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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

TESTIMONY REGARDING SB 2030 RELATING TO THE GENERAL EXCISE TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: JANUARY 29, 2008

TIME: 1:15PM

ROOM: 224

This bill proposes a "tax holiday," whereby retail purchases made by ultimate consumers for food and over-the-counter drugs would be exempt from the general excise tax for purchases made on a single particular day in December.

The Department of Taxation (Department) **strongly supports** the intent of this measure, which is to provide a measure of tax relief to the constituents of the State; **however the Department prefers the approach taken in the Administration measure, SB 1496.** The Department also notes the administrative difficulty it will encounter in administering the proposal.

I. TAX HOLIDAYS, GENERALLY

"Tax holidays" are generally designed to assist lower bracket taxpayers at times when cash becomes tight. Most tax holidays occur prior to the opening of school and apply the exemption to sales of clothing and school supplies on a particular day. In 2007, two states have tax holidays on which sales of all tangible personal property is exempt from tax (Louisiana, Massachusetts), while two others had "tax holidays" for the purchase of energy efficient products or weatherization products or school-related goods (Florida, Oklahoma). Some states impose limits based on a per-item cost or aggregate expenditure. The Department is not aware of any other state that offers a tax holiday for the purchase of food and/or over-the-counter drugs.

II. INADEQUATE DEFINITION OF "FOOD" OR "OVER-THE-COUNTER DRUG"

The measure fails to define "food" or "over-the-counter drug", other than to state, "food" means "any article or product purchased for human consumption and does not include alcoholic beverages." Likewise, "over-the-counter drug" is defined as "any drug that is not a "prescription drug" as that term is defined in section 237-24.3(7), Hawaii Revised Statutes." This leaves to

speculation about whether various items are or are not subject to the tax holiday. For example, is common rubbing alcohol included as an over-the-counter drug. The Department foresees substantial unease by the retailing community because of the lack of guidance on what constitutes a food item or an over-the-counter drug, and the Department would be required to expend substantial resources to draft rules over the meaning of these phrases.

III. INABILITY OF THE DEPARTMENT TO INSURE COMPLIANCE

The proposal provides that only retail sales for the consumer's own use are subject to the tax holiday, and not the sales of any item that will be resold. The Department would have no ability to determine whether the purchaser in fact consumed the items or resold the items. Likewise, the Department would have no way of determining whether retailers simply increased the cost of items to offset the decrease in the general excise tax or indeed the consumers ultimately benefited from tax holiday.

IV. INABILITY OF THE DEPARTMENT TO REPORT TO THE LEGISLATURE

The proposal sets the tax holiday as the first Saturday or Sunday in December,¹ and requires the Department to report to the Legislature at least twenty days prior to the convening of the 2009 Legislature on the costs of the tax holiday. The Department will be unable to meet this deadline. General excise tax returns for sales made in the month of December, 2008 are not due to the Department until January 31, 2009. It would then take additional time to tally the data, but in any event, such information will not be known until well after the Legislature has convened.

V. APPROPRIATION

This legislation requires the Department to adequately notify the public about the tax holiday. The Department's public outreach efforts will be most effective with additional resources to run newspaper and television commercial notices. The Department is currently without independent resources to accomplish this. In addition, the Department would need an appropriation to modify its computer system to obtain the information relating to this exemption.

VI. THE DEPARTMENT PREFERS SB 1496

The Department prefers the approach taken in SB 1496 because it exempts entirely the sale of food to those who would most benefit from it-the women, infants, and children which are enrolled in the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) as administered by the federal Food and Nutrition Service of the United States Department of Agriculture program. The Department strongly believes that SB 1496 provides substantial relief to those needing it most. In addition, the Administration's amount has already been factored into the Executive Budget.

This bill will result in a revenue loss of approximately \$407,000 (food = \$385,000 and drug

¹ The bill should choose one date to give retailers as much time and certainty as possible to prepare for the tax holiday.

Department of Taxation Testimony

SB 2030

January 29, 2008

Page 3 of 3

= \$22,000) in FY 2009.



founded 1881

January 22, 2008

The Honorable Lorraine Inouye, Member
Hawaii Senate
Hawaii State Capitol, Room 201
415 South Beretania Street
Honolulu, Hawaii 96813

By Email

Dear Senator Inouye:

Thank you for sponsoring **Senate Bill 2030**, which would create a one day sales tax holiday for nonprescription drugs and food. The bill was recently referred to the Economic Development and Taxation Committee.

CHPA is the 126-year-old trade association representing manufacturers of over-the-counter (OTC) medicines and nutritional supplements. Our mission is to promote the increasingly vital role of these products in America's healthcare system through science, education, and advocacy.

Over-the-counter (OTC) medicines are safe, cost-effective components of the nation's healthcare system. The average American household currently spends approximately \$185 on OTC medicines per year. The average senior citizen spends \$356 yearly on OTCs.

OTCs not only treat the symptoms of common ailments but also help prevent a number of costly chronic conditions through products like smoking cessation programs. Smoking is the number one cause of preventable death and disease in the United States. It has been estimated to cost our nation almost \$100 billion dollars in excess medical and indirect costs from disability and lost earnings. Fortunately, safe and effective pharmacologic treatments exist to help smokers quit, almost 80 percent of which are available over-the-counter. The cost of a full treatment course with these medicines can range up to \$200-\$350, so the savings realized from a sales tax exemption would create a significant incentive to take control of this behavior.

As result of their important role in maintaining affordable healthcare, the tax system should support access to over-the-counter medicines by exempting them from sales tax. A full exemption would be preferable, but we support even a one day tax holiday. Eleven of the 44 states with a sales tax currently exempt over-the-counter medicines.

If we can be of any assistance as you shepherd this bill through the legislative process, please contact me at 202-429-3537 or by email: aanderson@chpa-info.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Ashlen Anderson".

Ashlen Anderson, Manager
State Government Relations

Consumer Healthcare
Products Association
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L E G I S L A T I V E

TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Tax holiday

BILL NUMBER: SB 2029; SB 2030 (Similar)

INTRODUCED BY: SB 2029 by Inouye and 3 Democrats; SB 2030 by Inouye and 8 Democrats

BRIEF SUMMARY: SB 2029 adds a new section to HRS chapter 237 to provide that general excise taxes shall not be imposed on the retail sale of clothing or footwear, with a sales price of \$100 or less per item, sold on the first Friday of August and ending at midnight of the Sunday immediately following the Friday. Delineates exceptions to the tax holiday.

SB 2030 provides that the general excise tax holiday shall be held on the first Saturday or Sunday in December 2008 and be applicable to the purchases of food and over-the-counter drugs. The tax holiday shall not include alcoholic beverages or meals purchased in a restaurant or other establishment.

No special reporting procedures shall be required of retailers. Directs the director of taxation to report to the 2009 legislature on the costs of the tax holiday.

EFFECTIVE DATE: Upon Approval

STAFF COMMENTS: These measures would grant a tax holiday from the general excise tax on the purchase of the retail sales of clothing, footwear, food and over-the-counter drugs at a certain time of the year.

The idea of "temporary" tax holidays ignores the forces and factors of the market and ignores basic economics of the marketplace. Such temporary holidays tend to skew the normal course of business and people's attitudes and shopping patterns. It creates the "coupon" syndrome of people deciding that they should wait until the store has another "15% off weekend" or another coupon special. Why purchase that dress, shirt or turkey when it will go on sale next weekend in "another" one of those coupon offerings?

While the 4% or 4.5% is not as great as some of the discounts that have been offered by major department stores, it will create that anticipatory attitude that will cause shoppers to delay their purchases until that special weekend.

While these measure points out that retailers in other states where such tax holidays have been granted have not experienced a drop off of sales after the sales spike created by the tax holiday, it should be remembered that the shelf price of goods in those states tends to be relatively low by comparison to Hawaii and therefore the sales tax holiday is viewed simply as a bonus. Here in Hawaii, any temporary reduction in cost will tend to shift sales to that period where costs are less than what they would have been had cost reductions not been in effect. The hype of the sales tax holiday may bunch sales during that period, but what about before and after that holiday period? If a family buys the four sets of shoes they need for the family members, will they buy another set of shoes for each member the week or month after

SB 2029; SB 2030 - Continued

the sales tax holiday?

It must be recognized that with the higher cost of living in Hawaii, families are struggling to make ends meet and have only so much in disposable income. Such a tax holiday, combined with promotions by businesses, will skew sales and therefore cash flow. To a certain degree, sales tax holidays are regressive, that is the poor tend to end up paying more in taxes than those in higher income categories because they will be less likely to have the cash or the credit to participate at the time the holiday occurs.

Also, as noted in the purpose clause of SB 2029, for stores in those states which granted similar tax holidays additional staff was hired and store hours were extended. It is questionable whether or not this would be good for the work force in Hawaii. Creating artificial demand for employment merely insures that the cycle of lower paying positions is perpetuated. The jobs created by the tax holiday are not high paying, quality jobs, but positions that are created solely for the period of the holiday. These are not jobs that will offer benefits for the employees nor will they provide opportunities for those employees. To the extent that these temporary employees must be trained and then will be let go after the tax holiday period constitutes added costs to the business that will not have long-term benefits.

Further, one must ask the question to what degree did the tax holidays on the mainland states reflect an effort to deter cross-border shopping where adjacent or neighboring states do not apply their sales tax to the sale of clothing? For example, New Jersey, Massachusetts, Rhode Island, and Pennsylvania which are all within easy reach of New York, do not impose their sales tax on clothing.

Probably the most important and appropriate question is who is going to pay for this tax holiday? Given that state lawmakers and administration officials have not made a concerted effort to reduce the demand for tax revenues, will the burden of taxes be shifted to other businesses and individuals? Certainly the loss of revenues must be recaptured if the demand for spending those dollars is not reduced or contained. Would lawmakers be just as eager to enact this proposed tax holiday if it contained a provision that state spending had to be automatically reduced by the same dollar amount regardless of program? Probably not. But that is the problem with this and every other "goodie" tax proposal that would grant a tax break, lawmakers are just not willing to make concurrent reductions in state spending.

When and until state policy makers and administrators can get a firm grip on the spending spigot, any and all tax reduction proposals will be disingenuous. It should be remembered that the retail purchases this proposal intends to encourage are only possible if consumers have the resources to spend and have the confidence that there is stability in the economy. That stability in Hawaii is highly dependent, at this time, on the fiscal health of state and county governments.

Digested 1/28/08

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Committee on Economic Development & Taxation
State Capitol, Honolulu, Hawaii 96813



HEARING Tuesday, January 29, 2008
1:15 pm
Conference Room 224

RE: SB 2030, Relating to the General Excise Tax

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

Retail Merchants of Hawaii (RMH) is a not-for-profit trade organization representing about 200 members and over 2,000 storefronts, and is committed to support the retail industry and business in general in Hawaii.

RMH supports the intent of SB2030, which creates a one-day tax holiday for consumers on the purchases of food and over-the-counter drugs.

We do have serious concerns, namely, that most retailers' inventories include tens of thousands of food, over-the-counter drug and non-food items, and that programming POS systems to differentiate between these products may not be possible for some or, at the least, will be a time- and cost-consuming effort for most. A viable option perhaps would be to declare a tax holiday on all purchases for one day, or for a limited number of hours during the tax holiday day.

While during 2007, fifteen states (Alabama, Connecticut, Georgia, Florida, Iowa, Louisiana, Massachusetts, Missouri, New Mexico, North Carolina, Oklahoma, South Carolina, Tennessee, Texas and Virginia) plus the District of Columbia held tax holidays, usually on clothing and footwear under \$100 during the back-to-school season, these states have a different tax structure that appears to make this event less problematic.

We submit that perhaps further discussion and additional parameters might make the program more manageable, and look forward to working with the Legislature and Tax Department to create a tax holiday that will provide meaningful benefit for our residents and our economy as well.

Thank you for your consideration and for the opportunity to comment on this measure.

A handwritten signature in cursive script, appearing to read 'Carol Fukunaga', is written in black ink.

President

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