consider increasing the eligibility income level above the current $10,000 maximum to account for inflation and provide Lifeline Program services to more people who the Legislature may determine to be low-income and in need of assistance for these service.

6. Regarding section 432:1-403, HRS, exemption for nonprofit medical indemnity or hospital service associations or societies specifically from GET, the Public Service Company Tax, and the Insurance Premium Tax, DoTax should track exemptions claimed by such entities on a discrete basis to foster better estimations of costs and number of claims.

7. Regarding section 432:2-503, HRS, exemption for fraternal benefit societies specifically from GET, the Public Service Company Tax, and the Insurance Premium Tax, DoTax should track exemptions claimed by such entities on a discrete basis to foster better estimations of costs and number of claims.

8. The following exclusions be removed from future review, pursuant to section 23-71(c), HRS:

    a. Exclusion on Gross Receipts of Home Service Providers Acting as Service Carriers (Section 239-2, paragraph (5) of the definition of "gross income", HRS)

    b. Exclusion for Dividends 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 (Utility) Service Company Group (Section 239-2, HRS)

    c. Exclusion for Green Infrastructure Charges Received by Electric Utilities (Section 269-172, HRS)

These exclusions exclude revenue from taxation because the associated activities were not intended to be included 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 23-71 through 23-81, HRS
Sections 23-91 through 23-96, HRS

Deadline	HRS Ref.	Statute to be reviewed	Notes
2022 Session	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

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

Report Date	HRS Ref.	Statute to be reviewed	Notes
2023 Session	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 Session	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 Hawaiʻi convention center operator from the Hawaiʻi 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

Report Date	HRS Ref.	Statute to be reviewed	Notes
2025 Session	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
2026 Session	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

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

Report Date	HRS Ref.	Statute to be reviewed	Notes
2027 Session	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 Session	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 Session	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 Session	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 472,574 "low-income residents" statewide in 2019 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 Tax Provisions per "Low-Income Resident"

Statute	Tax Provision	Cost	Cost per "low-income resident"
Section 239-2	Exclusion for dividends 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 (utility) service company group	N/A	Cannot be calculated
Section 239-2 Paragraph 5 of the definition of "gross income"	Gross income of home service providers of mobile telecommunications services	N/A	Cannot be calculated
Section 239-5.5	Exemption for monthly surcharge assessments collected by a utility from ratepayers in emergency situations	N/A	Cannot be calculated
Section 239-6.5	Tax credit for Lifeline telephone service subsidies	$27,000	5.7 cents
Section 269-172	Exclusion for green infrastructure charges received by electric utilities	N/A	Cannot be calculated
Section 237-29.7	Exemption of gross income or gross proceeds received by insurance companies	N/A	Cannot be calculated
Section 431:7-207	Tax credit to facilitate regulatory oversight	$10.9 million	23.7 cents
Section 432:1-403	Exemption for nonprofit medical indemnity or hospital service associations or societies	N/A	Cannot be calculated
Section 432:2-503	Exemption for amounts received by fraternal benefit societies	N/A	Cannot be calculated

Source: Office of the Auditor

The following table contrasts GET data with Hawai‘i’s total 2019 population of 1,415,872 people.

Cost of Tax Provisions per Hawai‘i Resident

Statute	Tax Provision	Cost	Cost per Hawai‘i resident
Section 239-2	Exclusion for dividends 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 (utility) service company group	N/A	Cannot be calculated
Section 239-2 Paragraph 5 of the definition of “gross income”	Gross income of home service providers of mobile telecommunications services	N/A	Cannot be calculated
Section 239-5.5	Exemption for monthly surcharge assessments collected by a utility from ratepayers in emergency situations	N/A	Cannot be calculated
Section 239-6.5	Tax credit for Lifeline telephone service subsidies	$27,000	1.9 cents
Section 269-172	Exclusion for green infrastructure charges received by electric utilities	N/A	Cannot be calculated
Section 237-29.7	Exemption of gross income or gross proceeds received by insurance companies	N/A	Cannot be calculated
Section 431:7-207	Tax credit to facilitate regulatory oversight	$10.9 million	7.7 cents
Section 432:1-403	Exemption for nonprofit medical indemnity or hospital service associations or societies	N/A	Cannot be calculated
Section 432:2-503	Exemption for amounts received by fraternal benefit societies	N/A	Cannot be calculated

Source: Office of the Auditor

Department of Taxation's Response to Draft Copy of Report

ON JUNE 16, 2022, we transmitted a draft of this report to the Department of Taxation. The Department of Taxation did not provide comments to this report.

A copy of the transmittal letter is included as Attachment 1.

STATE OF HAWAIʻI
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaiʻi 96813-2917

LESLIE H. KONDO
State Auditor

(808) 587-0800
lao.auditors@hawaii.gov

June 16, 2022

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

The Honorable Isaac W. Choy
Director, Department of Taxation
Princess Ruth Keʻelikōlani Building
830 Punchbowl Street, Room 221
Honolulu, Hawaiʻi 96813

Re: DRAFT copy of (1) *Review of Tax Provisions Pursuant to Section 23-74, Hawaiʻi Revised Statutes* and (2) *Review of Income and Financial Institutions Tax Provisions Pursuant to Section 23-93, Hawaiʻi Revised Statutes*

Dear Director Choy:

Attached for your review are draft copies of the Auditor's:

1. *Review of Tax Provisions Pursuant to Section 23-74, Hawaiʻi Revised Statutes*; and
2. *Review of Income and Financial Institutions Tax Provisions Pursuant to Section 23-93, Hawaiʻi Revised Statutes*.

We wanted to thank you and your staff for your assistance as we prepared these reports.

Please let us know by **June 22, 2022** whether your department plans to provide comments on one or both of the draft reports. If you do wish to submit comments, we ask that you please provide them to us by **June 30, 2022**. 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, if you or your staff would like to schedule a meeting (virtual or in person) to discuss the drafts, please let us know by **June 22, 2022**. 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)