Selected Issue with The Hawaii General Excise Tax

2010-2013 Hawaii Tax Review Commission

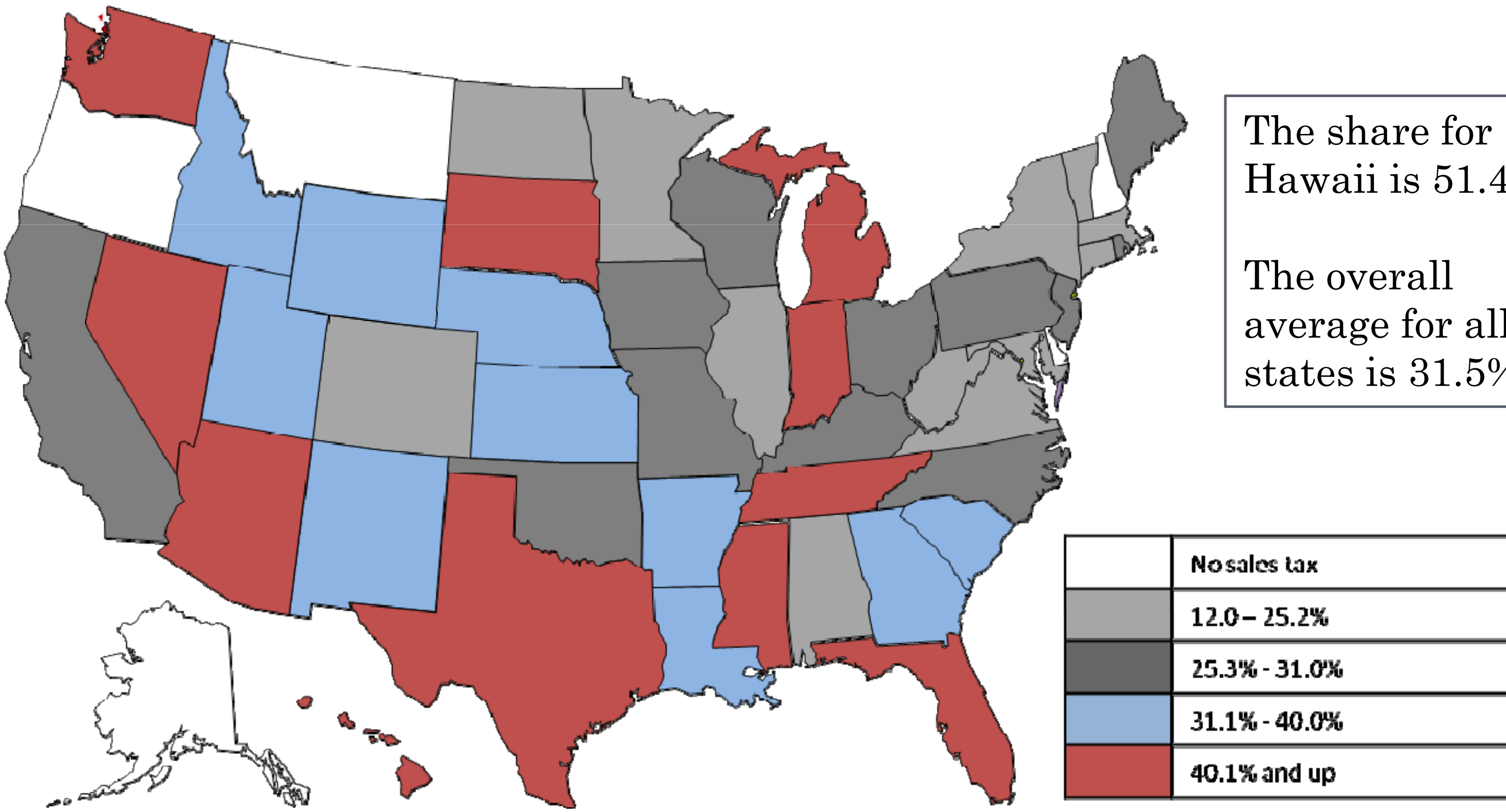
Report by Dr. William F. Fox
Presented by Dr. Donald Rousslang

July 24, 2012

ESTIMATES OF THE REVENUE LOST TO REMOTE SALES (E-COMMERCE AND CATALOGUE SALES)

Overview of the GET

Figure 1. State Sales Tax Collections as Share of Total Tax Revenue, 2011



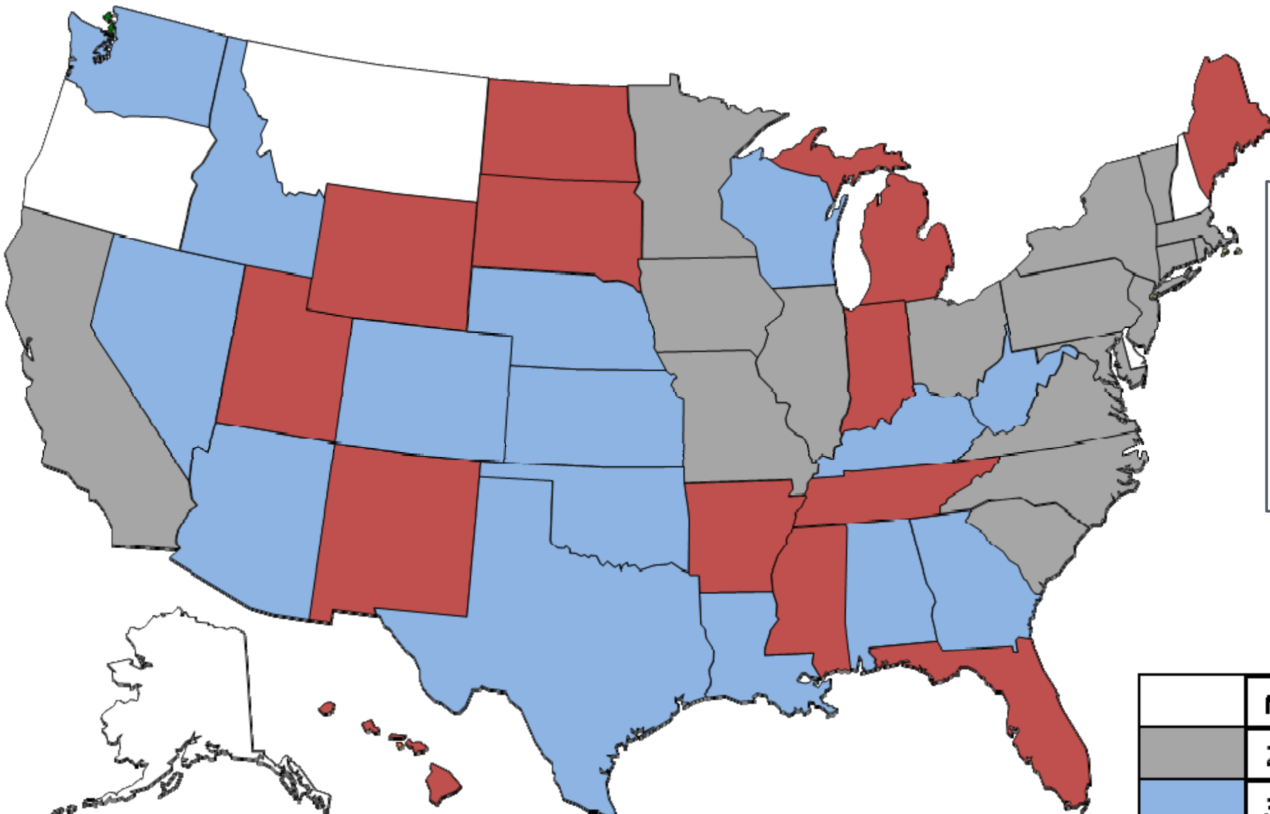
The share for Hawaii is 51.4%.

The overall average for all states is 31.5%

Source: Author's calculation

Overview of the GET

Figure 2. State Sales Tax as Percent of Personal Income, 2010



(white)	No sales tax
(gray)	23.0% - 32.9%
(blue)	33.0% - 38.0%
(red)	38.1% - 100.7%

Hawaii has the highest percentage at 100.7%.

The average for all states is 33%.

Source: Federal Tax Administration

ESTIMATES OF THE REVENUE LOST TO REMOTE SALES (E-COMMERCE AND CATALOGUE SALES)

- ***Data Sources***
  - U.S. Census Bureau data on total e-commerce in the U.S. from 2000 through 2009, broken down by type of sale: manufacturing, wholesaling, services, and retail.
  - U.S. Census Bureau data on types of customers for each type of seller (national data for all sales, not just e-commerce sales).
  - Estimates of compliance rates of e-commerce retailers at the national level, obtained by examining the websites of about 100 large e-commerce sellers. (The overall compliance was estimated to be 20%.)
  - Estimates of the compliance rates by business in paying Use Tax are taken from a study by the Washington State Department of Revenue. (It was estimated that businesses pay 77% of the Use Tax due on their e-commerce purchases.)

ESTIMATES OF THE REVENUE LOST TO REMOTE SALES (E-COMMERCE AND CATALOGUE SALES)

- ***Method***
  - **Step 1**:
    - Forecast total e-commerce sales for 2010 through 2015.
    - This was done by applying the historic relationship between e-commerce and U.S. GDP to forecasts of future U.S. GDP provided by Global Insights.
    - Growth in catalogue sales was projected to be much less, based on historic growth of non-store retailers.
  - **Step 2**:
    - Estimate e-commerce sales to Hawaii customers.
    - The Hawaii sales were estimated by assuming e-sales to Hawaii customers is equal to Hawaii's share of the total state and local sales taxes paid in the U.S.
    - This share was about 0.8% (Hawaii's share of the overall national economy is about 0.5%).

ESTIMATES OF THE REVENUE LOST TO REMOTE SALES (E-COMMERCE AND CATALOGUE SALES)

- ***Method***
  - **Step 3**:
    - Estimate the GET and Use Tax due on the e-sales.
    - This was estimated using the data on type of customer for each type of e-commerce seller.
    - For sales to businesses, the tax is ½% on inputs or purchases for resale and 4% on purchases for use by the business.
    - For sales to consumers (including catalogue sales), the tax is 4%.
  - **Step 4:**
    - Estimate compliance with the GET and Use Tax.
    - E-commerce sellers were assumed to pay 20% of tax due on all their sales to Hawaii customers.
    - Consumers were assumed not to pay Use Tax if the tax was not collected by the seller.
    - Businesses were assumed to pay 77% of the Use Tax on their purchases when the tax was not collected by the seller.
    - Compliance for catalogue retailers was assumed to be the same as for e-sales.

Estimates of the revenue lost to remote sales (e-commerce and catalogue sales)

- ***Summary of Results***
  - Table 1 shows the revenue losses attributable to e-commerce and catalogue sales.

Table 1
Tax Revenue Losses From E-Commerce and Catalogue Sales
(in $millions)

Tax Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Tax due	$241	$271	$297	$331	$384	$450
Mail Order	35	37	39	41	43	45
Total	276	308	336	371	427	495
Compliance	157	175	191	211	243	283
Revenue loss	$119	$133	$145	$160	$183	$211

  - Of the $145 million revenue loss shown for tax year 2012, about $114 was due to e-commerce sales and $31 was due to catalogue sales.

SUMMARY OF FEDERAL LEGISLATION ON REMOTE SALES

SUMMARY OF FEDERAL LEGISLATION ON REMOTE SALES

- The **Main Street Fairness Act** determines that simplification and harmonization have occurred when states become full members of the Streamlined Sales and Use Tax Agreement (SSUTA). Thus, states must comply with provisions of the SSUTA in order to require remote vendors to collect their sales tax.

SUMMARY OF FEDERAL LEGISLATION ON REMOTE SALES

- The **Marketplace Equity Act** develops a unique set of criteria that must be met before states can require remote firms to collect the sales tax.
- The criteria have some similarities to the SSUTA, but are not precisely the same. Among the criteria are that a state:
  - must develop a small seller exception, which would exempt firms with $1 million or less in national sales or $100,000 or less in sales to the state which would require the collection responsibility.
  - must have a remote seller tax return and a single tax authority for remote sellers.
  - must have a single set of definitions for taxable items across the state.
  - must impose either a blended state and local tax rate, a maximum state rate, or an applicable destination tax rate for each local jurisdiction into which sales are made.
  - must publish detailed information about the collection requirements about six months before the collection requirements can be imposed on remote sellers.

SUMMARY OF FEDERAL LEGISLATION ON REMOTE SALES

- The **Marketplace Fairness Act** mixes the approaches of the other two bills by allowing states to either be in compliance with the SSUTA or to comply with a set of other criteria. The alternative criteria include:
  - providing a single state agency to administer all sales and use tax legislation, a single audit for all state and local taxing jurisdictions, and a single sales tax return for remote sellers.
  - developing a uniform sales tax base for state and local governments.
  - requiring remote vendors to collect a destination tax for every jurisdiction.
  - providing software and services to facilitate collection by remote sellers.
  - relieving sellers from liability for tax collection error resulting from information provided by the state.
  - providing at least 30 days notice for local tax rate changes.

SUMMARY OF FEDERAL LEGISLATION ON REMOTE SALES

- A brief summary is given of efforts being undertaken by other states to combat revenue losses from e-commerce on pages 13 and 14.
- None of the efforts is deemed very effective.
- The main approaches have been to broaden the definition of nexus to include ownership of a related company or when an internet company with physical presence in the state directs sales to the remote firm (so-called "click-through nexus").
- A second approach has been to require information reporting by remote sellers.

Assessment of revenue costs of various GET exemptions

Assessment of revenue costs of various GET exemptions

- The report examines several GET exemptions, divided into two categories:
  - (1) consumer exemptions, and
  - (2) exemptions for business inputs.
- Category (1) includes exemptions for nonprofit organizations, for sales of prescription drugs, and for health insurance premiums paid to HMO's and mutual benefit societies.
- Category (2) includes exemptions for amounts received by hotel operators as reimbursement for employee wages, for rents from aircraft leasing, for aircraft maintenance and repairs, and for payments to subcontractors (the subcontractors' deduction).

ASSESSMENT OF REVENUE COSTS OF VARIOUS GET EXEMPTIONS

- The revenue gains are presented in Table 2 below. Behavioral responses may greatly reduce the revenue gains from eliminating the subcontractors' deduction and the exemption for amounts received by hotel operators for employee wages.

Table 2

Tax Revenue Losses From Various GET exemptions in 2012 (in $millions)

	Revenue gain	Gain as a percent of total tax collections
Nonprofits	$254.0	5.2
Health Insurance Premiums	108.0	2.2
Subcontractor's deduction	96.0	2.0
Hotel wages	46.0	1.0
Prescription drugs	30.0	1.0
Aircraft leasing	4.0	0.0
Aircraft maintenance	2.0	0.0
Total	$540.0	11.1

Consequences of replacing the revenue from the corporate and personal income taxes with an increase in the GET

CONSEQUENCES OF REPLACING THE REVENUE FROM THE CORPORATE AND PERSONAL INCOME TAXES WITH AN INCREASE IN THE GET

- Table 3 shows consequences of replacing net income taxes with the GET.

Table 3

Effects of Replacing the Revenue from the Corporate and Individual Net Income Taxes with an Increase in the GET

	Taxes Eliminated				
	Corporate and Individual	**Corporate only**	**Individual only**	**Individual below poverty**	**Individual for the bottom 90%**
Required GET Rate (in %)	6.1	4.1	6	4.2	5
After Behavioral Response (in %)	6.2	4.1	6.1	4.2	5.1

- Behavioral responses include increased work effort and investment (caused by eliminating the income taxes) and a shift in consumption from taxed items to untaxed items (such as remote sales).

THANK YOU