Review of General Excise and Use Tax Provisions Pursuant to Section 23-76, Hawai‘i Revised Statutes

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

Report No. 24-06
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OFFICE OF THE AUDITOR
STATE OF HAWAI‘I

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STATE OF HAWAIʻI

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Foreword

This report assesses certain exemptions under Hawai‘i’s General Excise Tax. Section 23-71 et seq., Hawai‘i Revised Statutes, require the Auditor to review tax provisions annually 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; Department of Health; and Department of Human Services for their assistance in providing data and other information for this report.

Leslie H. Kondo
State Auditor

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Review of General Excise and Use Tax Provisions Pursuant to Section 23-76, Hawai‘i Revised Statutes

Introduction

THIS REPORT assesses certain General Excise Tax (GET) exemptions that a taxpayer may claim to reduce tax liability. Specifically, to the extent available data allows, we report the costs and performance of exemptions and exclusions allowed in the following areas:

- Employee benefit plans (Section 237-24.3(4), Hawai‘i Revised Statutes (HRS));
- Food stamps and vouchers under the Special Supplemental Nutrition Program for Women, Infants, and Children (Section 237-24.3(5), HRS);
- Prescriptions and prosthetics (Section 237-24.3(6), HRS);

The information in this report may be used by lawmakers in evaluating whether an incentive should be retained, amended, or repealed. This report is to serve as a tool for informed policymaking.

- Merchants association dues for advertising or promotion (Section 237-24.3(8), HRS);
- Labor organization real property leases (Section 237-24.3(9), HRS);
- Reimbursement to the Hawai‘i Convention Center operator from the Hawai‘i Tourism Authority (Section 237-24.75(2), HRS);
- Wage and fringe benefit reimbursements to professional employer organizations (Section 237-24.75(3), HRS); and
- Enterprise Zones, regarding both qualified Enterprise Zone businesses and Enterprise Zone construction contractors (Section 209E-11, HRS).

The information in this report may be used by lawmakers in evaluating whether any particular incentive should be retained, amended, or repealed. This report is to serve as a tool for informed policymaking.

Section 23-71, HRS, requires the Auditor to review a variety of tax incentives identified in later sections of the chapter and outlines what, substantively, the Auditor is to analyze. Section 23-76, HRS, identifies the specific exemptions and exclusions to be reviewed in 2023. We review other tax incentives in other reports, and a list of which incentives will be reviewed in which year may be found in Appendix A. The exemptions and exclusions discussed in this report are to be revisited pursuant to a 10-year review cycle under Section 23-76, HRS.

Background

Hawai‘i’s GET applies to nearly all business activities in Hawai‘i. In FY2022, which ended June 30, 2022, GET and Use Tax revenues summed to $4 billion, or nearly 38 percent of the total tax revenue from all sources.

Lawmakers sometimes exclude or exempt certain revenues from taxation to promote social or economic goals, or for tax efficiency or equity. Section 1 of Act 261, Session Laws of Hawai‘i (SLH) 2016, which established the annual review of GET, Use Tax, Public Service Company Tax, and Insurance Premium Tax exemptions, exclusions, and credits, noted that such provisions reduce revenue to the State. That results in a need for all taxpayers, including those who do not directly benefit from such tax breaks, to compensate for the reduced revenue, or alternatively, the government must reduce spending on state programs. Despite the loss of revenue, the Legislature has stated that certain tax exemptions, exclusions, and credits are worthy of continuation for equity, efficiency, and economic and social policy purposes.

Accordingly, the Legislature found the Auditor's periodic reviews "necessary to promote tax equity and efficiency, adequacy of state revenues, public transparency, and confidence in a fair state government." Unfortunately, for most of the provisions now under review, neither the law nor the relevant legal history includes specific outcomes that the Legislature sought to achieve. The Legislature has not articulated the purpose of each provision nor has it identified criteria against which to measure each provision. Our mandate under which we conduct these reviews instructs us to determine the extent to which each provision achieves its purpose – a task made difficult when provisions fail to specify a purpose or a means by which to measure whether the purpose has been achieved.

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 Enterprise Zone exemptions be split from one section into two sections of the HRS, or otherwise separated, to delineate clearly between the two exemptions and reduce confusion regarding calculations related to their associated tax expenditures – as discussed in the Enterprise Zone exemption portion later in this report.

Hawai'i's General Excise Tax and Use Tax

Hawai'i's GET and Use Tax, together, ensure that the State of Hawai'i will reap at least some benefit, in the form of tax revenue, from business operations in the State. This is accomplished primarily by GET, a tax on the privilege of doing business in Hawai'i and the largest source of tax revenue in the State. For the privilege of doing business in the State of Hawai'i, a business must pay GET – a tax separate from, and in addition to, income tax. Unlike income tax, GET is a flat tax, meaning the rate of tax does not change with income level. It is also a tax on product values, gross sales proceeds, and gross income receipts, meaning the tax ignores business expenses. It applies to nearly every product or service sold in Hawai'i. GET does not apply, however, to out-of-state sellers. That is where the Use Tax applies.

Use Tax complements GET by taxing goods and services imported for use in Hawai'i and sold by sellers not already subject to GET. It "levels the playing field" between buying from those subject to GET and those not subject to GET – often meaning local and out-of-state businesses, respectively. One nuanced distinction between GET and Use Tax is that GET is usually assessed against gross proceeds or gross income, while Use Tax is assessed on the purchase price or value of the good or service used. Another distinction is that sellers typically pay GET, whereas purchasers or importers, depending on how the import is used, pay Use Tax.

Reporting for GET and Use Tax is accomplished via the filing of a return: the "General Excise/Use Tax Return." There are two types of General Excise/Use Tax Returns: periodic and annual.

The G-45 (Periodic Return):

Throughout the tax year, an individual or business subject to GET or Use Tax must file periodic GET/Use Tax returns, each of which is known as a Form G-45. Periodic returns may be due semi-annually, quarterly, or monthly, depending on how much the taxpayer estimates it will owe in GET, over the course of the year. The higher a taxpayer's gross income, the more the taxpayer will likely owe and the more frequently it should have to file. Large enterprises with high revenues typically file monthly, while small enterprises are likely to file semi-annually.

Electronic filing of the G-45 is mandatory for all filers owing more than $4,000 in GET for a given year. That means all monthly filers, including high-revenue businesses and import-heavy businesses must file electronically. As of April 9, 2024, we have found no law or guidance specifically requiring electronic filing for filers owing $4,000 or less, though the Department of Taxation (DOTAX) has announced that it may phase in more electronic filing mandates in the future. Electronic filing of a G-45 is accomplished via the Hawai'i Tax Online system.

The G-49 (Annual Return):

At the end of the tax year, all individuals or businesses subject to either GET or Use Tax file the annual GET/Use Tax return and reconciliation, or Form G-49. The annual return should equal the sum of all the periodic returns, meaning the G-49 and the aggregate of the year's G-45s should "reconcile" against each other.

Electronic filing is mandated for all G-49 filers. Electronic filing of a G-49 is accomplished via DOTAX's Hawai'i Tax Online system. Hawai'i Tax Online is a resource that allows taxpayers to manage their tax accounts online.

There are ancillary GET and Use Tax forms, beyond the G-45 and G-49, that must be filed under certain circumstances. An important one, for purposes of this review, is Schedule GE on which taxpayers claim exemptions and deductions. It accompanies a G-45 or G-49 as a schedule attached to the return, and failing to include it will result in disallowance of the exemption or deduction. Other forms beyond Schedule GE, the G-45, and the G-49, unless specifically discussed elsewhere in this report, are beyond the scope of our current review.

It is the position of DOTAX that an exclusion applies to revenue that was never meant to be taxable. As GET is a tax on the privilege of doing business, revenues that are not from business activities are typically excluded – either by default or under a specific exclusion enacted toward that end. Real estate is a classic example: revenues from the sale of real estate might be subject to income tax (as capital gains) but are not subject to GET. It is the business of selling or buying real estate, meaning the commissions earned from real estate sales, that is GET-taxable.[1] Taxpayers generally do not report excluded amounts to DOTAX, such that DOTAX cannot capture related information. Consequently, DOTAX does not report data on exclusions.

Rates at a Glance

While GET is a tax on 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 businesses, whereas a sales tax is a tax on consumers that is collected by a business. GET is also distinct in that it is assessed on nearly every business transaction – wholesale and retail, goods and services – resulting in a broad tax base. By contrast, a typical sales tax applies to retail sales of tangible goods only.

Retailing includes the selling of tangible personal property for end consumption or use by the purchaser – as opposed to selling for resale purposes – as well as the renting of tangible personal property and the rendering of services by a service business. For example, a farmer's market vendor selling mangoes to passers-by to eat should be taxed at the retail rate. Wholesaling includes a business's selling goods or services to another business for resale. Were that same market vendor to sell to a store owner who sold the mangoes to the store's customers, the vendor should be taxed at the wholesale rate.

For tax year 2023, GET rates were as follows:

- 0.15 percent on commissions from insurance sales;
- 0.5 percent on revenue received by manufacturers and wholesalers, as defined by statute and as discussed later in this report; and

[1] See sidebar, "Tax Expenditures: At What 'Cost'?" on page 13 for a detailed explanation of tax expenditures.

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

For tax year 2023 Use Tax rates were as follows:

Wholesale-to-Wholesale
0.0 percent (no tax) on the use of goods or value of services imported by GET-licensed wholesalers and on other items for other importers subject to the wholesale GET rate;

Wholesale-to-Retail and Certain Others
0.5 percent on the use of goods or value of services imported by GET-licensed retailers, publishing, certain professional services, and the furnishing of transient accommodations; and

Retail-to-End Consumers and All Others
4.0 percent on the value transacted in all other cases of goods and services imports, and in all cases of intangible property imports.

As the rates above illustrate, manufacturers, wholesalers, and, in the case of Use Tax, resellers, benefit from lower rates. Consequently, whether a taxpayer qualifies for any of the above rates is of critical importance to determining GET and Use Tax liability.

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

Since 2007, the City and County of Honolulu has imposed a 0.5 percent GET and Use Tax surcharge to help fund its public transportation system. Hawai‘i, Kaua‘i, and Maui counties have also each adopted 0.5 percent surcharges. There is no surcharge on revenues exempt from GET or Use Tax. Hence, in addition to reducing overall state revenue, exemptions and exclusions reduce county revenue.

How We Got GET
General Excise Tax in Hawai‘i

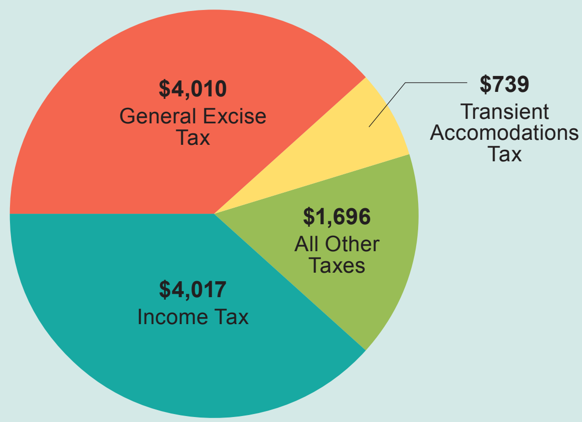
HAWAI‘I’S GET, like most sales taxes across the country, is a product of the Great Depression. While the Territory of Hawai‘i did not experience the level of unemployment and economic distress experienced by more industrialized areas of the United States, falling land values during the early 1930s led 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, a tax on gross proceeds.

Containing elements of both business and consumption taxation, GET was designed to redistribute the tax burden to different industries and their consumers.[2] 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), 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 FY2023, DOTAX reported that retailing had a tax base of $47.55 billion, or 33.9 percent of the total tax base, with services at $20.18 billion, or 14.4 percent of the tax base.

Tax Collections
Dollars (in millions)



Source: DOTAX Annual Report for fiscal year 2021-2022

In FY2022, the State General Fund, which is the State’s chief operating fund, realized a total of $10.46 billion in tax collections. Most of that revenue came from two taxes: GET and income tax. 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 $4.02 billion. GET, the fund’s second largest tax revenue source, accounted for $4.01 billion, or 38.3 percent of total general fund tax revenue. The Transient Accommodations Tax, the State’s third-largest revenue source, accounted for $739 million, or 7.1 percent.

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

Analysis of Reviewed Tax Provisions

What did we review?

This report reviews a total of eight tax provisions encompassing nine exemptions from GET, pursuant to Section 23-76, HRS. One provision, regarding State of Hawai‘i Enterprise Zones, includes two exemptions: one for qualified Enterprise Zone businesses and one for contractors engaged in construction in Enterprise Zones. Though they are reported by taxpayers to DOTAX separately, we review the two Enterprise Zone exemptions together to follow closely our mandate and issue a recommendation on the singular provision to which both relate.

Our analysis included reviewing confidential DOTAX taxpayer records under authority provided by Section 231-3.3, HRS, which was adopted under Act 177, SLH 2017, to facilitate our reviews. That section requires that any information accessed by the Auditor remain confidential, with limited exceptions.

What did we find?

We determined that six exemptions appear to be achieving what we understand to be their originally intended purposes. We could not determine whether the remaining three exemptions (including the two Enterprise Zone exemptions combined under Section 209E-11, HRS) were achieving their purposes, primarily because of a lack of data regarding utilization and economic impact. The statute requiring us to conduct these reviews does not set forth benchmarks or metrics to assess whether the provisions reviewed are achieving their intended purposes, and, prior to 2017, DOTAX did not systematically track GET and Use Tax exemptions. The following Table 1 summarizes our results.

Table 1. Summary of Results

HRS Section	Incentive Type	Subject Matter Covered	Achieves Purpose?	Recommendation
237-24.3(4)	GET exemption	Employee Benefit Plans	Yes	Retain
237-24.3(5)	GET exemption	Food Stamps and Vouchers Under the Special Supplemental Nutrition Program for Women, Infants, and Children	Yes	Retain
237-24.3(6)	GET exemption	Prescriptions & Prosthetics	Yes	Retain
237-24.3(8)	GET exemption	Merchants Association Dues	Yes	Retain
237-24.3(9)	GET exemption	Labor Organization Property Leases	Yes	Retain
237-24.75(2)	GET exemption	Hawai‘i Convention Center Operator	Cannot measure	Retain
237-24.75(3)	GET exemption	Professional Employer Organizations	Yes	Retain
209E-11	GET exemptions*	Enterprise Zones	Cannot measure	Cannot determine

* Note: There are two Enterprise Zones exemptions written into Section 209E-11, HRS. Both were analyzed together, as they relate to the same tax provision that the Auditor is mandated to review.

Assessment Challenges:

Few Metrics on Purpose Achievement and No Data on Economic Impact

A significant challenge we encountered was the lack of any metrics by which to quantify or otherwise assess whether an exemption is meeting its purpose and how it is affecting, if at all, the State economy. Our mandate at Section 23-71, HRS, requires that, with respect to any reviewed exemption enacted because of its purported economic or employment benefit, the Auditor quantify the benefit and comment on whether the benefit outweighs the cost of the exemption. Our mandate does not provide criteria or other direction for identifying or quantifying the intended benefit, and – for most exemptions – businesses are not required to provide information on jobs created or other economic impact information to the State. Additionally, most provisions reviewed in this report, like those reviewed in prior reports, do not include purpose statements or other explicit indications as to what their intended benefits were or are. Our mandate does specify, however, that the purpose of an incentive may be "reasonably identified by the auditor." Where possible, we considered House and Senate committee reports and other sources of legislative history to identify purpose and intended benefits, to the extent the Legislature discussed such before or during enactment. Ultimately, we were able to calculate expenditure values from DOTAX data, but not the extent to which many of the exemptions affected the economy. In short, we could usually measure the cost, but not the benefit, of an exemption.

Lack of Forecasting Tools and Data

Lack of current data and forecasting tools also hindered our ability to predict future tax expenditures. Our mandate requires not only a review of past incentive performance, but also an estimation of tax expenditure for the current and next two calendar years. The latest DOTAX and Department of Business, Economic Development and Tourism (DBEDT) data is from 2022, and our office does not have economic modeling software or similar tools for predictive calculations. We also note that, according to DBEDT, the COVID-19 pandemic significantly impacted at least one exemption in this report, such that any trend mapped using data from 2022 and earlier might be of dubious reliability for future value estimations. Even absent the pandemic, proving causality between an exemption and a rise or decline in any particular economic activity is not feasible without identifying and eliminating other potential causes. Regarding job creation, for example, there is no readily available data proving or disproving that a business claiming an exemption and creating jobs would have created those jobs irrespective of any exemption claim. Likewise, there is no data readily available regarding the economic impact of businesses ineligible to claim a particular exemption, or eligible businesses that elect not to claim an exemption to which they are entitled.

Use of Statutory Formula for Low-Income Resident Calculations

An additional concern is that we conducted an analysis of the impact of the tax provisions on “low-income residents” using a formula provided in the statute. We question whether the calculations represent the “value” that repeal of a particular tax provision 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 on “low-income resident” calculations can be found in Appendix B.

Undefined Terms

An additional concern is that the term *tax expenditure* is not defined in Hawai‘i’s laws, including in Section 23-71, HRS, which mandates this review. The following sidebar explains how tax exemptions and exclusions generally work, but as noted in previous reports, the Auditor and DOTAX have different interpretations of how to calculate 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'?" on page 13.

Exclusions and Exemptions

TAX BREAKS to promote tax equity, efficiency, or various economic and social goals 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

According to DOTAX, exclusions are tax law provisions that remove from tax reporting, entirely, revenues from activities never intended to be taxed. Income that is excluded is not reported on a tax return, as if the income never existed for tax purposes. As unreported, it is effectively ignored in tax calculations and not subject to taxation.

EXEMPTIONS

Exemptions refer to revenues from taxable activities or goods that, for policy purposes, are not subject to taxation. Income that is exempt typically is reported on a tax return or other tax record, but is subtracted out of taxable income. Thus, there should be a record of each exemption claimed. Tax exemptions usually, but not always, have associated tax expenditures.

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

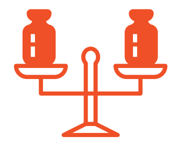
Tax Equity and Efficiency: Finding the Balance

WE ARE REQUIRED to assess whether the tax provisions reviewed are necessary to promote or preserve tax equity or efficiency. The law, however, does not define these terms. Rather, our analysis is based upon criteria developed by the U.S. Joint Committee on Taxation and 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 taxpayers fairly, which means, among other things, that similar taxpayers be taxed similarly while taxpayers with the greatest ability to pay have the highest tax burdens. 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 payment ability pay more.

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.

Section 23-71, HRS, requires the Auditor to determine not only whether reviewed tax provisions promote tax equity or efficiency, but also whether they are "necessary to promote or preserve tax equity or efficiency." That mandate implies a need to consider each provision within Hawai‘i's current social, economic, and budgetary contexts.



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

Tax Expenditures: At What "Cost"?

IN 2022, there were 935 claims for all exemptions reviewed in this report. Taxpayers claimed $3,726,755,969 in exemptions that we reviewed, resulting in, according to our calculations, $100,917,175 in tax expenditure. Overall, 29,080 taxpayers representing 12.1 percent of the total number of GET and Use Tax filers claimed 33,290 GET exemptions, totaling $32.6 billion, in 2022.

As DOTAX explains in its 2022 Hawai'i General Excise and Use Tax Exemptions report, tax expenditures "are the implied revenue cost of the deviation from applying the excise and use tax on all consumers in Hawaii without any exemptions." The report lists exemptions that DOTAX categorizes as tax expenditures at wholesale and retail rates (0.5 percent and 4.0 percent, respectively), and lists exemptions that DOTAX does not consider to be tax expenditures, but which may represent forgone opportunities to shift tax burdens to non-residents.

There are also certain exemptions that DOTAX does not consider to be "tax expenditures" and for which it therefore does not include tax expenditure amounts in its report. For example, there are GET exemptions for worker wages, stock and bond sales, bad debts, and fee simple land sales. These items, DOTAX states, are not traditionally included in the base of a sales or excise tax. They are not properly part of a broad-based tax on consumption and would not be subject to a sales or excise tax. Thus, as per DOTAX, no actual tax is forgone, meaning there is no associated tax expenditure.

DOTAX acknowledges that the assumptions underlying its classification scheme may change. The estimated tax expenditure stemming from exemptions varies significantly depending on the method used to calculate it. DOTAX calculates tax expenditure of GET exemptions using the GET wholesale rate of 0.5 percent for all business-to-business claimants. The implicit assumption is that, were the exemption nonexistent, all business-to-business taxpayers would pay GET on unexempted income at the wholesale rate only. We question DOTAX's assumption, as at least some claims for these exemptions were actually made at the retail rate, signaling that the taxpayers consider the underlying transactions retail, and not wholesale. Whether a taxpayer might recharacterize a transaction from retail to wholesale, depending on whether a taxpayer is paying tax or exempting income, is a matter of conjecture. Our estimate is based on the value of the claims and the actual tax rate against which they were claimed and, for 2022, comes to $100,917,175.

Another concern is that, as DOTAX's 2022 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:

> *The data presented in this report provide 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 impact estimate must account for the potential substitutional and behavioral effects of repealing an exemption.*

Table 2. Exemption Claims and Expenditures 2019 to 2022

The following table summarizes claim amounts and expenditure data for the exemptions reviewed in this report and for which data is available.

Year	Claim amounts	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	$3,726,756,000	$100,917,000	$73,861,000
2021	$3,941,486,000	$111,253,000	$79,182,000
2020	$3,387,747,000	$99,841,000	$74,692,000
2019	$3,466,918,000	$107,869,000	$85,031,000
Total	**$14,522,906,000**	**$419,881,000**	**$312,766,000**

Differences between the Auditor's estimates and DOTAX estimates are specific to each exemption and explained in each exemption's section of this report.

Source: DOTAX[3]

[3] The Office of the Auditor performed some calculations by itself, using DOTAX data.

General Excise Tax Exemption for Employee Benefit Plans (Section 237-24.3(4), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$332,397,000	33	$13,295,860	$27.65	Yes

Source: DOTAX 2022 Hawai'i General Excise and Use Tax Exemptions report[4]

Relevant Legislative History

1985
Act 88, SLH 1985, enacted the exemption as Section 237-24(22).

1987
Act 39, SLH 1987, renumbered the exemption from subsection (22) to subsection (21) of Section 237-24, HRS.

1993
Act 220, SLH 1993, reassigned the exemption from Section 237-24(21) to Section 237-24.3(5), HRS.

1994
Act 116, SLH 1994, provided that the exemption would not apply to real estate rental investment income received after June 30, 1994.

2013
Act 160, SLH 2013, reassigned the exemption from Section 237-24.3(5) to Section 237-24.3(4), HRS.

What does this exemption do?

This exemption exempts from GET two sets of income related to employee benefit plans (Plans). First, it exempts contributions, dividends, interest, and other income received by a Plan. Second, it exempts income received by a nonprofit organization or office as payments for costs and expenses incurred for the administration of a Plan. Not exempt are gross rental income and gross rental proceeds from investments in real property. Real property investment income remains taxable, even if it signifies one of the two sets of income that the provision would otherwise exempt.

A Plan, for purposes of the exemption, includes both employee welfare benefit plans and employee pension benefit plans. An employee welfare benefit plan is a plan, fund, or program established or maintained by an employer or employee organization for the purpose of providing to participants medical, unemployment, vacation, apprenticeship, day care, scholarship, and legal services benefits. An employee pension benefit plan is a plan, fund, or program established or maintained by an employer or employee organization and that defers employee income or otherwise provides employee retirement income.

How the Exemption is Claimed

Claimants exempt qualified amounts by reporting the revenue on "Schedule GE (Form G-45/G-49)," the General Excise/Use Tax Schedule of Exemptions and Deductions (hereafter referred to as Schedule GE) submitted with a GET return. The taxpayer includes

[4] The Office of the Auditor performed some calculations by itself, using DOTAX data.

on Part I of Schedule GE all exemptions claimed, reporting the amount of each exemption and other information specific to the exemption, including an “ED Code,” or exemption/deduction code, that corresponds to the law allowing the exemption. The ED Code for the Employee Benefit Plans exemption is 114.

Neither Schedule GE nor any GET return requires claimants to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues associated with income related to employee benefit plans must be reported on Schedule GE, data exists to quantify tax expenditure.

What is the purpose of this exemption?

Neither the 1985 original enactment nor any related committee report specifies any particular legislative purpose for exempting benefit plan income. However, the Senate Committee on Labor and Employment referenced testimony from the United Brotherhood of Carpenters and Joiners of America that general excise tax reduces moneys available to pay benefits to employees and retirees. We infer, then, that one intended purpose of removing general excise tax is to increase moneys available to pay benefits to employees and retirees – noting that, per our mandate, the purpose of an incentive may be “reasonably identified by the auditor.”

Is the exemption meeting its purpose?

How much the removal of general excise tax through this exemption in fact increases moneys available to pay benefits to employees and retirees is something we cannot determine. Benefit plans, and not necessarily their employees and retirees, are the direct beneficiaries of the exemption. While we know from claims made that benefit plans are saving tax dollars, there is no data readily available to indicate or prove whether those dollars are passed on to employees and retirees or diverted elsewhere. In other words, we do not know – and cannot assume – what benefit plans are doing with their tax savings.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2019-2022?

DOTAX reports 59, 57, 37, and 33 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this provision was $395,321,000, $356,437,000, $501,247,000, and $332,397,000, respectively.

When determining the tax expenditure corresponding to this exemption, DOTAX appears to treat this incentive as an exclusion. It assigns no – or $0 – tax expenditure to the exemption for every year.

We disagree with the DOTAX treatment of the exemption and its corresponding calculation of the associated tax expenditure of $0. We believe the exemption does yield an expenditure because, prior to the existence of the exemption, the State did, in fact, tax relevant income. The exemption signifies a forgoing of tax revenue and thus an expenditure.

We calculated the amount of revenue that would have been collected but for the exemption, in the table below. As all claims related to transactions taxable at the 4 percent rate, which is the rate indicated by those claiming the exemption, we multiplied the sum of all claims by 4 percent to determine the revenue forgone, i.e., the tax expenditure associated with the exemption.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	33	$332,397,000	$13,296,000	$0
2021	37	$501,247,000	$20,050,000	$0
2020	57	$356,437,000	$14,257,000	$0
2019	59	$395,321,000	$15,813,000	$0

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai'i General Excise and Use Tax Exemptions reports[5]

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

There is no readily available data correlating, in any way, claims to exempt benefit plan income and economic or employment benefits to Hawai'i.

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

We recommend that the GET exemption for benefit plan income be retained. We see no reason to modify the exemption, and repeal would lead to the imposition of a tax known to reduce benefit plan moneys available to employees and retirees. Retaining the exemption will ensure that it continue to meet its purpose of preventing the reduction of such moneys.

[5] The Office of the Auditor performed some calculations by itself, using DOTAX data.

General Excise Tax Exemption for Food Stamps and Vouchers under the Special Supplemental Nutrition Program for Women, Infants, and Children (Section 237-24.3(5), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Auditor’s Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$1,016,107,000	390	$0	$0	Yes

Source: DOTAX 2022 Hawai‘i General Excise and Use Tax Exemptions report[6]

Relevant Legislative History

1985

Congress passed the Food Security Act of 1985, which prohibited states that impose a sales tax on food stamp purchases from participating in the federal food stamp program. It was effective after the end of each state’s next legislative session, affording each state time to modify its laws, if needed.

1986

Act 86, SLH 1986, enacted the exemption for food stamp purchases, codified as Section 237-24(23), HRS, but with a proviso. The proviso was that the exemption would apply only if the U.S. Secretary of Agriculture determined that the application of Hawai‘i’s GET to food stamp purchases would disqualify Hawai‘i from participating in the Food Stamp Program, under the Food Security Act of 1985.

Congress passed the School Lunch and Child Nutrition Amendments of 1986, prohibiting states that impose a sales tax on purchases made under the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)[7] from participating in that program.

1987

Act 15, SLH 1987, removed the proviso from Section 237-24(23), HRS, exempting all federal food coupons unconditionally. Act 15 also expanded the exemption to exempt amounts received for purchases made with food vouchers under WIC.

Act 39, SLH 1987, reassigned the exemption from subsection (23) to subsection (22) of Section 237-24, HRS.

1993

Act 220, SLH 1993, reassigned the exemption from Section 237-24(22) to Section 237-24.3(6), HRS.

2013

Act 160, SLH 2013, reassigned the exemption from Section 237-24.3(6) to Section 237-24.3(5), HRS.

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[6] The Office of the Auditor performed some calculations by itself, using DOTAX data.

[7] The Child Nutrition Amendments of 1986, as well as Act 15, SLH 1987, and Section 237-24.3(5), HRS, all use “Food” or “Foods” in place of “Nutrition” in the full program name for WIC. However, the Hawai’i Department of Health uses “Nutrition” in the program name. In this report, we use “Nutrition” in the program name to align with other current government publications and to reflect the fact that WIC covers not only food products, but also nutrition counseling, screening, and health services referrals.

What does this exemption do?

This provision exempts from GET all revenues from purchases using U.S. Department of Agriculture (USDA) food coupons under the Food Stamp Program or with USDA food vouchers under the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). It states that Chapter 237, HRS – which relates to GET – does not apply to purchases made with food stamps or with WIC vouchers.

The Food Stamp Program, officially known as the Supplemental Nutrition Assistance Program (SNAP), is a federal program that provides food and nutritional support to qualifying low-income and needy households. It is funded through the USDA and administered at both the federal and state levels. In Hawai‘i, the Department of Human Services (DHS) administers the program.

WIC is also a federally funded program that provides supplemental foods, nutrition education, breastfeeding promotion, and health and social service referrals to qualifying low-income and pregnant, breastfeeding, or postpartum women, and persons under age five who are at medical or nutritional risk. The USDA administers the program at the federal level, and the Hawai‘i Department of Health (DOH) administers it at the state level.

How the Exemption is Claimed

Businesses that receive food stamps and WIC food vouchers report the corresponding revenues on Schedule GE, under Exemptions/Deductions (ED) Code 119, “Food Stamps and WIC (§237-24.3(5)).” The revenues are thus reported and are subtracted from the businesses’ total revenues on the periodic G-45 and the annual G-49, resulting in no GET liability on those revenues. We note that even though the exemption applies to separate federal food assistance programs – one for food stamps and one for WIC food vouchers – it evolved as, and continues to be reported as, a single exemption.

Claimants are not required to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues associated with food stamps and WIC food vouchers must be reported on Schedule GE, data exists to quantify tax expenditure.

What are the purposes of this exemption?

The Food Security Act of 1985 prohibits states participating in the Food Stamp Program from imposing sales tax on food stamp receipts. Enacting the exemption allowed Hawai‘i to continue to participate in the program.

The School Lunch and Child Nutrition Amendments of 1986 prohibit states participating in the WIC program from imposing sales tax on WIC receipts. Enacting the exemption allowed Hawai‘i to continue to participate in the program.

Is the exemption meeting its purposes?

Allowing continued participation in both the food stamp and WIC programs, the exemption is achieving its purposes as intended.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption in 2019-2021?

DOTAX reports 411, 392, 383, and 390 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this exemption was $366,558,000, $499,320,000, $830,302,000, and $1,016,107,000, respectively.

We and DOTAX agree that the tax expenditure for all four years should be zero, but we agree for different reasons. DOTAX reasons that purchases made with food stamps and WIC vouchers would not be subject to a sales, excise, or other form of consumption tax, even absent an exemption, because the federal government does not permit such taxation of such items. That is, the State would collect $0 even without the exemption, because it would not be allowed to tax the underlying items. While we agree with the ultimate outcome, we note that the relevant federal law – the Food Security Act of 1985, as amended – does not directly prohibit taxation; instead, it prohibits participation in the food stamp program for any state that does tax food stamp purchases. If it so wished, Hawai‘i could, legally, impose GET law on revenue relating to food stamp and WIC program-related purchases. However, taxing the receipts would mean non-participation in the programs, which would mean no more receipts, which would mean $0 tax.

Year	Number of Claims	Amount Claimed	Auditor’s Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	390	$1,016,107,000	$0	$0
2021	383	$830,302,000	$0	$0
2020	392	$499,320,000	$0	$0
2019	411	$366,558,000	$0	$0

Source: DOTAX[8]

[8] The Office of the Auditor performed some calculations by itself, using DOTAX data.

Is there an economic or employment benefit to Hawai‘i, and if so, do the benefits outweigh the costs of this exemption?

The primary benefit of this exemption is the continued ability of the State to participate in the Food Stamp Program and WIC. It is in part because of the exemption that the State receives federal funds to feed and safeguard the health of low-income residents in need. Given that the tax expenditure is $0, and assuming that the Legislature and State generally view welfare positively, the impact to Hawai‘i residents should be purely beneficial.

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

We recommend that the GET exemption for food stamp and WIC voucher purchases be retained without modification. Maintaining the nontaxability of such purchases is necessary to continuing Hawai‘i participation in the Food Stamp and WIC programs. As stated by the Senate Committee on Human Services, loss of participation would have a significant negative impact on the public health of the people of Hawai‘i.

General Excise Tax Exemption for Prescriptions and Prosthetics (Section 237-24.3(6), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$1,842,604,000	268	$73,704,160	$153.29	Yes

Source: DOTAX 2022 Hawai‘i General Excise and Use Tax Exemptions report[9]

Relevant Legislative History

1986
Act 306, SLH 1986, enacted the exemption as Section 237-24(23).

1987
Act 7, SLH 1987, adjusted the definitions of “prescription drugs” and “prosthetic device.”

1993
Act 220, SLH 1993, reassigned the exemption from Section 237-24(23) to Section 237-24.3(7), HRS.

2013
Act 160, SLH 2013, reassigned the exemption from Section 237-24.3(7) to Section 237-24.3(6), HRS.

What does this exemption do?

This provision exempts from GET the revenue from certain sales of prescription drugs and prosthetic devices. It states that Chapter 237, HRS – which relates to GET – does not apply to the qualified sales. To qualify for the exemption, the sale must be by a hospital, infirmary, medical clinic, health care facility, pharmacy, or, in the case of a drug sale, a pharmacist or practitioner licensed to administer the drug. The sale must also be to an individual. Services sold in connection with the sale of any drug or prosthetic device do not qualify the exemption.

Section 237-24.3(6), HRS, defines “prescription drugs” to include only those drugs whose introduction or delivery into interstate commerce has been approved by the U.S. Secretary of Health and Human Services, and sold by licensed pharmacists or practitioners licensed to administer them. Statutorily excluded from prescription drugs covered by the exemption are cannabis and manufactured cannabis products.

Section 237-24.3(6), HRS, defines “prosthetic device” to include any artificial device used to replace a missing or removed part of the human body, so long as the device is prescribed by a licensed practitioner of medicine, osteopathy, or podiatry and sold by that practitioner or a dealer of such devices. Also included are components of, and accessories to, such device. Notably excluded, for exemption purposes, are all auditory, ophthalmic, dental, and ocular devices.

[9] The Office of the Auditor performed some calculations by itself, using DOTAX data.

We note that while the sales of the tangible drugs and devices themselves are exempt, this exemption does not apply to any services rendered in connection with such sales. Income from such services remain subject to GET.

How the Exemption is Claimed

A seller of prescription drugs and prosthetic devices reports corresponding revenues on Schedule GE, under Exemptions/Deductions (ED) Code 113, “Drugs and Prosthetic Devices (§237-24.3(6)).” Although the revenues relating to the sale of prescription drugs are reported together with those from the sale of prosthetic devices, the combined revenues are subtracted from the business’s total revenues on the periodic G-45 and the annual G-49. No GET should be owed on the relevant revenues.

Claimants are not required to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues associated with prescription drugs and prosthetic devices must be reported on Schedule GE, data exists to quantify tax expenditure.

What are the purposes of this exemption?

The exemption for prescription drugs and prosthetic devices was part of a package of GET exemptions aimed at encouraging business expansion. According to the Senate Committee on Ways and Means, the exemptions would increase revenues to the State through business activity and lower the pyramiding tendences of GET, ultimately reducing costs to final purchasers. With respect to prescription drugs and prosthetics, a more specific goal was to assist lower income and elderly populations. The committee believed that the exemption would be of particular assistance to the chronically ill and alleviate the high cost of living in Hawai‘i.

Is the exemption meeting its purposes?

Regarding the purpose of encouraging business expansion, there is insufficient readily available data to draw a causal link between the tax exemption and any related business expansion in the State.

Regarding the purpose of reducing costs to final purchasers and alleviating the high cost of living in Hawai‘i, the exemption should be having an effect exactly equal to the amount of tax that, absent the exemption, would be passed on to consumers. As detailed in the economic impact paragraphs below, prices for prescription drugs have risen more than twice as fast as household income, such that any tax savings should have also risen.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption in 2019-2022?

DOTAX reports 300, 311, 261, and 268 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this provision was $2.07, $1.82 billion, $1.98 billion, and 1.84 billion, respectively.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	268	$1,842,604,000	$73,704,000	$73,704,000
2021	261	$1,978,324,000	$79,124,000	$79,133,000
2020	311	$1,818,196,000	$70,809,000	$72,728,000
2019	300	$2,074,100,000	$81,360,000	$82,964,000

Source: DOTAX[10]

The expenditures calculated by DOTAX appear to imply that DOTAX treats all claims for this exemption as related to retail transactions only. The rate applicable to retail transactions is 4 percent, and the DOTAX expenditure values (apart from rounding to the nearest $1,000) are exactly 4 percent of corresponding claim totals. Our office agrees with the DOTAX approach insofar as the exemption applies to sales to individuals only and individual buyers are likely not reselling prescription drugs or prosthetics. We note, however, that some taxpayers in fact claimed the exemption under the wholesale rate. As our office is not at liberty to recharacterize the nature of a transaction as reported by a taxpayer, we calculated expenditure by using a mix of retail and wholesale rate claims. For each year, we multiplied 4 percent by the retail claim amount and 0.5 percent by the wholesale claim amount, and summed the two arithmetic products.

Is there an economic or employment benefit to Hawai‘i, and if so, do the benefits outweigh the costs of this exemption?

As discussed above, there should be a benefit to those consumers to the extent tax savings are passed to end consumers. Drug prices have risen, such that the tax benefit should, in turn, have grown. During the five-year period of 2015 through 2019, the annual cost of prescription drug treatment increased by 26.3 percent in Hawai‘i, while the annual

[10] The Office of the Auditor performed some calculations by itself, using DOTAX data.

average income for State residents grew by only 10.5 percent. During the six-year period of 2012 through 2017, the most prescribed drug in Hawai‘i, atorvastatin (better known by its generic name Lipitor), saw its price rise by 137 percent. As of 2021, inflation in the U.S. average price of Lipitor surpassed the global median of national averages by approximately 2,200 percent, making Lipitor the drug with the third-highest U.S. inflation rate relative to the rest of the world.

Despite the rise in drug prices and corresponding increase in tax savings, the ultimate value of the benefit remains relatively low inasmuch as Hawai‘i – despite high prices – boasts the lowest per capita out-of-pocket expenditure on prescription drugs. On average, a Hawai‘i resident spends only $82.08 per year on prescription drugs.

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

We recommend that the GET exemption for prescription drugs and prosthetic devices be retained without modification. While low out-of-pocket costs appear caused more by insurance coverage and low incidence rates than by any tax exemption, retaining the exemption should help maintain the low-cost status quo. Repealing the exemption, by contrast, could cause a rise in prices, and given the purpose of reducing costs to final purchasers and alleviating the high cost of living in Hawai‘i, we see no reason for any statutory modification.

General Excise Tax Exemption for Merchants Association Dues for Advertising or Promotion (Section 237-24.3(8), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$6,864,000	8	$274,575	$0.57	Yes

Source: DOTAX 2022 Hawai‘i General Excise and Use Tax Exemptions report[11]

Relevant Legislative History

1986
Act 340, SLH 1986, enacted the exemption as Section 237-24(24).

1993
Act 220, SLH 1993, reassigned the exemption from Section 237-24(25) to Section 237-24.3(9), HRS.

2013
Act 160, SLH 2013, reassigned the exemption from Section 237-24.3(9) to Section 237-24.3(8), HRS.

What does this exemption do?

This provision exempts from GET the dues received by an unincorporated merchants association from its members to promote and advertise the association for the benefit of all its members as a whole. More specifically, the exemption applies to dues received for "advertising media, promotional, and advertising costs," including dues received as reimbursements of those costs. The advertising and promotional costs must also be for the benefit of all members of the association. The exemption specifically disqualifies costs to benefit a particular member or group of members comprising less than the whole. Dues that the merchants association uses for other purposes, including to cover other association-related costs, are not exempt from GET under this provision.

How the Exemption is Claimed

A merchants association receiving dues to cover qualified advertising and promotional costs reports the revenues on Schedule GE, under Exemptions/Deductions (ED) Code 129, "Merchants' Association Dues (§237-24.3(8))." Although the dues revenues are reported, they are subtracted from the association's gross income on the periodic G-45 and the annual G-49. No GET should be owed on the relevant revenues.

Claimants are not required to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues from association dues must be reported on Schedule GE, data exists to quantify tax expenditure.

[11] The Office of the Auditor performed some calculations by itself, using DOTAX data.

What is the purpose of this exemption?

This exemption was enacted to ensure that dues to cover promotional and advertising costs be exempt from GET. It is a general principle that, in the context of an association, corporation, or legal person that has members or shareholders, the reimbursement of costs or advances made for or on behalf of one person by another should not be taxable. Consistent with that principle, in 1968, DOTAX advised the Ala Moana Center Association that such dues were non-taxable reimbursements. In 1973, DOTAX advised the Pearlridge Center Association the same. In 1979, however, DOTAX issued Tax Information Release (TIR) 67-79, which superseded the earlier opinions and asserted such dues were subject to GET. This exemption, enacted in 1986, overruled that TIR, reasserting that such dues are to be exempt.

Is the exemption meeting its purpose?

Yes, the exemption is meeting its purpose of ensuring that merchant association dues to cover promotional and advertising costs remain exempt from GET. Whether the exemption is redundant in light of a possible preexisting exclusion, as discussed in the expenditure paragraphs below, does not affect the fact that the exemption, by its operation, furthers its intended purpose.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2019-2022?

DOTAX reports 30, 24, 9, and 8 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this exemption was $17,864,000, $12,696,000, $7,569,000, and $6,864,000, respectively.

When determining the tax expenditure corresponding to this exemption, DOTAX appears to treat all the underlying transactions as wholesale transactions and calculates the amount of the tax expenditure using the wholesale GET rate. That is, DOTAX assumes that, were the association dues subject to GET, the association would pay the wholesale rate of 0.5 percent on the membership dues – eightfold lower than the 4 percent rate applicable to retail transactions. By contrast, we calculate the amount of the tax expenditure (i.e., the loss of tax revenue to the State) based on the tax rate that taxpayers actually reported when claiming the exemption, and over 99 percent of claims reflected the 4 percent retail rate. Hence, our tax expenditure values are roughly eight times those of DOTAX.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure*	DOTAX Tax Expenditure
2022	8	$6,864,000	$275,000	$34,000
2021	9	$7,569,000	$303,000	$38,000
2020	24	$12,696,000	$508,000	$63,000
2019	30	$17,864,000	$715,000	$89,000

* Our expenditure calculations for this exemption assume that, were the exemption repealed, DOTAX would follow the same approach it took immediately prior to exemption enactment. That is, DOTAX would treat merchants' association dues as taxable, as it did in issuing Tax Information Release 67-79.

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai‘i General Excise and Use Tax Exemptions reports[12]

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

There is no readily available data demonstrating any causal relationship between this exemption and employment or economic statistics. However, the effect of the exemption is to prevent GET imposition upon dues that, immediately prior to the exemption, were taxable. Consequently, there is an economic benefit in the form of GET savings to the merchants associations.

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

We recommend retention of this exemption. It is meeting its purpose of ensuring that association dues intended to cover association advertising remain untaxed by GET, overruling a Tax Information Release with which the Legislature disagreed. While at first glance the exemption might appear superfluous in light of the principle that an association's cost reimbursements by its members be GET-free, the TIR triggered the need for the exemption to achieve that goal.

[12] The Office of the Auditor performed some calculations by itself, using DOTAX data.

General Excise Tax Exemption for Labor Organization Real Property Leases (Section 237-24.3(9), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$298,000	15	$11,914	$0.02	Yes

Source: DOTAX 2022 Hawai‘i General Excise and Use Tax Exemptions report[13]

Relevant Legislative History

1993
Act 43, SLH 1993, enacted the exemption as Section 237-24(26).

2013
Act 160, SLH 2013, reassigned the exemption from Section 237-24.3(10)[14] to Section 237-24.3(9), HRS.

What does this exemption do?

This provision exempts from GET income received by a labor organization from leasing real property to another labor organization or to a trust fund established by a labor organization for the benefit of its members and their families and dependents. The claimant labor organization must be qualified as an Internal Revenue Code Section 501(c)(5) non-profit organization. Among other things, that means the organization’s earnings must not inure to the benefit of any particular member, and its goals must be the betterment of the conditions of those engaged in labor, agriculture, or horticulture, the improvement of the grade of related products, and improved efficiency in those fields.

How the Exemption is Claimed

A labor organization reports its qualified rental income on Schedule GE, under Exemptions/Deductions (ED) Code 125, “Labor Organizations (§237-24.3(9)).” Although the revenues are reported, they are subtracted from the labor organization’s total revenues on the periodic G-45 and the annual G-49. No GET should be owed on the relevant revenues.

Claimants are not required to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues from rental income must be reported on Schedule GE, data exists to quantify tax expenditure.

[13] The Office of the Auditor performed some calculations by itself, using DOTAX data.

[14] We note that the exemption was enacted as part of Section 237-24, HRS, but is referenced in later law as part of Section 237-24.3, HRS. This appears to imply that the section went through a renumbering, similar to the renumbering cited for other exemptions discussed earlier in this report. Much renumbering of Section 237-24 to Section 237-24.3 occurred in Act 220, SLH 1993, but that Act excluded mention of this particular exemption for labor organizations.

What is the purpose of this exemption?

The purpose of this exemption is to counteract a U.S. Supreme Court case that affected labor organizations' funding – to promote the activities of, and allow flexibility in the operations of, organized labor. In *Communications Workers v. Beck*, 487 U.S. 735 (1988), the U.S. Supreme Court ruled that trade unions could not collect dues for any purpose other than collective bargaining. Consequently, unions saw their collections curtailed and testified in support of tax relief. This exemption is an example of relief extended to the unions.

Is the exemption meeting its purpose?

Given that the purpose of this exemption is to promote organized labor generally, it would appear to be meeting its purpose. Ultimately, the tax exemption resulted in less tax due from labor organizations. Lower taxes for the organizations should facilitate the continuing of such organizations' activities, functions, and operational flexibility.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2019-2022?

DOTAX reports 22, 23, 13, and 15 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this exemption was $47,295,000, $47,535,000, $282,000, and $298,000, respectively. Our figures coincide roughly with those of DOTAX, as both we and DOTAX applied the 4 percent retail rate to all transactions. All claims for this exemption were made at the retail rate.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure*	DOTAX Tax Expenditure
2022	15	$298,000	$11,914	$12,000
2021	13	$282,000*	$11,277	$11,000
2020	23	$47,535,000	$1,901,416	$1,901,000
2019	22	$47,295,000	$1,891,786	$1,892,000

* In 2021, DOTAX implemented an electronic filing software change that restricted the types of business activities to which the GET exemption could apply, making it harder for people to claim the exemption erroneously. DOTAX suspects that, prior to 2021, certain exemption claims were made erroneously.

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai‘i General Excise and Use Tax Exemptions reports[15]

[15] The Office of the Auditor performed some calculations by itself, using DOTAX data.

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

While we lack data showing any causal relationship between claims for this exemption and any economic or employment impact on the Hawai‘i economy, we suspect that the exemption has negligible or no impact on the State due to the low amount claimed. As of 2021, the amount claimed was only $282,000, signifying about $11,000 in State expenditure – or a cost of $0.02 per low-income resident.

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

We recommend retaining this exemption. The provision meets its purpose of promoting the activities and functions of organized labor, by exempting lease revenues and thereby increasing funds available to associations.

General Excise Tax Exemption for the Hawai‘i Convention Center Operator (Section 237-24.75(2), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Unique Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$22,184,000	9	$887,354	$1.85	Cannot be determined

Source: DOTAX 2022 Hawai‘i General Excise and Use Tax Exemptions report[16]

Relevant Legislative History

2007
Act 173, SLH 2007, enacted the exemption as Section 237-24.75(2).

What does this exemption do?

This provision exempts from GET amounts received by the operator of the Hawai‘i Convention Center for reimbursements of costs or advances made pursuant to a contract with the Hawai‘i Tourism Authority (HTA). It applies only to the entity contracted by HTA to operate the Hawai‘i Convention Center, meaning no other taxpayer is able to exempt revenue under this provision, including entities receiving reimbursements under contracts with HTA . It also applies to payments only from HTA, meaning the convention center operator cannot exempt from GET any reimbursements it might receive from private persons or other governmental bodies.

How the Exemption is Claimed

The operator of the Hawai‘i Convention Center reports revenues that it intends to exempt on Schedule GE, under Exemptions/Deductions (ED) Code 121, "Hawaii Convention Center Operator." The revenues are thus reported, but are subtracted out – via Schedule GE and the periodic G-45 – prior to calculating the amount of revenue subject to GET. No GET should be owed on the exempted revenues.

What is the purpose of this exemption?

The purpose of this exemption is to ensure that payments from HTA to the Hawai‘i Convention Center operator are not reduced by GET. HTA contracts with the operator, to whom the HTA reimburses the costs of operating and marketing the center. The payments are not payments for services, but are reimbursements mandated by rules of the special fund through which the moneys flow. If those amounts were subject to

[16] The Office of the Auditor performed some calculations by itself, using DOTAX data.

GET, then the operator – by having to pay tax – would have fewer funds than designated for operating and marketing the facility. Eliminating the tax ensures that no such reduction in funds occur.

That last point could best be illustrated by a few numbers mentioned explicitly by the Legislature in the Act establishing the exemption. At the time of enactment, the operator had received $16 million in cost advances and reimbursements, upon which DOTAX sought to impose a $700,000 tax. The Legislature indicated that the $700,000, going toward GET, could not be used by the operator to cover expenses. Indeed, the operator would not even be able to cover the tax with its true compensation, which was only $500,000, presumably meaning that the operator would have to use at least some of its reimbursement moneys to pay tax. In short, the exemption was enacted to ensure that the special fund function as it was legally required to work – that moneys from the fund be used only to cover convention center operational expenses, and not to pay tax.

Is the exemption meeting its purpose?

Yes, the exemption is meeting its purpose. It allows all reimbursement moneys paid from HTA to be used to cover expenses for which they were issued.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2019-2022?

This exemption is for the convention center operator only, such that, for any year in which there is only one operator, there should be only one claim of this exemption. Indeed, for 2021 and 2020, DOTAX suppressed disclosure of data relating to this exemption because there were fewer than 5 claimants. It is DOTAX policy to withhold the number of taxpayers claiming an incentive when that number is five or fewer. That is to prevent readers from being able to identify any particular taxpayer and thus protect confidential taxpayer information.

With regard to tax year 2019, our expenditure differs from that of DOTAX because we apply the 4 percent retail rate of tax, while DOTAX applies the 0.5 percent wholesale rate. As detailed previously in this report, we disagree with the approach that business-to-business transactions ought to be characterized as wholesale transactions regardless of how taxpayers, themselves, characterized their own transactions. To apply one rate when a taxpayer has identified another as applicable is tantamount to recharacterizing the transaction, and while DOTAX in its enforcement capacity may be authorized to take such action, we are not.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	9	$22,184,000	$887,354	$111,000
2021	Suppressed*	Suppressed*	Cannot be determined	Cannot be determined
2020	Suppressed*	Suppressed*	Cannot be determined	Cannot be determined
2019	6	$17,206,000	$688,241	$86,000

* It is DOTAX policy to withhold the number of taxpayers claiming an incentive when that number is five or fewer. That is to prevent readers from being able to identify any particular taxpayer and thus protect confidential taxpayer information.

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai‘i General Excise and Use Tax Exemptions reports[17]

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

We lack the data necessary to determine whether this exemption has any economic impact upon the State. Without amounts claimed, numbers of claimants, or expenditure values, and no performance benchmarks or other metrics identified in Section 237-24.75(2), HRS, we cannot conduct a cost-benefit analysis, estimate any direct employment impact, or otherwise calculate the economic effects of the exemption.

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

We recommend that the Hawai‘i Convention Center operator GET exemption enacted at Section 237-24.75(2), HRS, be retained.
At least one taxpayer – and presumably only one taxpayer, the Convention Center Operator – is claiming the exemption, which means reimbursements from the HTA are not being reduced by any need to pay GET. Keeping such reimbursements free from reduction by tax, the exemption is meeting its legislative purpose.

[17] The Office of the Auditor performed some calculations by itself, using DOTAX data.

General Excise Tax Exemption for Wage and Fringe Benefit Reimbursements to Professional Employer Organizations (Section 237-24.75(3), HRS)

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$251,451,000	63	$10,027,671	$20.86	Yes

Source: DOTAX 2022 Hawai'i General Excise and Use Tax Exemptions report[18]

Relevant Legislative History

2007
Act 225, SLH 2007, enacted the exemption as Section 237-24.75(2).

2013
Act 174, SLH 2013:

- Renumbered the exemption from Section 237-24.75(2) to 237-24.75(3);
- Required registration (including payment of registration fees) of professional employer organizations under Chapter 373L, HRS, for exemption qualification;
- Required proof of compliance with professional employer organization registration laws;
- Added to professional employer organization registration laws the requirement that each professional employer organization disclose its professional employer agreement clients, its in-state payroll provider(s), and its latest W-3 tax form, which lists its employees and how much they were paid;
- Allowed posting an irrevocable letter of credit in place of a surety bond for a professional employer organization to enter into a professional employer agreement with a client, and prescribed amounts and language requirements for any such letter of credit or surety bond;
- Added and revised definitions for key terms, such as "Professional Employer Organization," "Department," and "covered employee;" and
- Revised statutory language in other ways, such as rephrasing "professional employment organizations" to "professional employer organizations," replacing "assigned employees" with "covered employees," and updating cross-references to other code sections.

What does this exemption do?

This provision exempts from GET revenue received by professional employer organizations, registered with the Hawai'i Department of Labor and Industrial Relations, from their client companies for wage reimbursements and other compensation reimbursements. Removing such revenues from GET effectively prevents double-taxation, as without the exemption the client companies would owe GET on their

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[18] The Office of the Auditor performed some calculations by itself, using DOTAX data.

income and employer organizations would owe GET on the same dollars passed to them to cover wages. The elimination of double taxation is further explored in our section on this exemption's purpose, below.

A professional employer organization, for purposes of the exemption, means an organization that contracts with client companies to provide that company with long-term employees, and specifically excludes companies providing temporary help services or similar short-term employment services. Only those amounts received by the professional employer organization from a client company that were disbursed by the professional employer organization to cover employee wages, salaries, payroll taxes, insurance premiums, and benefits such as retirement, vacation, and sick pay are exempt from GET. The exemption does not apply if the professional employer organization has not fulfilled or maintained registration requirements or failed to pay any withholding taxes with respect to the covered employees.

How the Exemption is Claimed

A professional employer organization reports wage reimbursement revenues on Schedule GE, under Exemptions/Deductions (ED) Code 137, "Professional Employer Organizations (§237-24.75(3))." Although relevant revenues are reported, they are subtracted from the business's total revenues on the periodic G-45 and the annual G-49. No GET should be owed on the relevant revenues.

Claimants are not required to provide proof of or otherwise substantiate the exemptions on their GET filings. However, because revenues associated with the exemption must be reported on Schedule GE, data exists to quantify tax expenditure.

What is the purpose of this exemption?

This exemption was part of a larger package of provisions – Act 225, SLH 2007 – whose collective purpose was to make outsourcing of employment and payroll more cost-effective for Hawai‘i's small business owners, while protecting employee rights. The particular cost savings embodied by the GET exemption is the elimination of double taxation. Without the exemption, there would be two levels of general excise taxation on the same income, as follows: first, GET would apply to revenues recognized by the employer client of the professional employer organization, from whatever services or products the client sells; second, GET would apply to revenues recognized by the professional employer organization itself, from its selling hiring services to the client – and including any wage reimbursements. The provision exempts the wage reimbursements, thus eliminating double taxation to the extent of those amounts.

Is the exemption meeting its purpose?

The direct beneficiaries of the exemption are the professional employer organizations receiving reimbursements for the wages paid to employees assigned to clients. Indirectly, clients of such organizations benefit to the extent GET is not passed on to them. Ultimately, the benefit to the client means that the exemption appears to be achieving its purposes.

What were the number of claimants, total amount claimed, and tax expenditures for this exemption from 2019-2022?

DOTAX reports 42, 43, 52, and 63 GET filings claiming the exemption in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under this exemption was $72,433,000, $181,867,000, $183,366,000, and $251,451,000 respectively. Over 99 percent of claims for this exemption were made at the retail rate, a fact for which our expenditure calculation accounts.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022	63	$251,451,000	$10,028,000	$0
2021	52	$183,366,000	$7,322,000	$0
2020	43	$181,867,000	$7,274,000	$0
2019	42	$72,433,000	$2,896,000	$0

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai'i General Excise and Use Tax Exemptions reports[19]

Note that the DOTAX expenditure value with respect to this exemption, for each of the last four years, is $0. This implies that DOTAX considers the incentive to be an exclusion, as opposed to exemption – meaning no GET was intended to apply or would be collected even were the exemption repealed. We disagree with that understanding of the tax incentive, as prior to the exemption the relevant reimbursements were, in fact, taxed. The Legislature enacted the exemption specifically to carve out the reimbursements from taxable income, and thereby prevent double taxation, as previously discussed.

We are aware of a separate, statutory exclusionary rule applicable to reimbursements, but we believe such rule should not apply with respect to the specific category of income covered by this exemption. Codified

[19] The Office of the Auditor performed some calculations by itself, using DOTAX data.

at Section 237-20, HRS, is a general principle that reimbursements of costs or advances made for or on behalf of another shall not constitute gross income of that person – meaning such income will be excluded and not reportable. However, that rule is tempered by two limitations, both of which should prevent it from applying to the revenues covered by this incentive. First, the Section 237-20 principle appears in the context of companies or other legal persons receiving reimbursements from their constituents – such as a corporation reimbursed by its own shareholders or an association reimbursed by its members. Here, the income is not flowing from a constituent to a whole, but from a purchaser of services to an entirely unrelated seller. Second, the principle, by its own language later in the statute, does not apply when the person receiving the reimbursement also receives additional monetary consideration for covering the relevant costs or advances. Here, the professional employer organization, in addition to receiving reimbursements, is paid an additional amount for its services, which include the payment of employee compensation. Ultimately, the exclusionary rule for reimbursements should not apply to reimbursements to professional employer organizations from those organizations' clients.

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

There is insufficient data readily available to draw any conclusion as to whether this exemption has been the cause of any economic activity, or lack thereof, in the State.

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

We recommend that the exemption for professional employer organizations be retained. It appears to be meeting its intended purpose without any significant adverse effect.

General Excise Tax Exemptions for Enterprise Zones (Section 209E-11, HRS)

These exemptions were enacted as a part of Act 78, SLH 1986, in which the Legislature asserted that there were certain areas in the State needing particular attention of government to help attract private-sector investment. These areas, or "Enterprise Zones," are meant to be major economic development tools to help bring business and employment opportunities to otherwise economically challenged areas. Eligible businesses located within an Enterprise Zone and that meet hiring requirements are exempt from GET and may claim personal or corporate non-refundable income tax and state unemployment premium credits, among other benefits. Counties can also offer additional incentives, such as incremental property tax relief, priority permit processing, or fee waivers.

Exemption at a Glance (2022)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
$254,851,000	**149**	**$2,715,641**	**$5.65**	**Cannot determine**

Source: DOTAX 2021 Hawai'i General Excise and Use Tax Exemptions report[20]

Relevant Legislative History

1986
Act 78, SLH 1986, enacted the provision as part of an entirely new HRS Chapter on State Enterprise Zones.

1989
Act 390, SLH 1989

- Defined and delimited key terms, notably including "qualified business" and "service business or calling;"
- Updated U.S. census references to reflect the then-upcoming census of 1990;
- Required the DBEDT to consult the DOTAX in adopting Enterprise Zone rules;
- Reduced for Enterprise Zone business qualification the employee growth requirement from 10 percent to 5 percent, but required for continued qualification that the post-growth level of employment be maintained year over year;
- Required for Enterprise Zone business qualification that products sold in an Enterprise Zone have their transfer of title and delivery occur within the Enterprise Zone and that services sold in an Enterprise Zone be delivered in the Enterprise Zone; and
- Specifically with respect to the GET exemption, narrowed income covered to gross proceeds from the manufacture of tangible personal property, the wholesale sale of tangible personal property, or the engaging of a service business or calling.

While most of the above changes enacted by Act 390 did not affect the GET exemption directly, they affected who may qualify for the exemption and when, and how the Enterprise Zone chapter – including the GET exemption – is enforced and managed.

[20] The Office of the Auditor performed some calculations by itself, using DOTAX data.

1996
Act 286, SLH 1996:

- Added and clarified various definitions relevant to the type of business that qualifies as an Enterprise Zone business, notably narrowing "service business" and "full-time employee;"
- Required for qualification as an Enterprise Zone business that a business increase its average annual number of full-time employees by 10 percent by the end of its first year of participation in the Enterprise Zone program;
- Required for continued qualification that a business maintain its heightened level of employment after its first year; and
- Exempted from certain qualification requirements agriculture producers in a county populated by fewer than one-hundred thousand.

1997
Act 262, SLH 1997, further narrowed the definitions of certain services and further specified requirements by which certain agricultural producers may qualify for the exemption.

Act 262 also expanded the exemption provision to cover Use Tax and to include contractors engaging in construction in an Enterprise Zone for a qualified Enterprise Zone business.

2000
Act 118, SLH 2000:

- Further revised various definitions;
- Expanded the exemption to apply to businesses engaging in research, development, sale, or production of genetically engineered medical, agricultural, or maritime biotechnology products;
- Required construction contractors seeking to qualify to be duly licensed.

2002
Act 146, SLH 2002, permitted businesses to use their average number of full-time employees as of August 31, 2001 – and not their fiscal year ends – for Enterprise Zone business qualification purposes, for any fiscal year that included September 11, 2001.

2008
Act 143, SLH 2008:

- Added provisions for leased employees and employees under a joint employment agreement;
- Expanded application of the Enterprise Zone chapter to agricultural processors and added various special provisions for agricultural producers and processors;
- Added a force majeure tolling proviso to the seven-year maximum duration of the GET exemption, and defined "force majeure" for Enterprise Zone chapter purposes; and
- Precluded agricultural businesses other than producers of genetically-engineered agricultural products from exempting gross proceeds from retail sales.

2009
Act 174, SLH 2009:

- Revised the business activity requirement for otherwise qualified businesses, including the addition of wind energy sales to qualified utilities as an eligible activity;
- Eased a requirement that employment (or agricultural production or processing) occur within the same zone to one that the occurrence be within the same county as the business seeking Enterprise Zone qualification;
- Allowed for the limited liability company as an entity choice for a business seeking Enterprise Zone qualification;
- Revised the Enterprise Zone income tax credit in ways that did not affect the GET exemption;
- Allowed the construction contractor GET exemption to apply not only to Enterprise Zone businesses, but also to businesses approved for the Enterprise Zone program (even if not yet in the Enterprise Zone); and
- With respect to manufacturers and agricultural producers and processors only, allowed an extension of the GET time limit to ten years.

What does this exemption provision do?

This provision exempts from GET the revenue from activities in an Enterprise Zone by two distinct types of business: a business qualified by the Hawaiʻi Department of Business, Economic Development and Tourism (DBEDT) as an Enterprise Zone business and a licensed construction contractor.

Enterprise Zone Businesses

The first of the two exemptions in Section 209E-11, HRS, applies to businesses operating within an Enterprise Zone. The law allows qualified businesses in an Enterprise Zone not to have to pay GET on proceeds from eligible business activities undertaken in the same county as that zone. What businesses qualify, and which activities are eligible, are identified by other sections of the HRS Chapter on Enterprise Zones, as follows.

A business is a "qualified business" for exemption purposes if it is so authorized by DBEDT, which requires that the business engage in eligible business activity in an Enterprise Zone, attribute at least 50 percent of its gross receipts to operations within Enterprise Zones in the same county, and meet one of two additional growth requirements, depending on whether it is an agricultural or non-agricultural business. The additional growth requirement for an agricultural business is a rise of at least two percent in gross sales of agricultural products produced or processed within Enterprise Zones in the same county as the Enterprise Zone of operations. The additional growth requirement for a non-agricultural business is a rise of at least ten percent in average number of full-time employees over the first year within Enterprise Zones in the same county as the Enterprise Zone in which the business primarily operates. The business must also maintain the new, heightened level of employment, during each successive year. In the case of any business selling physical goods or services, the items sold must also be sold within an Enterprise Zone – and, in the case of goods, that Enterprise Zone and the Enterprise Zone in which title transfers must all be within the same county. Finally, to remain qualified year after year, any qualified business must submit and have approved by DBEDT annual applications for recertification.

Eligible business activity is defined by an exhaustive list of qualifying activities. Eligible activities are prescriptively limited to:

- The manufacture or wholesale sale of tangible personal property;
- Services in the repair of ships, aircraft, or assisted technology equipment, or in the fields of telecommunications, information technology design and production, medicine, healthcare, education, or training;

- Genetically-engineered medical, agricultural, or maritime biotechnology product research, development, sale, or production;
- Wind energy production for sale to a public utility; and
- Agricultural production or processing within an enterprise zone, except that retail sales of non-genetically-engineered agricultural products are not exempt.

Statutorily excluded are any activities of a medical cannabis dispensary, regardless of whether such activities would otherwise qualify.

The exemption can be claimed for up to seven years only or, in the case of manufacturing or the producing or processing of agricultural products, for up to ten years.

Enterprise Zone Construction Contractors
The second of the exemptions in Section 209E-11, HRS, is for income from Enterprise Zone construction within an Enterprise Zone. Income received by a contractor for construction work is exempt from GET, provided that the contractor is Hawai‘i-licensed and the work is performed in an Enterprise Zone for an Enterprise Zone qualified business.

How the Exemptions are Claimed

With respect to claims by qualified businesses, taxpayers report revenues that they intend to exempt on Schedule GE, under Exemptions/Deductions (ED) Code 115, “Enterprise Zones (§209E-11).” The revenues are thus reported, but are subtracted out – via Schedule GE and the periodic G-45 – prior to calculating the amount of GET owed. No GET should be owed on the relevant revenues.

With respect to claims by construction contractors serving qualified businesses, taxpayers report in precisely the same way, but under ED Code 107, “Contracting Activity in an Enterprise Zone (§209E-11).” The two exemptions – one for qualified businesses and one for construction contractors – are tracked separately by DOTAX.

What is the purpose of these exemptions?

The purpose of the Enterprise Zone program was to stimulate business and industrial growth in areas where such would result in neighborhood revitalization. Such growth was to be accomplished by regulatory flexibility and tax incentives, with these exemptions as incentives provided under the program.

Are the exemptions meeting their purpose?

We cannot determine from data available whether either GET exemption is meeting its purpose. DBEDT annually publishes a report evaluating the effectiveness of the Enterprise Zone program and providing related recommendations to the Governor, but it is unclear from the DBEDT reports how much, if at all, the GET exemption stimulated business and industrial growth in areas needing revitalization. In 2022, DBEDT-certified Enterprise Zone companies reported 855 new or maintained jobs statewide, signifying a decline from the 1,113 reported in 2021. DBEDT attributed much of the decline to the COVID-19 pandemic, and the report does not evaluate the extent to which jobs created and maintained impacted the economic vitality of their surrounding Enterprise Zone. Secondly, there is no way to segregate any impact caused by the GET exemption under Section 209E-11 from any impact caused by the rest of the Enterprise Zone program – notably the Enterprise Zone income tax credit allowed under Section 209E-10, HRS. There are also no benchmarks or performance targets for the Enterprise Zone exemption established in Section 209E-11.

What were the number of claimants, total amount claimed, and tax expenditures for these exemptions from 2019-2022?

DOTAX reports 192, 187, 169, and 149 GET filings claiming the exemptions in 2019, 2020, 2021, and 2022, respectively. For each of those years, the total amount of revenue that was exempted under the exemptions was $476,140,000, $471,695,000, $440,397,000, and $254,851,000, respectively. Over 88 percent of claims for the exemptions were made at the wholesale rate, for which our expenditure calculation accounts.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2022 Total	**149**	**$254,851,000**	**$2,715,641**	**$9,710,000**
Claims under ED 115	124	$241,034,000	$2,162,957	$9,641,000
Claims under ED 107	25	$13,817,000	$552,684	$69,000
2021 Total	**169**	**$440,397,000**	**$4,442,913**	**$16,765,000**
Claims under ED 115	141	$416,081,000	$3,470,290	$16,643,000
Claims under ED 107	28	$24,316,000	$972,623	$122,000
2020 Total	**187**	**$471,695,000**	**$5,091,327**	**$16,791,000**
Claims under ED 115	129	$412,342,000	$3,784,663	$16,494,000
Claims under ED 107	58	$59,353,000	$1,306,664	$297,000
2019 Total	**192**	**$476,140,000**	**$4,505,518**	**$18,431,000**
Claims under ED 115	129	458,581,000	$4,047,896	$18,343,000
Claims under ED 107	63	17,559,000	17,559,000	$88,000

Source: DOTAX 2019, 2020, 2021, and 2022 Hawai‘i General Excise and Use Tax Exemptions reports[21]

We note that DOTAX appears to calculate the expenditure for ED 115, pertaining to qualified businesses, differently from how it calculates that for ED 107, pertaining to contractors. With respect to qualified businesses claiming the exemption for operating in an Enterprise Zone, DOTAX uses the retail rate only – for all such claimants. Implicit in the use of the retail rate is an assumption that all such businesses are selling to end consumers only. With respect to construction contractors, by contrast, DOTAX appears to assume that all contractors are selling to buyers who are *not* end consumers. It applies the wholesale rate to expenditure calculations with respect to contractors.

[21] The Office of the Auditor performed some calculations by itself, using DOTAX data.

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

The DBEDT annual Enterprise Zone report from 2022 shows that Enterprise Zone companies claiming the exemptions have created or maintained jobs, but we cannot determine to what extent there is or is not a causal connection between such job creation and the exemptions. According to the report, Enterprise Zone companies reported creating or maintaining 1,113 jobs in 2021. Forgone revenue from Enterprise Zone GET exemptions for the same year totaled $4,442,913. Hence, even excluding the expenditure of any Enterprise Zone income tax credits, the GET exemptions cost the State $3,992 per job. Based on DOTAX expenditure values above, the cost per job rises to $15,062. Factoring in Enterprise Zone income tax expenditures would only raise the cost per job further. DBEDT has stated the cost per job of the income tax credit and a related GET exemption, combined, has been fairly consistent in past years, never exceeding $2,500. However, DBEDT assumes the wholesale rate for all related transactions and does not factor in construction contractor claims under exemption/deduction code 107.

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

We lack sufficient adequately reliable data and analysis to determine whether the tax credit should be retained, substantively amended, or repealed. The ultimate goal of the exemption is to revitalize neighborhoods, a goal we understand to imply job growth and job maintenance. While the rate of job growth in Enterprise Zones has decreased, DBEDT attributes that decline to COVID-19 – and jobs have consistently grown or been maintained. Unfortunately, we cannot determine to what extent the decrease may be due to an exemption or another cause. Additionally, the Legislature did not include performance criteria for measuring achievement of the purpose of the exemptions. Ultimately, to what extent the exemptions motivate business growth in Enterprise Zones is something we cannot determine.

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
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

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

Report Date	HRS Ref.	Statute to be reviewed	Notes
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

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 and Hawai‘i 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 that definition, we find an estimated 480,801 "low-income residents" statewide in 2020 based on data provided by the Department of Business, Economic Development and Tourism. Using that number of low-income residents, we calculate the cost of each exemption per low-income resident, included in the table below.

We also include in the table below the cost of each exemption per Hawai‘i resident, regardless of income level. Such cost is calculated using Hawai‘i's 2022 resident population of 1,440,196 people. The results in the table below follow and include the Auditor's tax expenditure estimates only; they do not factor in DOTAX expenditure estimates.

Cost of Tax Provisions Per Resident and Per Low-Income Resident

HRS Section	Matter	Auditor's Cost Estimate	Cost Per DBEDT "Low-Income Resident"	Cost Per Hawai‘i Resident
237-24.3(4)	Employee Benefit Plans	$13,295,860	$27.65	$9.23
237-24.3(5)	Food Stamps and Vouchers under the Special Supplemental Nutrition Program for Women, Infants, and Children	$0	$0	$0
237-24.3(6)	Prescriptions & Prosthetics	$73,704,160	$153.29	$51.18
237-24.3(8)	Merchants Association Dues	$274,575	$0.57	$0.19
237-24.3(9)	Labor Organization Property Leases	$11,914	$0.02	$0.01
237-24.75(2)	Hawai‘i Convention Center Operator	$887,354	$1.85	$0.62
237-24.75(3)	Professional Employer Organizations	$10,027,671	$20.86	$6.96
209E-11	Enterprise Zones	$2,715,641	$5.65	$1.89

Source: Office of the Auditor