May 13, 2021

2020-2022 Hawaii Tax Review Commission
c/o Tax Research and Planning Office
Department of Taxation
Via Email: tax.research@hawaii.gov

Dear Commissioners:

We at the Tax Foundation of Hawaii applaud your mission. Reviewing the Hawaii tax system for equity and efficiency is a formidable task, and different Commissions over different years have raised a host of issues. Some have been addressed and others have not.

I am writing today to bring to the Commission’s attention an issue on which there is already much complexity and unfairness within the industry: excise taxation of transportation.

The attached article, “Why Are We Taxing Transportation?” published in Tax Notes State last year, should give you an idea of the constitutional, statutory, and policy considerations involved.

Even as recently as the 2021 Legislature, legislation introduced showed confusion in this area. House Bill 408 would have directed the Department to apply the GET to air tours, disagreeing with its interpretation of federal preemption. But the Departments of Taxation and Attorney General gave testimony that led to deferral of the bill despite supportive testimony from several individuals and coalitions.

If you believe that this topic is worthy of more in-depth consideration, I would be happy to take part in further discussions you may wish to have about it.

Sincerely,

Thomas Yamachika
President
Why Are We Taxing Transportation?

by Tom Yamachika

Reprinted from Tax Notes State, June 22, 2020, p. 1447
Why Are We Taxing Transportation?

by Tom Yamachika

I am sometimes asked if I have any radical ideas to change the tax system in Hawaii. Here’s one: Stop taxing transportation of goods and people. Why? States face federal prohibitions against taxing parts of the transportation industry, and then Hawaii has a patchwork of exemptions that affect the industry as well. Repeal of the taxation system in the entire transportation sector would decrease complexity, restore some level in the competitive playing field, and lead to a lower cost of living in a state that is now infamous for its astronomical living costs.

First, air transportation enjoys protected status. Federal laws prohibit any state from applying a gross receipts tax, like Hawaii’s general excise tax (GET), to transportation charges. Back in the late 1970s and early ’80s, Hawaii tried to tax air carriers by imposing the public service company tax, which applies to public utilities in lieu of Hawaii’s sales tax equivalent, the GET. Hawaii was very creative. The Hawaii Supreme Court held, and our state told the U.S. Supreme Court, that our tax was actually a tax on real and personal property (which was allowed), but because it was so difficult to value the kinds of property that utilities had — like airspace rights, rights of way for power and cable lines, or easements for water pipes — the tax used the gross income of an airline as a proxy for valuing its property. The U.S. Supreme Court didn’t buy the argument. In effect, the justices said in a unanimous 8-0 decision: “It’s still a tax measured by gross receipts, which is a gross receipts tax under federal law, and we interpret that federal law.”

Despite this ruling, zealous tax auditors still tried to go after helicopter tour companies — and those companies pushed back, leading the Department of Taxation to rule in 1989 that those gross receipts were immune from both the public service company tax and the GET.

There are also federal restrictions on taxing transportation by water. Federal law prohibits anyone other than the federal government from taxing a vessel, its passengers, or its crew while

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the vessel is operating on navigable waters. In 2010 the Hawaii Intermediate Court of Appeals ruled that the GET as applied to charges for chartering a sport fishing boat was valid because it was a tax on the business and not on the vessel, passengers, or crew. The court reasoned that the federal law was meant to prohibit fees and taxes on a vessel simply because the vessel sails through a given jurisdiction and didn’t mean to affect whether sales or income taxes can apply in general. The Hawaii Supreme Court declined to review the case, as did the U.S. Supreme Court. Thus, the GET apparently could be applied to intrastate water transportation.

But that case did not definitively resolve the question whether GET can be applied to interstate or international water transportation. The U.S. Supreme Court had held in the distant past that states could not apply a gross income tax to activities in interstate commerce. One case directly involved transportation by water being conducted by a company shipping goods between California and Hawaii, and the Court said in no uncertain terms that a tax on gross earnings was prohibited. Supreme Court cases extended the immunity from tax to stevedoring, as it was seen to be inseparable from the underlying transportation. But on April 26, 1978, the Court overruled those cases, holding that nondiscriminatory taxation was permissible under the commerce clause. The Hawaii Department of Taxation pounced on that decision, issuing guidance saying the GET would be imposed on stevedoring and other transportation-related activities, including the transportation itself.

The guidance, however, alarmed then-Gov. George Ariyoshi, who was concerned about the impact on the state’s economy and welfare. He apparently ordered the department to do an about-face, which it did, ruling:

The implementation of the guidelines for the taxation of stevedoring and other interstate commerce activities published in Tax Information Release No. 56-78, issued June 15, 1978, is hereby suspended indefinitely. The effective date for their implementation was to have been July 1, 1978. Stevedoring and other interstate commerce activities and the proceeds derived therefrom have historically enjoyed exemption from State taxation and the exemption will continue for an indefinite period. No assessment of such taxes will therefore be made by the State of Hawaii at this time.

That ruling was listed several times in the past as being in effect and not obsolete, and has never been revoked or obsoleted. There is therefore a continuing question whether the department has chosen not to tax interstate or international shipping (and ancillary activities such as stevedoring) for policy reasons.

In the meantime, fine distinctions are being made. In cases involving UPS and Lynden Air Freight, the Hawaii Supreme Court held that when a shipper pays for a shipment to go from (or to) a location in Hawaii other than the airport, GET can and does apply to the revenue allocable to the transportation by ground between the Hawaii place of origin (or destination) and the airport.

Application of the GET is also tricky because transportation of either people or cargo often involves transit of open ocean, outside the taxing jurisdiction of Hawaii. The Department of Taxation ruled in 1981 that it was not taxing transactions that took place more than 3 miles offshore, referring to receipts from the sale of

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9 33 U.S.C. section 5(b).
11 Id.
13 Puget Sound Stevedoring Co. v. State Tax Commission, 302 U.S. 90 (1937); and Joseph v. Carter and Wekes Stevedoring Co., 330 U.S. 422 (1947). Both cases were overruled; see infra note 14 and accompanying text.
liquor and other beverages on interisland flights. But it has ruled on multiple occasions that journeys between islands of the state, even though crossing international waters, are fully subject to GET, citing a century-old Supreme Court case allowing California to regulate ferry service between San Pedro and Santa Catalina Island because there was no intervening jurisdiction. The result is that transportation by water is, at least in theory, fully subject to tax if the transportation is between Hawaiian islands, but that the tax only reaches the 3 miles nearest Hawaii for transportation between Hawaii and another state or country, so in the latter case the GET needs to be apportioned if it applies at all.

Exemptions also pepper the landscape. The GET exempts amounts received from the loading, transportation, and unloading of agricultural commodities shipped for a producer or produce dealer on one island of this state to a person, firm, or organization on another island of this state. The exemption contemplates that separate companies, many of which exist in the maritime transportation sector, are hired to do tasks separable from the actual transportation (such as stevedoring). Other exemptions cover specific services, including loading or unloading cargo from ships, barges, vessels, or aircraft (but do not exempt the services if the origin and destination are on the same Hawaiian island); tugboat services, including pilotage fees and towing fees; and transportation of pilots or governmental officials to ships, barges, or vessels offshore, rigging gear, checking freight and similar services, standby charges, and use of moorings and running mooring lines. There is also an exemption for income associated with an aircraft service or maintenance facility, but only for aircraft operating with two or more jet engines.

In short, the landscape here is filled with complexity and disparities between different sectors in the transportation and shipping industries. Are there good reasons why, as a matter of tax policy, Hawaii should tax water and ground transportation when air transportation can’t be taxed? One of the reasons often given to explain Hawaii’s astronomical cost of living is that goods and people need to be shipped in and out, and that isn’t done for free. The GET becomes another part of that cost. That may explain why Hawaii has so many exemptions applicable to this industry.

What will happen if the GET is not imposed? The industries would compete on a more level playing field, residents would feel some relief in the cost of living department (or at least sellers wouldn’t be able to use the tax on shipping goods in as an excuse), and the government revenues might not drop precipitously because fewer costs may lead to more buying and thus more total revenue subject to GET taxation.

So why is Hawaii taxing transportation? Let the debate begin!

21 Wilmington Transportation Co. v. Railroad Commission of California, 236 U.S. 151 (1915).
22 Haw. Rev. Stat. section 237-24.3(1). A previous version of the exemption restricted its application to products raised, grown, or caught in Hawaii and was declared unconstitutional as violating the commerce clause. In re Hawaiian Flour Mills Inc., 76 Haw. 1, 868 P.2d 419 (1994).