

December 12, 2023

**VIA EMAIL**

The Honorable Ronald D. Kouchi  
Senate President  
415 South Beretania Street  
Hawai'i State Capitol, Room 409  
Honolulu, Hawai'i 96813

**VIA EMAIL**

The Honorable Scott K. Saiki  
Speaker, House of Representatives  
415 South Beretania Street  
Hawai'i State Capitol, Room 431  
Honolulu, Hawai'i 96813

Re: *Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai'i Revised Statutes, Report No. 23-14*

Dear President Kouchi and Speaker Saiki:

Please find attached Report No. 23-14, *Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai'i Revised Statutes*, along with a copy of the Auditor's Summary. The audit was performed pursuant to Section 23-71 et seq., Hawai'i Revised Statutes, and is a report on certain tax exemptions and exclusions.

The report is accessible through our website at:  
<https://files.hawaii.gov/auditor/Reports/2023/23-14.pdf>.

The summary is also accessible through our website at:  
<https://files.hawaii.gov/auditor/Overviews/2023/23-14AuditorSummary.pdf>

If you have any questions about the report, please contact me.

Very truly yours,

Leslie H. Kondo  
State Auditor

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Attachments

ec/attach: Members of the Senate  
Members of the House of Representatives  
Carol Taniguchi, Senate Chief Clerk  
Brian Takeshita, House Chief Clerk

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# Auditor's Summary

## Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai'i Revised Statutes

Report No. 23-14



PHOTO: ISTOCK.COM

**THIS REPORT ASSESSES** seven exemptions and one exclusion under Hawai'i's General Excise Tax (GET) and Use Tax laws. Section 23-71 et seq., Hawai'i Revised Statutes (HRS), requires the Auditor to review GET and Use Tax provisions annually, on a 10-year recurring cycle. In fiscal year 2022, which ended June 30, 2022, GET and Use Tax revenues accounted for \$4 billion, or nearly 38 percent of the State's total tax revenue from all sources.

Specifically, this report reviews the following eight tax provisions:

- GET exemption for the loading, transportation, and unloading of agricultural commodities shipped for a producer or produce dealer on one island to a person, firm or organization on another island, Section 237-24.3(1), HRS;
- GET exemption for the loading or unloading of cargo from ships, barges, vessels, or aircraft, including stevedoring services, Section 237-24.3(3)(A), HRS;
- GET exemption for tugboat services, including pilotage fees and fees from the towage of ships, barges, or vessels in and out of state harbors, or from one pier to another, Section 237-24.3(3)(B), HRS;
- GET exemption for the transportation of pilots or governmental officials to offshore vessels; rigging gear; checking freight; standby charges; and use and running of mooring lines, Section 237-24.3(3)(C), HRS;

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**In fiscal year 2022, which ended June 30, 2022, GET and Use Tax revenues accounted for \$4 billion, or nearly 38 percent of the State's total tax revenue from all sources.**

- Use Tax exclusion for imported oceangoing vehicles used for the interisland public transportation of passengers, Section 238-1, paragraph 7 of “use” definition, HRS;
- Use Tax exemption for imported alcohol and tobacco to be consumed outside Hawai'i by vessel and airline passengers and crew, Section 238-3(g), HRS;
- Use Tax exemption for imported vessels constructed before July 1, 1969, under the Fisheries New Vessel Construction Loan Program, Section 238-3(h), HRS; and
- GET exemption for shipbuilding and ship repairs rendered to surface vessels federally owned or engaged in interstate or international trade, Section 237-28.1, HRS.

We determined that one Use Tax exclusion and three GET exemptions are meeting their stated or inferred purposes, and that one GET exemption is not meeting its purpose. As we explain in the report, making conclusions as to whether purposes are being met is challenging when amounts claimed are not tracked or where no benchmarks or metrics are statutorily set forth to assess whether a provision is achieving its intended purpose.



Link to the complete report:

**Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai'i Revised Statutes**

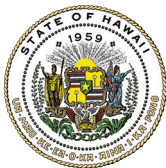
<https://files.hawaii.gov/auditor/Reports/2023/23-14.pdf>

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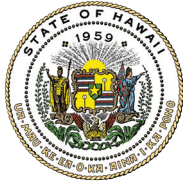
# Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai'i Revised Statutes

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

**Report No. 23-14**  
December 2023



**OFFICE OF THE AUDITOR**  
STATE OF HAWAII



## OFFICE OF THE AUDITOR STATE OF HAWAII

### Constitutional Mandate

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

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

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

### Our Mission

To improve government through independent and objective analyses.

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

### Our Work

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

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

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

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

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## Foreword

This report assesses certain exemptions and exclusions under Hawai'i's General Excise Tax and Use Tax. Section 23-71 et seq., Hawai'i Revised Statutes, requires 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; and the Department of Commerce and Consumer Affairs for their assistance in providing data and other information for this report.

Leslie H. Kondo  
State Auditor



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# Table of Contents

<b>Introduction</b> .....	1
<b>Analysis of Reviewed Tax Provisions</b> .....	8
<b>Assessment Challenges: Lack of Data on Cost and Causation</b> .....	9
<b>Tax Exemptions and Exclusion</b>	
General Excise Tax Exemption for Interisland Loading, Transportation, and Unloading of Agricultural Commodities (Section 237-24.3(1), HRS).....	15
General Excise Tax Exemption for Cargo Loading and Unloading, Tugboat and Towage Services, and the Transportation of Pilots or Governmental Officials (Sections 237-24.3(3)(A), (B), and (C), HRS).....	21
Use Tax Exclusion for Interisland Oceangoing Public Passenger Transport (Section 238-1, paragraph 7 of “use” definition, HRS).....	26
Use Tax Exemption for Liquor and Tobacco Imports Consumed Out-of-State By Carrier Crew and Passengers (Section 238-3(g), HRS).....	29
Use Tax Exemption for Use of Vessels Constructed Prior to July 1, 1969, Under DBEDT Loans (Section 238-3(h), HRS) .....	32
General Excise Tax Exemption for Certain Shipbuilding and Ship Repair (Section 237-28.1, HRS).....	35
<b>Appendices</b>	
Appendix A   Schedule of Tax Statutes for Review .....	39
Appendix B   Impact on “Low-Income Residents” .....	45







# Review of General Excise and Use Tax Provisions Pursuant to Section 23-75, Hawai‘i Revised Statutes

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## Introduction

**T** HIS REPORT assesses certain General Excise Tax (GET) and Use Tax exemptions and exclusions 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 in the following areas:

- Interisland agricultural shipments (Section 237-24.3(1), Hawai‘i Revised Statutes (HRS));
- Cargo loading and unloading (Section 237-24.3(3)(A), HRS);
- Tugboat and towage services (Section 237-24.3(3)(B), HRS);
- Other maritime services and vessels (Sections 237-24.3(3)(C), 238-1 paragraph (7) of “use” definition, 238-3(h), and 237-28.1, HRS); and

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

- The interstate sales of liquor and tobacco products (Section 238-3(g), HRS).

The information in this report may be used by lawmakers in evaluating whether any particular exemption or exclusion should be retained, amended, or repealed. It 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 and outlines what, substantively, the Auditor is to analyze. Section 23-75, HRS, identifies the specific exemptions and exclusions to be reviewed in 2022. 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 23-71, HRS.

## Background

Hawai'i's GET and Use Tax, viewed together, apply 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 State's 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 means all taxpayers, including those who do not directly benefit from such tax breaks, must compensate for the reduced revenue, or alternatively, the government must reduce spending on state programs. Despite the loss of revenue, the Legislature believes certain tax exemptions, exclusions, and credits should be in place for equity, efficiency, and economic and social policy purposes.

Accordingly, the Legislature found the Auditor's reviews "necessary to promote tax equity and efficiency, adequacy of state revenues, public transparency, and confidence in a fair state government." Unfortunately, for most of the provisions now under review, neither the law nor the relevant legislative 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.

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

1. Exclusion for the value of oceangoing vehicles for public passenger transportation from one point to another in the State (see definition of “use” in paragraph 7 of Section 238-1, HRS).
2. Exemption for the value of vessels constructed under Section 189-25, HRS, relating to commercial fishing vessel loans, prior to July 1, 1969 (Section 238-3(h), HRS).

According to the Hawai‘i Department of Taxation (DOTAX), 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.<sup>1</sup> Taxpayers generally do not report excluded amounts to DOTAX, such that DOTAX cannot capture related information. Ultimately, DOTAX does not report data on the use of exclusions.

## **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, which the Legislature explicitly identified as a “privilege tax” on business activity in the State. For the privilege of doing business in the State of Hawai‘i, a business must pay GET – a tax additional 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 gross 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 sellers not engaged in business activity in the State. That is where 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

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<sup>1</sup> See sidebar, “Tax Expenditures: At What Cost?” on p. 13 for a detailed explanation of tax expenditures.

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 imported for use in Hawai‘i. Another distinction is that sellers typically pay GET, whereas importing purchasers 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, a GET or Use Tax taxpayer 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 and Use Tax, combined, over the course of the year. The higher a taxpayer’s gross revenue or value of taxable items, 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 Form G-45 is mandatory for all filers owing \$4,000 or more in GET and Use Tax for a given year. That means all monthly filers, including high-revenue businesses and import-heavy businesses must file electronically. As of November 7, 2023, there is no mandatory e-filing for smaller businesses, though DOTAX has announced that it may phase in more electronic filing mandates in the future. Electronic filing of Form G-45 is accomplished via the Hawai‘i Tax Online system managed by DOTAX.

### **The G-49 (Annual Return)**

After the end of the tax year, all taxpayers file the annual GET/Use Tax return, also known as the Reconciliation or Form G-49. The annual return should equal the sum of all the periodic returns, meaning the Form G-49 and the aggregate of the year’s Form G-45s should “reconcile” against each other.

Electronic filing is mandated for all Form G-49s. Electronic filing of Form 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.

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Ancillary GET and Use Tax forms, beyond Forms G-45 and G-49, must be filed under certain circumstances. An important one, for purposes of this review, is Schedule GE. Schedule GE is a form on which taxpayers declare exemptions and deductions (but not exclusions) that they claim. It accompanies Forms G-45 or G-49 as a schedule attached to the return and failing to include it will result in a disallowance of an exemption or deduction. Other forms beyond Schedule GE and Forms G-45 and G-49, unless specifically discussed elsewhere in this report, are beyond the scope of our current review.

## 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 the 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 farmers’ market vendor’s selling mangoes to passers-by for consumption should be taxed at the retail rate. Wholesaling includes a business’s selling goods or services to another business for resale. Were that same farmers’ market vendor to sell to an intermediary who uses the mangoes to make jam that the intermediary later sells to passers-by at another farmers’ market, the vendor should be taxed at the wholesale rate.

For tax year 2022, 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
- 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 2022, Use Tax rates were as follows:

- **Wholesale-to-Wholesale**  
0.0 percent (no tax) on the use of goods imported by any GET-licensed goods wholesaler and also on the value of services imported by any GET-licensed service provider, manufacturer, or contractor who is subject to the wholesale GET rate;
- **Wholesale-to-Retail and Certain Others**  
0.5 percent on the value of goods or services imported by licensed resellers engaged in manufacturing, retail, publishing, certain professional services, and certain others; 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 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. Also important to determining overall GET and Use Tax liability are tax surcharges that may apply.

### **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 the construction of its rail system, recently named Skyline. Hawai'i and Kaua'i counties have also each adopted 0.5 percent surcharges. Maui county does not currently have a surcharge but, pursuant to an ordinance passed in 2023, will implement a 0.5 percent surcharge as of January 1, 2024. There is no surcharge on revenues exempt or excluded 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

**HAWAII'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.<sup>2</sup> 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.

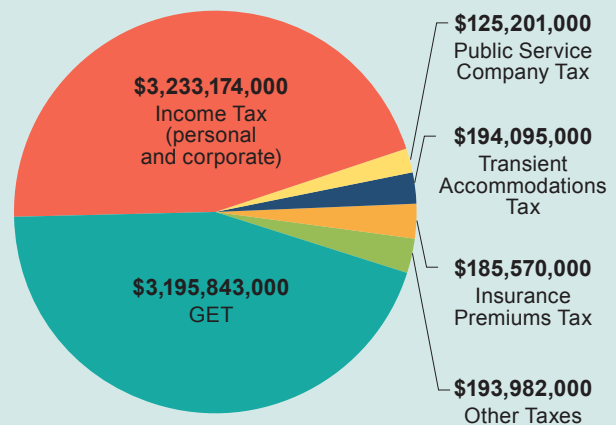
Even by 1939, the retailing industry was accounting for the Territory's largest "taxable value," or "tax base," at \$123.72 million, or 33 percent of the Territory's total \$376.71 million tax base. At \$41.60 million, sugar comprised 11 percent of the tax base, with pineapple close behind at \$35.44 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

<sup>2</sup> *Hawaii's General Excise Tax*, Report No. 2, 1963, Legislative Reference Bureau, State of Hawai'i, p. 8.

\$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 FY2022, DOTAX reported that retailing had a tax base of \$43.31 billion, or 33.9 percent of the total tax base, with services at \$18.26 billion, or 14.3 percent of the tax base.

**General Fund Tax Revenues**



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

In FY2021, the State General Fund, which is the State's chief operating fund, realized a total of \$7.13 billion in tax revenue. Most of that revenue came from two taxes: GET and net income tax. The net income tax collections, which are comprised of both individual and corporate income tax revenues, represent Hawai'i's largest tax revenue source and accounted for \$3.23 billion. GET, the fund's second largest tax revenue source, accounted for \$3.20 billion, or 45 percent of total General Fund tax revenue. The Transient Accommodations Tax, or hotel room tax, the State's third-largest revenue source, accounted for \$194.1 million.



## Analysis of Reviewed Tax Provisions

### What did we review?

This report reviews a total of eight tax provisions, which include seven exemptions and one exclusion. Pursuant to Section 23-75, HRS, we analyzed the three exemptions provided under Section 237-24.3(3), (A), (B), and (C), HRS together, as though they were one provision. DOTAX combines claims data on those three exemptions into one exemption claim code, such that there is no discrete data on annual claims and costs for those three exemptions, even though each exemption relates to a different business activity. Consequently, we analyzed the three exemptions as though they were one exemption.

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 one exclusion achieves the main purpose for which it was adopted, one exemption partially achieves its purpose, and one exemption does not meet its purpose at all. We could not determine whether any of the remaining three exemptions were achieving their purposes, primarily because of a lack of data regarding their utilization. The relevant law 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. Table 1 summarizes our results.

**Table 1. Summary of Results**

HRS Section	Incentive Type	Subject Matter Covered	Achieves Purpose?	Recommendation
237-24.3(1)	GET exemption	Agricultural commodities shipping	Cannot measure	Cannot determine
237-24.3(3)(A), (B), and (C)*	GET exemption	Cargo/towage services, and transportation of pilots/officials	Partially	Retain
238-1, paragraph (7)	Use Tax exclusion	Interisland oceangoing public transportation	Yes	Retain
238-3(g)	Use Tax exemption	Liquor and tobacco sales to common carriers	Cannot Measure	Retain
238-3(h)	Use Tax exemption	Vessels built before 1969, under a certain loan program	No	Repeal
237-28.1	GET exemption	Shipbuilding and ship repair	Cannot measure	Cannot determine

\* Note: These three exemptions were analyzed together as DOTAX tracks these as one exemption.

## Assessment Challenges: Lack of Data on Cost and Causation

Many challenges hindered our ability to report information and analyze the exemptions and exclusion in the manner required under Section 23-71, HRS. Most significantly, there was a lack of available data.

While the department’s Tax System Modernization project has allowed for better data collection, DOTAX currently does not capture additional specific information we need to more meaningfully assess the exemptions from GET and Use Tax. For some provisions, the lack of historical data precluded us from determining “the amount of tax expenditure for the exemption, exclusion, or credit for each of the previous three calendar years,” as required by Section 23-71, HRS. The absence of historical data also hindered our ability to estimate the amounts of tax expenditures for the current and next two calendar years. Without that data and the specialized training, knowledge, and tools to forecast economic trends, we determined any projection on the future cost of exemptions and exclusion would be too speculative and unreliable to be included in this report. As data continues to be collected, we may reach a point in the future where meaningful projections can be made. As DOTAX only recently began collecting data, that point is likely to be some years away. Prior to 2017, DOTAX did not systematically track GET and Use Tax exemptions, exclusions, and credits, meaning there is little data about the number of claimants and amounts claimed.

We were further challenged to determine whether the purpose of or intent behind some exemptions had been achieved. When the purpose of a tax provision was not explicitly stated within legislation, we used other sources, such as committee reports and other legislative history, to infer the purpose of an exemption or exclusion; however, even then, we often were unable to assess whether a particular tax provision is meeting its purpose, since none of the provisions include specific benchmarks or other criteria against which effectiveness of the provisions is to be measured. The legislative acts that created the incentives lacked benchmarks or targets against which to measure achievement of the intended purpose.

In addition, an analysis of economic or employment benefits compared against forgone tax revenue, or a cost-benefit analysis, was hampered by a variety of other factors. Businesses that benefit from these incentives are not required to provide amounts claimed or employment information to DOTAX. Additionally, we were unable to share taxpayer names or tax return data with other state agencies to identify and verify, for example, employment and payroll data for taxpayers claiming exemptions that may be intended to stimulate local employment. Taxpayers do not report to DOTAX data on jobs, wages, or other economic activities that may have been generated because of a tax provision.

Further, our analysis could not account for a variety of unintended effects. For example, some businesses that claimed an exemption aimed at generating economic activity may have received tax benefits for jobs that would have been created irrespective of the tax preference, while other jobs may have been filled by non-residents. We were likewise unable to assess the disadvantages faced by businesses and industries that were not eligible for the tax preference. As a result of these challenges, we could not find a causal connection between any potential Hawai'i employment or economic gains and the use of these tax provisions.

Finally, as required by statute, we conducted an analysis of the impact of the tax provisions on “low-income residents” using the formula provided in the statute. However, we question whether the calculations represent the “value” that repeal of a particular 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, as well as our calculations, can be found in Appendix B.

An additional concern is that the term *tax expenditure* is not defined in Hawai'i's laws, including Section 23-71, HRS, which mandated

this review. The following table explains how tax exemptions and exclusions generally work. However, 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

**Exclusions are tax law provisions that remove from gross income, entirely, revenues from activities that, according to DOTAX, were never intended to be taxed. Income that is excluded is not reported anywhere 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.**

For example, the Section 238-1, HRS, exclusion for interisland oceangoing public passenger transport eliminates such activity from the definition of “use” subject to Use Tax. There are no records of claimants for this exclusion as amounts subject to the exclusion are not reported on General Excise/Use Tax Returns. While the exclusion is not reported, the direct beneficiaries would be in-state businesses that purchase from out-of-state businesses vessels for interisland service.

### 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, as exempt. Thus, there should be a record of each exemption claimed. Tax exemptions often, but not always, have associated tax expenditures.**

For example, shipbuilders and ship repairers of surface vessels that are federally owned or engaged in interstate or international trade can exempt from the GET via Section 237-28.1, HRS, revenues arising from shipbuilding and ship repairs rendered to such vessels. Taxpayers claiming the exemption are required to report these amounts on their GET returns under the Exemptions/ Deductions Code for Section 237-28.1, HRS.

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

## 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 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 analyze 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 2020, there were 132 claims for the five exemptions reviewed in this report. Taxpayers claimed \$947.2 million in exemptions from GET liability, resulting in, according to DOTAX, \$4.74 million in tax expenditure. Overall, 25,597 taxpayers representing 11 percent of the total number of GET and Use Tax filers claimed 29,772 GET exemptions in 2020. Those taxpayers claimed \$33.3 billion in exemptions, resulting in, according to DOTAX, \$440.6 million in tax expenditures in 2020.

As DOTAX explains in its 2020 *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 and 4.0 percent, respectively) and lists exemptions and exclusions that DOTAX does not consider to be tax expenditures, but which may represent forgone opportunities to shift tax burdens to non-residents.

We do not always agree with DOTAX’s definition of exclusion or, hence, with the identification of certain items of income as exclusions. The DOTAX view is that an exclusion, as opposed to an exemption, is an item that the Legislature never intended to be part of the tax base. While we agree that an exclusion implies such an intent, we assert that an exclusion, to be so labeled, must be an item that is not taxable under general rules and therefore requires no statutory carveout to be absent from the tax base. Often, this means that the item is simply excluded from the definition or description of what is taxable. Such is the case with real estate sales and bad debts, which do not fall within the definition of “gross income” to which GET applies. There is no law specifically targeting such sales or debts for exemption because no such law is needed; the items are not taxable by default, under the general rules – as items presumably never intended to be part of the tax base – and are therefore exclusions, as opposed to exemptions. Sometimes, an item is excluded because federal law preemptively prohibits state taxation from applying.

The distinction between exemption and exclusion makes a difference with respect to tax expenditure. An exclusion necessarily yields \$0 in tax expenditure, as the excluded item is not, and presumably never will be, part of the tax base – because such is the Legislative intent and the mechanical function of the general tax rules. An exemption, by contrast, yields a tax expenditure above \$0 because, but for a statutory carveout specifically identifying and exempting the item, the item would be taxable under the general rules. Intercompany business charges, for example, are items that we believe would be subject to GET were it not for the narrow law that specifically exempts them; absent that carveout, the charges would be GET-taxable. In other words, the general GET rules apply unless specifically limited, which is why the statutory carveout for intercompany charges is necessary. Consequently, while DOTAX attaches a \$0 tax expenditure to the incentive, treating it similarly to how DOTAX treats an exclusion, we believe that there is an expenditure. Assuming at least some taxpayers claim the exemption, the State forgoes revenue by keeping the exemption enacted.

With respect to incentives that result in tax expenditures, the amount of each expenditure is debatable, as its calculation is based upon debatable assumptions. DOTAX acknowledges such in its report:

*The decision on how to classify GET exemptions as tax expenditures at the wholesale rate, retail rate, or not at all is based on economic parameters and assumptions. Thus, if DOTAX’s assumptions change, then the distribution of exemptions among the categories may change.*

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. It multiplies the total claim amount for all five exemptions under review by that rate, arriving at, for 2020, \$4.74 million. The implicit assumption is that, were the exemption nonexistent, all business-to-business taxpayers would pay GET on

## Tax Expenditures: At What “Cost”? (continued)

unexempted income at the wholesale rate only. We question DOTAX’s assumption, as over 98 percent of all claims for each of the five exemptions for which we have data 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 2020, comes to \$37.3 million.

Another concern is that, as DOTAX’s 2020 *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 provides only the amounts of each exemption claimed and should not be relied on as an estimate of the amount of revenue that may be realized by repealing an exemption. A revenue impact estimate would have to account for the potential substitutional and behavioral effects of repealing an exemption.*

**Table 2. Exemption Claims and Expenditures 2019 to 2021**

The following table summarizes claim amounts and expenditure data for the exemptions reviewed in this report for which data is available (Section 237-24.3(1), HRS; Sections 237-24.3(3)(A), (B), and (C), HRS; and Section 237-28.1, HRS).


Year	Claim amounts	Auditor’s Estimated Tax Expenditure	DOTAX Tax Expenditure
2021	\$ 945,157,000	\$ 37,308,828	\$ 4,725,541
2020	\$ 947,154,000	\$ 37,337,810	\$ 4,735,000
2019	\$ 870,166,000	\$ 34,362,105	\$ 4,351,000
<b>Total</b>	<b>\$ 2,762,477,000</b>	<b>\$ 109,008,743</b>	<b>\$ 13,811,541</b>

Source: DOTAX<sup>3</sup>

<sup>3</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.

# General Excise Tax Exemption for Interisland Loading, Transportation, and Unloading of Agricultural Commodities (Section 237-24.3(1), HRS)

## Exemption at a Glance (2021)

Amount claimed	Number of Unique Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
				
\$9,708,000	No data available	\$383,814	80 cents	Cannot be measured

Source: DOTAX 2021 Hawai'i General Excise and Use Tax Exemptions report<sup>4</sup>

### Relevant Legislative History

- 1966**  
 Act 28, SLH 1966, enacted the exemption.
- 2011**  
 Act 105, SLH 2011, suspended the exemption from July 1, 2011, through June 30, 2013.

### What does this exemption do?

This provision exempts from GET all revenues resulting from the loading, transportation, and unloading of agricultural commodities shipped for a producer or produce dealer on one island to a person, firm, or organization on another. “Agricultural commodities” include fresh fruits, fresh vegetables, nuts, coffee (including green coffee beans, cherry coffee beans, and parchment coffee), and raw unprocessed honey. The exemption applies to agricultural commodities produced in the State or imported. A “producer” is a person or entity that grows or produces for market any agricultural commodity, while a “produce dealer” is one who sells, markets, or distributes – entirely or partially at the wholesale level – any agricultural commodity or whose business is soliciting or negotiating the sale of any farm product.

Without the exemption, revenues from the loading, transportation, and unloading of agricultural commodities would generally be subject to GET. The 4.0 percent retail rate should apply, as such services cannot typically be resold, and therefore, each relevant loading, transportation, and unloading transaction should be considered a retail transaction. Statistics collected by DOTAX reveal that the vast majority of claims did come from taxpayer-reported retail transactions, noting that in 2020 and 2019, retail transaction claims represented 98.9 and 97.7 percent, respectively, of the total dollar amount claimed.

<sup>4</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.



There are a few key points to consider when examining this exemption. First, it is important to distinguish between revenue from selling agricultural commodities and revenue from shipping agricultural commodities. The GET exemption applies to revenues from loading, transportation, and unloading only. Second, the exemption applies to any amount of revenue from loading, transportation, and unloading, regardless of type of shipper. Air carriers, as well as water carriers, may realize revenue that qualifies for the exemption. In 2018, 2019, 2020, and 2021, there were only 13, 12, 18, and 9 claimants, respectively, and Hawai'i has only one active and registered interisland water carrier of cargo. There are several interisland air carriers whose income may be eligible for the exemption, including five that, as of 2019, comprised 93.68 percent of the interisland air cargo market.

### **How the Exemption is Claimed**

Claimants exempt amounts received from the loading, transporting, and unloading of agricultural commodities shipped interisland by reporting the revenue on "Schedule GE (Form G-45/G-49)," the General Excise/Use Tax Schedule of Exemptions and Deductions, which is submitted with a GET return. The taxpayer includes on Part I of Schedule GE all exemptions claimed, writing down the amount of each exemption and other information specific to the exemption, including an "ED Code," or exemption/deduction code, that corresponds to the statutory provision allowing the exemption. The ED Code for the Shipping and Handling of Agricultural Commodities exemption is 145. A taxpayer is not required to submit evidence substantiating the claim unless that taxpayer is audited.

### **What is the purpose of this exemption?**

The 1966 Senate Committee on Ways and Means reported that a purpose of the bill that became Act 28, SLH 1966, was to create certain tax exemptions "to stimulate agricultural production and encourage sales by local businessmen of locally produced and other products for consumption out-of-state." The committee concluded that the exemptions "will avoid pyramiding of excise taxes on agricultural products," thereby benefiting and stimulating the State's economy.



## Tax Pyramiding

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

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

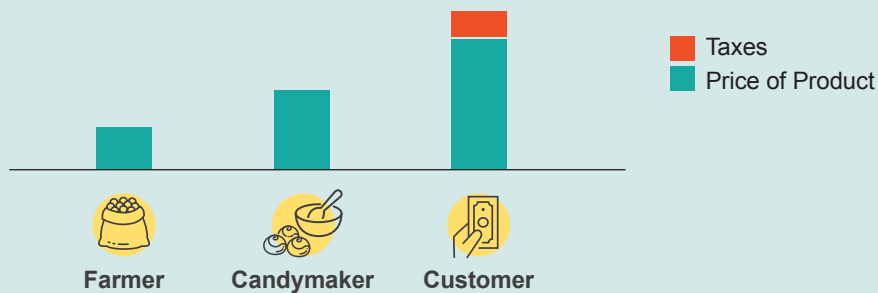
Having a tax on a tax often results in higher total costs to the consumer. For example, when a farmer sells macadamia nuts to a candymaker, the farmer’s revenue from the sale is subject to GET. The farmer will

often include the amount of its GET liability in the price of the macadamia nuts. The candymaker incorporates the macadamia nuts in its candy and is subject to GET on the revenues from the sale of the candy to customers. The retail price of the candy will often include the cost of the macadamia nuts, which includes the farmer’s GET liability, as well as the amount the candymaker must pay in GET on the revenue from the sale of the candy.

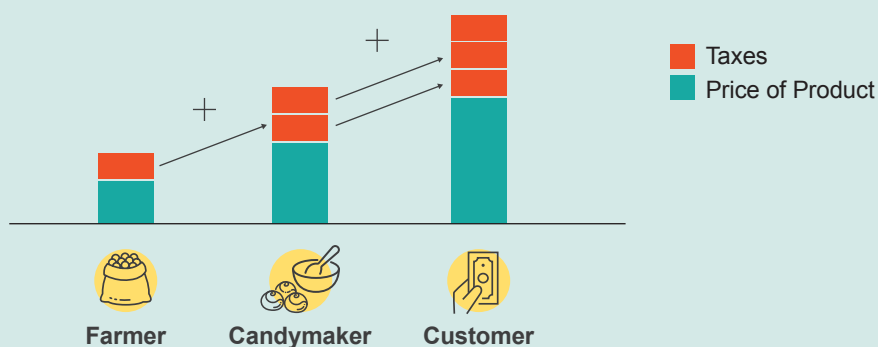
In order to reduce the effects of tax pyramiding, Hawai'i imposes a lower GET rate (0.5 percent) on wholesale, or business-to-business, transactions of goods or services intended for resale. The retail GET rate (4.0 percent) is generally applied only at the consumer level.

## The Effect of Pyramiding Under a General Excise Tax

### Sales Tax on Final Consumption



### General Excise Tax



The exemption for interisland shipping of agricultural commodities was one of multiple GET exemptions created by Act 28, SLH 1966. The exemptions, according to a report by the House Committee on Governmental Financing, were “to stimulate and encourage economic growth in business and agriculture.” The report stated, “such exemptions will increase sales” and “mitigate excise tax pyramiding on agricultural products, thereby stimulating and encouraging our economy.” No committee report describes the purpose of each exemption separately, but another report by the Senate Ways and Means Committee similarly clarifies that a primary overall goal of the bill is “to stimulate agricultural production, and encourage sales by local businessmen” of locally produced goods.

### **Is the exemption meeting its purpose?**

Unknown. There is no data readily available to determine whether the exemption has had any effect on agricultural production or sales of locally produced agricultural commodities, either in-state or out-of-state. We assume that any shippers claiming the exemption, including mixed-cargo shippers, are exempting revenue related to agricultural cargo only. We also assume that shippers are not undermining the exemption’s purpose of stimulating local agricultural production by passing on as a cost the very amount of benefit they receive from the exemption. However, DOTAX does not require claimants to report whether they passed on the GET savings resulting from the exemption to farmers and others shipping qualified produce interisland.

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

DOTAX reports 12, 18, and 9 GET filings claiming the exemption for loading, transportation, and unloading of “agricultural commodities” shipped interisland in 2019, 2020, and 2021, respectively. For each of those years, the total amount of revenue that was exempted under this exemption was \$911,000, \$1,050,000, and \$9,708,000, respectively.

When calculating the tax expenditure corresponding to a particular exemption, DOTAX applies the wholesale rate (0.5 percent) to business-to-business transactions. That appears to be the approach for all business-to-business transactions, regardless of what, other than its business-to-business nature, is known or unknown about a transaction. Accordingly, DOTAX calculates the amount of tax expenditure relating to this exemption by applying the GET wholesale rate of 0.5 percent, resulting in tax expenditures of \$5,000, \$5,000, and \$49,000 for 2019, 2020, and 2021, respectively.

We disagree with DOTAX’s application of the GET wholesale rate to all business-to-business transactions. As the tax filing data shows, nearly

all claims for this credit were made on transactions otherwise taxed at the GET retail rate of 4 percent. Only \$129,000, or about 1 percent of the total 2021 claims of \$9,708,000, was made at the lower half-percent wholesale rate. In other words, taxpayers reported that around 99 percent of their revenues exempt under this exemption, at least for 2021, would have been taxed at 4 percent but for the exemption. As such, for 2021, the true amount of tax forgone – the true tax expenditure – caused by the exemption should be closer to 4 percent of the amount claimed.

We calculate the tax expenditure associated with this exemption by using both rates, in proportion to how much each rate was claimed. For each year, we:

1. multiply the exemption amount claimed under the 4 percent rate by 4 percent,
2. multiply the amount claimed under the 0.5 percent rate by 0.5 percent, and
3. sum the two products.

This method resulted in tax expenditures of \$35,705, \$41,580, and \$383,805, for 2019, 2020, and 2021, respectively.

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2021	9	\$9,708,000	\$383,805	\$49,000
2020	18	\$1,050,000	\$41,580	\$5,000
2019	12	\$911,000	\$35,705	\$5,000

Note: DOTAX Tax Expenditure amounts rounded to the nearest thousand.

Source: DOTAX 2019, 2020, and 2021 Hawai'i General Excise and Use Tax Exemptions reports<sup>5</sup>

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

While the purpose of the tax exemption is to stimulate agricultural production and encourage sales of local agricultural products, there is no readily available data for us to make any direct correlation, or draw any causal relationship, between the exemption and any economic or employment activity.






<sup>5</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.

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

Without data that would allow us to assess whether the exemption is stimulating agricultural production or sales of locally produced agricultural products, we are unable to determine whether the exemption is achieving its legislative purpose and hence cannot determine whether it should be retained, amended, or repealed. There is no readily available data to confirm that farmers and wholesalers shipping agricultural commodities interisland are benefiting from lower tax costs, as the Legislature may have intended. As the shipper claims the exemption, and assuming a shipper would include GET in price absent any exemption, any benefit to anybody other than the shipper would require tax savings to be passed from the shipper to the producers or produce sellers. Exemption claims jumped by over \$100,000 from 2019 to 2020 and by over \$8 million from 2020 to 2021, but also declined by over \$7 million from 2018 to 2019 – leading us to question to what extent the exemption was a significant factor in driving sales.

# General Excise Tax Exemption for Cargo Loading and Unloading, Tugboat and Towing Services, and the Transportation of Pilots or Governmental Officials (Sections 237-24.3(3)(A), (B), and (C), HRS)

## Exemptions at a Glance (2021)

Amount claimed	Number of Unique Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
				
\$605,587,000	41	\$23,770,858	\$49.44	Partially

Note: DOTAX combines claims data on the three exemptions in Sections 237-24.3(3)(A), (B) and (C), HRS, into one exemption code entitled "Services Related to Ship and Aircraft." There is no discrete data on the annual claims and costs for each of the three exemptions. Therefore, we report on these exemptions together.

Source: DOTAX 2021 Hawai'i General Excise and Use Tax Exemptions report<sup>6</sup>

### Relevant Legislative History

- 1978-1979**  
 In April 1978, the U.S. Supreme Court ruled that states may tax the privilege of conducting interstate commerce if certain conditions are met, notably including the requirement that the tax have a substantial nexus with the state in question. Thereafter, DOTAX established guidelines for taxing stevedoring and other interstate commerce activities that previously had not been subject to excise taxes. However, the governor suspended the assessment of these taxes, expressing concerns about their economic impact, given the State's already high shipping costs and reliance on imports. In 1979, in

response to the Supreme Court decision, the Hawai'i Legislature passed Act 74, SLH 1979, which codified interstate commerce-related exemptions or exclusions that existed prior to the decision. Act 74 did not specify particular activities as exempt, instead indicating that "exemptions or exclusions from tax under [the] chapter allowed on or before April 1, 1978" would continue undiminished.

- 1987**  
 Act 292, SLH 1987, updated exemption language to specify its application to particular activities, principally including the loading and unloading of cargo, tugboat services, and the transportation of pilots or government officials.

- 2011**  
 Act 105, SLH 2011, suspended the exemptions from July 1, 2011, through June 30, 2013.
- 2022**  
 Act 80, SLH 2022, amended the exemptions to include stevedore services. The act also added an exemption for harbor wharfage and demurrage collected for payment to the State of Hawai'i Department of Transportation.

<sup>6</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.

### **What do these exemptions do?**

The first exemption, codified as Section 237-24.3(3)(A), HRS, exempts revenue received from the loading or unloading of cargo from ships, barges, vessels, or aircraft, including stevedoring services from GET. "Stevedoring services" means the loading and unloading of cargo transported or to be transported on vessels and other craft, and the handling of lines of vessels and other craft at any port within the State.

The second exemption, codified as Section 237-24.3(3)(B), HRS, exempts revenue received from tugboat services, including pilotage fees and fees for the towage of ships, barges, or vessels in and out of state harbors or from one pier to another from GET.

The third exemption, codified as Section 237-24.3(3)(C), HRS, exempts revenue received from the transportation of pilots or governmental officials to offshore vessels; rigging gear; checking freight; standby charges; and use and running of mooring lines from GET.

### **How the Exemptions are Claimed**

A taxpayer claiming any of these three exemptions is required to report revenues from relevant activities on its Schedule GE, under Exemptions/Deductions (ED) Code 143. All three exemptions are reported under that same ED Code 143, as the instructions indicate:

Amounts received from the loading or unloading of ships or aircraft; tugboat services including pilotage fees and towage of ships, barges, or vessels in and out of harbors or from one pier to another; and the 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 are exempt. Report these amounts with ED Code 143 on the Schedule GE.

As with other exemptions, DOTAX generally relies on what a taxpayer reports as true. A taxpayer is not required to submit evidence substantiating the claim unless that taxpayer is audited.

### **What is the purpose of these exemptions?**

In 1979, one year after the Supreme Court decision, the Legislature addressed the concern that the imposition of GET on proceeds from interstate commerce activities would have a substantial impact on the State's economy, as nearly all consumer goods had to be imported. It enacted the exemptions to maintain a status quo

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of not taxing various interstate and international shipping activities, after the Supreme Court decision altered the status quo. It further implied overarching aims of preventing an increase in the cost of living, supporting air and ocean transportation lifelines, and benefiting the overall economy. Generally, the intention was to codify, after 1978, an exemption that existed before 1978.

### **Are the exemptions meeting their purpose?**

With respect to the purpose of continuing exemptions that existed prior to the 1978 Supreme Court decision, the exemptions appear to be meeting their purpose. Prior to the U.S. Supreme Court's decision, no GET was imposed on revenues from cargo loading and unloading, tugboat and towage services, and the transportation of pilots or governmental officials. The decision had the potential to change that, and result in tax imposition, but the exemptions now in place maintain the status quo of keeping such revenues GET-exempt.

With respect to the overarching purpose of mitigating a rise in the cost of shipping and a consequent rise in the cost of living, it appears that the exemptions have had minimal or no effect on the economy and thus have not met that purpose. In 2021, according to the State of Hawai'i Data Book published by the Department of Business, Economic Development and Tourism (DBEDT), Hawai'i's cost of living was the highest in the nation, with an average home price of about \$1.39 million, a monthly energy bill of \$470, and a half gallon of milk at \$4.31. The exemptions for 2021 numbered only 41 and reduced the combined revenue of claimants by \$605.6 million. Ultimately, the cost of living is so high, and the value of the exemptions so comparably low, that the tax savings from the exemptions likely have a small, if not negligible, effect on affording living in Hawai'i.

### **What were the number of claimants, total amount claimed, and tax expenditures for these exemptions in 2019-2021?**

DOTAX calculates the amount of tax expenditures relating to these exemptions using the GET wholesale rate of 0.5 percent, understanding these amounts to derive from business-to-business transactions that should be taxed at the wholesale level. We question that approach, as nearly all claims were actually made at the retail rate, and only \$12,932,000, or approximately 2 percent of total 2021 claims of \$605,587,000 were made at the wholesale rate. Our estimates for the tax expenditures resulting from these exemptions (below) are based on the value of the claims applied against the actual tax rates at which the claims were made. (For details regarding the different approaches in calculating tax expenditure, please see our above section on the exemption for the interisland loading, transportation, and unloading of agricultural commodities.)



Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2021	41	\$605,587,000	\$23,770,858	\$3,028,000
2020	50	\$626,438,000	\$24,722,080	\$3,132,000
2019	48	\$603,236,000	\$23,772,195	\$3,016,000

Note: DOTAX Tax Expenditure amounts rounded to the nearest thousand.

Source: DOTAX 2019, 2020, and 2021 Hawai'i General Excise and Use Tax Exemptions reports<sup>7</sup>

**Is there an economic or employment benefit to Hawai'i, and if so, do the benefits outweigh the costs of these exemptions?**

As there are no performance benchmarks identified in Sections 237-24.3(A), (B), or (C), HRS, nor any data available regarding the sales, production, or other activities that might be generated because of the exemption, there is no data upon which to base a return-on-investment calculation, cost-benefit analysis, or direct employment impact estimate.

For context, we note the following Hawai'i State Data Book information regarding the level of economic activity relating to areas encompassed by these exemptions:

- In 2021, Hawai'i was ranked the most expensive state in the country to live in.
- In 2021, total cargo volume for the Port of Honolulu was 9.60 million tons, while in 2002 it was 8.24 million tons.
- In 2021 there were 39 businesses providing support activities for water transportation statewide, with average annual employment of 1,412 people. That includes marine cargo handling as well as port and harbor operations. That contrasts with 1997 data that showed there were 134 businesses providing support activities for water transportation statewide with employment of 2,551.

**Should these exemptions be retained without modification, amended, or repealed?**

Although the purpose of these exemptions includes preventing an increase to the cost of shipping, and thus averting a rise in the cost of living, the only direct beneficiaries are stevedores, tugboat operators, and other maritime-related service businesses. As previously

<sup>7</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.

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mentioned, the intended purpose is achieved only if affected businesses pass GET savings to customers, in the form of lower rates or some other benefit. We reiterate that there is no data as to whether businesses are doing so, and no correlation can be drawn between the claim exemptions and any specific or general economic or employment activity.


We recommend retaining each exemption, without any amendment or other revision. The primary purpose of the statutory exemptions is to maintain GET exemptions that prevailed prior to 1978. The prior exemptions appear to have been judicially based, such that when that judicial basis was dissolved by a 1978 Supreme Court opinion, the Hawai‘i legislature chose to continue the exemptions statutorily. The present statutory exemptions continue to serve the purpose of maintaining the GET exemptions.

### **Issue of concern**

DOTAX’s practice of aggregating data for the three exemptions claimed under Sections 237-24.3(3)(A), (B), and (C), HRS, precludes an analysis of each exemption separate from the others. One part of the statute concerns the loading or unloading of cargo from ships, barges, vessels, or aircraft. A second part concerns tugboat and towage services. A third and final part concerns the transportation of pilots or governmental officials to vessels. Combining the categories into one reporting category obscures which claims were made for which exemption and, perhaps more importantly, hinders our ability to assess each provision individually per Section 23-75, HRS. Our review of DOTAX filings for the ED Code for these exemptions revealed that claimants included a shipping company, a stevedore business, and an airline service. DOTAX should consider requiring each of the three exemptions to be independently claimed and tracked, to foster better analysis of each exemption in the future.

## Use Tax Exclusion for Interisland Oceangoing Public Passenger Transport (Section 238-1, paragraph 7 of “use” definition, HRS)

### Exclusion at a Glance

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
				
No data available	One or zero <sup>8</sup>	No data available	Cannot be calculated	Yes

Sources: DOTAX and Public Utilities Commission

### Relevant Legislative History

**1974**

Act 144, SLH 1974, enacted the provision.

**2011**

Act 105, SLH 2011, suspended the provision from July 1, 2011, through June 30, 2013.

### What does this exclusion do?

This exclusion allows a Hawai'i business to import an oceangoing vehicle from an out-of-state seller without having to pay Use Tax on the purchase price, provided that the vehicle is used for interisland public transportation of passengers. The exclusion is a special carveout for businesses involved in interisland oceangoing public transport only and represents an exception to the general rule that Use Tax would apply to an out-of-state transaction with a non-GET-licensed seller. While Use Tax would normally “level the playing field” between purchasing from a local business and purchasing from an out-of-state business, the exclusion undoes that leveling and thus slants the field in favor of the out-of-state seller.

The exclusion applies strictly to vessels transporting passengers. It does not apply to vessels transporting only cargo, though it may apply to a vessel transporting a mix of passengers and goods. A business must be a “public utility” to claim it, meaning it must own or operate equipment “for public use for the transportation of passengers or freight.” Boats solely for private use should not qualify for the exclusion, and the law statutorily disqualifies operators of luxury cruises.

### How it works

The provision excludes the application of Use Tax to oceangoing vehicles imported and used for interisland passenger service. The

<sup>8</sup> There is only one possible claimant of this exclusion, as there is only one registered public passenger carrier for interisland travel. Whether that carrier in fact claims the exclusion is unknown because exclusions are not reported.

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taxpayer claiming the exclusion does not report the cost of the imported vessel on its General Excise/Use Tax Return, such that no Use Tax is calculated or due. Ultimately, DOTAX receives nothing to indicate that the taxpayer imported the vessel or availed itself of the exclusion.

### **What is the purpose of this exclusion?**

Act 144, SLH 1974, states: “The purpose of this bill is to encourage private industry to participate in and help solve the State’s waterborne transportation problems by exempting from use taxes those high-speed oceangoing vehicles used for passenger transportation from one point to another within the State.” The Legislature wanted to provide a tax incentive, recognizing that the State of Hawai‘i had encouraged the development of alternate modes of interisland water transportation and that “several private firms ... committed substantial capital funds in attempting to provide this necessary alternative.” The Act did not define “high-speed” service, but we note that the 1974 legislation closely preceded the 1975 introduction of the SeaFlite public ferry service between the islands of O‘ahu, Maui, and Kaua‘i. The SeaFlite ferries were 50-mile-an-hour hydrofoils that operated from 1975 to 1978.

### **Is the exclusion meeting its purpose?**

In our opinion, the exclusion is meeting its explicitly stated purpose of encouraging private industry to participate in and help solve the State’s waterborne transportation problems, but to an extremely limited extent. As of October 16, 2023, there is only one passenger water carrier registered with the Public Utilities Commission (PUC), which operates solely between Lahaina Harbor, Maui, and Manele Bay, Lāna‘i. Only one other water carrier is registered with the PUC, and that company’s current vessels would not qualify for the exclusion because they are for the purpose of transporting cargo only.

### **What were the number of claimants, total amount claimed, and tax expenditures for this exclusion from 2019-2021?**

As previously detailed, taxpayers are not required to report excluded revenues on their General Excise/Use Tax Return. Therefore, there is no tax return data available as to the number of claims or claimants or as to the amount of claims. We do know from PUC records that only one water carrier should qualify to use the exclusion.

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






Although the exclusion was adopted with an economic purpose of encouraging private industry to solve the State's waterborne transportation problems, it is our understanding that there currently are no interisland oceangoing passenger services other than a single route between Maui and Lāna'i, and there is no expenditure data upon which to base a cost-benefit analysis. Consequently, we cannot determine whether the cost outweighs any benefit. However, we do note that, for the one carrier operating along the Maui-Lāna'i passage, the exclusion should reduce the total cost of any new vessel imported – theoretically helping to maintain a route that has existed for 30 years.

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

We recommend that the exclusion be retained without modification. The exclusion is meeting its purpose, to a limited degree, and continues to offer an incentive for new attempts at interisland oceangoing public transport. While the tax expenditure is not calculable due to the nonreporting of exclusions, we note that there is currently only one passenger carrier, operating only one route, that could claim the exclusion.

# Use Tax Exemption for Liquor and Tobacco Imports Consumed Out-of-State By Carrier Crew and Passengers (Section 238-3(g), HRS)

## Exemption at a Glance

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

Source: DOTAX correspondence

### Relevant Legislative History

#### 1966

Act 28, SLH 1966, enacted the provision codified as Section 238-3(g), HRS.

#### 2011

Act 105, SLH 2011, suspended the provision from July 1, 2011, through June 30, 2013.

### What does this exemption do?

This provision allows liquor and tobacco imports not to be subject to Use Tax, when the imported products are to be consumed out-of-state by vessel and airplane passengers and crew. Specifically, the provision exempts amounts paid for liquor and tobacco products imported to the State and sold to a person or common carrier for out-of-state consumption by that person or the carrier’s passengers and crew. Covered products include liquor as defined in Chapter 244D, HRS, and cigarettes and tobacco products as defined in Chapter 245, HRS. Covered carriers include those engaged in interstate commerce only, whether ocean-going or by air.

### How it works

When this exemption applies, the cost of the liquor or tobacco import is simply not reported, such that no Use Tax is calculated or due. The price does not appear anywhere on a taxpayer’s General Excise/ Use Tax Return, and DOTAX does not track the exemption. The non-reporting can make this exemption resemble an exclusion, but it is our position that Section 238-3(g), HRS, is an exemption because it is a statutory exception to the general rule that imported tangible personal property is subject to Use Tax. Hence, without any statutory carveout, Use Tax should apply to all imported liquor and tobacco.

### What is the purpose of this exemption?

This Use Tax exemption was enacted as part of a larger package of exemptions (Act 28, SLH 1966) whose collective purpose was, in relevant part, “to stimulate agricultural production, and encourage sales by local businessmen of locally produced and other products

## The 1960s: Peak and Decline of Agriculture, Rise of Tourism

**THE 1960s** were a decade of major economic transformation for Hawai'i. Agriculture reached its plantation era zenith, with sugar production peaking and pineapple production providing over 80 percent of the world's supply. All milk products and nearly half of all fruits and vegetables consumed were locally grown. Statehood permitted access to federal funds for developing programs, such as farm credit. Statehood also ushered in workers' rights and unions, and producers of sugar, pineapple, and other monocrops began leaving Hawai'i – quickly – for cheaper labor in India, Cuba, the Philippines, and Puerto Rico. Tourism began to replace agriculture as the primary economic driver, as air transportation became affordable and a post-World War II economic boom continued. Vegetable imports rose 31 percent between 1961 and 1970, exceeded local production by the end of the 1970s, and would continue to rise, rapidly. It was in the 1960s that Hawai'i's economic character as an agricultural state, and as an export state, was transformed.

for consumption out-of-state.”<sup>9</sup> The legislative history shows that, in 1966, the Legislature was prioritizing agricultural growth as a matter of urgency. The Legislature officially, explicitly declared Act 28 to be a constitutional “urgency measure deemed necessary in the public interest.” Expanding upon “extensive changes” made in 1965, the Legislature in 1966 stated, “It is apparent at this time that additional changes in the tax laws may be necessary. It is urgent and in the public interest that adjustments and changes in the tax laws be made at the earliest possible opportunity....” We note that, when Act 28 was passed, Hawai'i's economy was undergoing a significant transformation from agriculture to tourism (see sidebar).

Without the exemption, importing goods to Hawai'i – even just to store those goods for later resale – should trigger Use Tax. Imposing such tax should have the result of putting such imports on a “level playing field” with locally produced goods, which are subject to General Excise Tax. However, for goods to be consumed outside of Hawai'i, and assuming Use Tax is passed on to customers, the Use Tax would also cause goods imported to Hawai'i to be more expensive than goods purchased elsewhere. That is because the imports would be subject to Hawai'i Use Tax, while the goods purchased elsewhere – that is, goods not imported to Hawai'i – would not. What the exemption does is carveout an exception for goods to be consumed out of state, and specifically for alcohol and tobacco products to be consumed by common carrier passengers and crew. Thus, while the exemption undoes any “leveling of the playing field” between Hawai'i imports and Hawai'i local goods, it “levels the playing field” between Hawai'i imports and out-of-state purchases. In summary, the exemption removes an incentive for carriers to purchase their alcohol and tobacco out of state – or, in other words, incentivizes buying alcohol and tobacco imports in Hawai'i.

The exemption under Section 238(3)(g), HRS, eliminates the disadvantage of Use Tax otherwise imposed upon a Hawai'i importer, putting the Hawai'i importer on a “level playing field” with the out-of-state seller, which is not subject to GET. With the Use Tax exemption in place, and with a separate GET exemption in place for tangible personal property consumed out of state, there should be no excise tax specifically on the importation or sale of liquor and tobacco products to be consumed outside of Hawai'i by carrier passengers and crew.

<sup>9</sup> This exemption was passed as one of many, which included the first exemption discussed in this report: that for the interisland shipping of agricultural commodities.

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### **Is the exemption meeting its purpose?**

While we note that this exemption was enacted as part of the larger Act 28, which may or may not have achieved its overarching purpose of stimulating agricultural production or encouraging sales of locally produced goods, we lack the data necessary to determine whether this particular exemption met any such goal. DOTAX does not track data regarding this exemption, such that its 2019, 2020, and 2021 reports on GET exemption usage and tax expenditure include no relevant information. We do note, however, that if importers are claiming the exemption at all, then the exemption should be meeting its purpose of creating a competitive marketplace for Hawai'i importers selling to common carriers, as described in the previous paragraph. A leveling of the playing field for such importers could be inferred to encourage sales by local businesspeople of goods for consumption out of state.

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

DOTAX has no available data as to who is claiming the exemption, the number of entities benefiting from the exemption, or the total amount exempted from Use Tax. DOTAX does not track this exemption, such that its 2019, 2020, and 2021 reports do not include pertinent data.

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

We cannot determine what economic or employment benefits the exemption yields, if any. That is for lack of data, as usage and effects of this exemption are not tracked by DOTAX.





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

We recommend that the exemption in Section 238-3(g), HRS, be retained without modification. While we lack data that would allow us to confirm that the exemption is stimulating agricultural production or encouraging sales by local importers, we believe that if the exemption is used at all, it should only encourage such sales. In other words, we see no negative repercussions of retaining the exemption and suspect only positive ones actually ensue.



## Use Tax Exemption for Use of Vessels Constructed Prior to July 1, 1969, Under DBEDT Loans (Section 238-3(h), HRS)

### Exemption at a Glance

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

### Relevant Legislative History

#### 1969

Act 181, SLH 1969, enacted the provision as Section 238-3(h), HRS.

#### 2011

Act 105, SLH 2011, suspended the provision from July 1, 2011, through June 30, 2013.

### What does this exemption do?

This provision exempts from Use Tax the cost of any imported vessel constructed prior to July 1, 1969, under a certain loan program that existed at that time. The loan program was the Fisheries New Vessel Construction Loan Program: a fishing industry support program by which DBEDT issued loans to finance the purchase, construction, renovation, maintenance, and repair of vessels. Technically, the exemption concerns any loan issued under Section 189-25, HRS, which today includes loans made by DBEDT under other programs – such as those issued in cooperation with National Marine Fisheries Service and the Small Business Association – but, because the exemption specifies construction prior to 1969, the loan issued must have been one from before July 1, 1969. In short, a vessel must have been constructed under the Fisheries New Vessel Construction Loan Program for its importer to qualify for the exemption.

### How it works

If this exemption applies, the cost of the imported vessel is simply not reported, such that no Use Tax is calculated or due. The price of the imported vessel does not appear anywhere on a taxpayer's General Excise/Use Tax Return, and DOTAX does not track the exemption. The non-reporting can make this exemption resemble an exclusion, but it is our position that Section 238-3(h), HRS, is an exemption because it is a statutory exception to a general rule that imported tangible personal property is subject to Use Tax. Without any statutory carveout, Use Tax should apply to the imported fishing vessels.

Furthermore, committee reports from the time of enactment specify that the allowance is an “exemption” and they identify its purpose as “to exempt” vessels constructed under the Fisheries New Vessel Construction Loan Program.

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### **What is the purpose of this exemption?**

According to the Committee on Lands and Natural Resources, “It was hoped that, by the passage of [Act 181, including the exemption under review], the legislature would thereby encourage fishermen to invest in new vessels capable of long-range fishing with modern equipment and new techniques.” Back in 1965, the Legislature had started the Fisheries New Vessel Construction Loan Program to inject new life into Hawai‘i’s fishing industry, which the Committee described as having been “depressed.” Under the program, the Department of Land and Natural Resources was authorized to make loans in conjunction with financial institutions and the Federal government to individuals or businesses for the purpose of constructing new vessels. The Legislature recognized that vessel construction and use would be financially burdensome and risky, and sought to provide additional support, in the form of tax relief, so that the program could continue to benefit the fishing industry and State as a whole. The Legislature further emphasized that the relief would be retroactive, drawing special attention to a particular taxpayer who had already borrowed through the program and had been faced with the State’s Use Tax in addition to the loan debt.

### **Is the exemption meeting its purpose?**

No, the exemption does not meet its purpose of encouraging investment in “new vessels capable of long-range fishing with modern equipment and new techniques” because it requires use of a vessel “constructed ... prior to July 1, 1969.” There are likely no existing or potential claimants. New claimants are likely to be zero, as claiming the exemption requires use of a vessel not only built prior to July 1, 1969, but also built under a very specific State loan program that, due to a funding repeal, effectively no longer exists.<sup>10</sup> Without moneys, no loans may be issued, and without loan issuance, no vessel can be constructed using such a loan – in any year.

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<sup>10</sup> Between 1986 and 1996, there had been minimal activity under the Fisheries New Vessel Construction Loan Program and DBEDT, which had taken over administration of the program, suspended all purchase and construction loans, processing repair and maintenance loans only. In 1996, Act 143 consolidated the program with the Hawaii Capital Loan Program and an associated revolving loan fund: the Hawaii Capital Loan Revolving Fund (Fund). After the consolidation, the Legislature merged the State’s large and small vessel purchase and repair funds into that same Fund. Ultimately, in 2003, the Legislature repealed the Fund entirely, and remaining moneys were transferred to the Hawai‘i General Fund.

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

DOTAX has no available data as to who is claiming the exemption, the number of entities benefiting from the exemption, or the total amount exempted from Use Tax. DOTAX does not track this exemption, such that its 2019, 2020, and 2021 reports do not include pertinent 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 regarding usage of this exemption, we suspect that the exemption has negligible, if any, impact on the economy of Hawai'i due to the expected rarity of potential claimants. Claiming the exemption requires the importation and use of a vessel constructed not only prior to July 1, 1969, but also under a specific fisheries loan program that existed at that time. We have been unable to identify an imported vessel constructed prior to July 1, 1969, pursuant to that loan program, which is now defunct due to a 2003 funding repeal.

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

We recommend repealing this exemption. In our view, it does not continue to meet its original purpose of encouraging investment in new, modern vessels; in fact, it runs contrary to that intent by requiring use of vessels constructed prior to 1969. We suspect that the tax expenditure and economic impact associated with this exemption are negligible or zero, such that repeal should not have any significant adverse effect on the State.

# General Excise Tax Exemption for Certain Shipbuilding and Ship Repair (Section 237-28.1, HRS)

## Exemption at a Glance (2021)

Amount claimed	Number of Unique Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Resident	Meeting its Purpose?
				
\$329,862,460	70	\$13,154,165	\$27.36	Cannot be determined

Source: DOTAX 2021 Hawai'i General Excise and Use Tax Exemptions report<sup>11</sup>

### Relevant Legislative History

- 1971**  
Act 204, SLH 1971, enacted the provision codified in Chapter 237, HRS.
- 2011**  
Act 105, SLH 2011, suspended the provision from July 1, 2011, through June 30, 2013.

### What does this exemption do?

This exemption allows a taxpayer not to pay GET on revenue arising from shipbuilding and ship repairs rendered to surface vessels federally owned or engaged in interstate or international trade. Without the exemption, GET would be due on such revenue.

### How it works

Taxpayers report revenues that they intend to exempt on Schedule GE under Exemptions/Deductions (ED) Code 144, "Shipbuilding and Ship Repairs: Gross proceeds arising from shipbuilding and ship repairs rendered to surface vessels federally owned or engaged in interstate or international trade are exempt." The revenues are thus reported, but are subtracted out – on the same Schedule GE – prior to calculating the amount of GET owed. No GET is owed on the relevant revenues. However, because revenues are included and subtracted out, as opposed to being left unreported, there exists data usable for analysis.

### What is the purpose of this exemption?

The Legislature explicitly intended for this exemption to facilitate the shipbuilding and ship repair businesses in Hawai'i to compete on an even basis with businesses operating in states that do not charge an excise tax on such activities. Its intent was that the exemption "result in an expansion of the State's economy through the servicing of shipping and provide a chance to build a new industry which will create new and different tax bases."

<sup>11</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.

### **Is the exemption meeting its purpose?**

International shipping is of critical importance to Hawai'i and ocean vessel servicing has expanded in the State, but, without further data, we are unable to determine how much of the industry growth is due to the GET exemption. Hawai'i shipbuilding and ship repair businesses appear to be surviving economic competition, as demonstrated by employment growth and consecutive year-on-year growth of exemption amounts claimed. However, we cannot draw a causal relationship between industry survival and the GET exemption. There is no data regarding sales, production, jobs, wages, or other measures generated specifically by businesses claiming the exemption, nor are there performance benchmarks identified in Section 237-28.1, HRS. Similarly, there is no data as to whether the exemption has been a motivating factor for decision-making within the industry. Without the requisite data, we cannot determine with any acceptable level of statistical accuracy whether economic growth has been caused by the exemption in particular.

We do note that international shipping and ship construction and repair have continued to be critical components of Hawai'i's economy. According to a 2019 DBEDT report on Marine Cargo and Waterborne Commerce in Hawai'i's Economy from 2001-2016, the marine cargo industry is predominantly international. In every year covered by the report, imports exceeded exports by over 600 percent and, by tonnage, international imports represented 63.6 percent of all such imports. Notably, the largest international imports, collectively representing 78 percent of all imports, were petroleum products upon which other transportation, electricity generation, and industry in the State depend. As for vessel construction and repair, another DBEDT 2016 report, entitled "Performance of the Manufacturing Industries in Hawai'i and the U.S.," shows that ship and boat building accounted for 780 out of a total of 814 transportation equipment industry manufacturing jobs in 2015. That was an increase from 516 ship and boat building jobs reported in 2005.

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

DOTAX calculates the amount of tax expenditure relating to this exemption using the GET wholesale rate of 0.5 percent, understanding the claims to derive from business-to-business transactions that should be taxed at the wholesale level. We question that approach, as nearly all claims were actually made at the retail rate, and only \$1,153,000, or less than one percent of total claims of \$329,862,000, were made at the wholesale rate. As such, our estimates for the tax expenditures resulting from this exemption (below) are based on the value of the claims applied against the actual tax rate at which claims were made.

(For details regarding the different approaches in calculating tax expenditure, please see our above section on the exemption for the interisland loading, transportation, and unloading of agricultural commodities.)

Year	Number of Claims	Amount Claimed	Auditor's Estimated Tax Expenditure	DOTAX Tax Expenditure
2021	75	\$329,862,000	\$13,154,000	\$1,649,000
2020	64	\$319,666,000	\$12,574,000	\$1,598,000
2019	74	\$266,019,000	\$10,554,000	\$1,330,000

Note: DOTAX Tax Expenditure amounts rounded to the nearest thousand.

Source: DOTAX 2019, 2020, and 2021 Hawai'i General Excise and Use Tax Exemptions reports<sup>12</sup>

### **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 is meeting its purpose of creating new and different tax bases. While the exemption saved businesses a total of over \$36 million in GET from 2019 to 2021, such data is insufficient to prove any causal relationship, or motivational relationship, between the exemption and any expansion of the shipbuilding and ship repair industry. In other words, we do not know whether shipbuilders or ship repairers would have expanded in Hawai'i regardless of the exemption.

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

Without evidence of any causal relationship between the exemption and the expansion of the shipbuilding and ship repair industry, we are unable to determine whether the exemption should be retained without modification, amended, or repealed. While exemption amounts claimed have risen year over year, denoting rising revenues, we cannot know to what extent the rise is due to the exemption. The fact that the exemption is being used, however, implies that repealing it could adversely impact taxpayers – at least 75 taxpayers as of the end of 2021. We also note that, when GET applies, businesses paying it typically pass the cost on to consumers.

<sup>12</sup> Some calculations were by the Office of the Auditor alone, using DOTAX data.



# 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
2024 Session	23-76	237-24.3(4)	Amounts received by employment benefit plans and amounts received by nonprofit organizations or offices for the administration of employee benefit plans
		237-24.3(5)	Amounts received from food coupons under the federal food stamp program or vouchers under the Special Supplemental Foods Program for Women, Infants and Children
		237-24.3(6)	Amounts received from the sale of prescription drugs or prosthetic devices
		237-24.3(8)	Amounts received as dues by unincorporated merchants associations for advertising or promotion
		237-24.3(9)	Amounts received by labor organizations from real property leases
		237-24.75(2)	Reimbursements to the Hawai'i convention center operator from the Hawai'i Tourism Authority
		237-24.75(3)	Reimbursements to professional employer organizations from client companies for employee wages and fringe benefits
		209E-11	Amounts received by qualified businesses in Enterprise Zones
	23-95	235-5.5	Deduction for individual housing account deposit
		235-7(f)	Deduction of property loss due to a natural disaster
		235-16.5	Credit for cesspool upgrade, conversion, or connection
		235-19	Deduction for maintenance of an exceptional tree
		235-55.91	Credit for the employment of a vocational rehabilitation referral
		235-110.2	Credit for in-kind services contribution for public school repair and maintenance
		235-110.8	Credit for ownership of a qualified low-income housing building
241-4.7	Credit for ownership of a qualified low-income housing building		



Report Date	HRS Ref.	Statute to be reviewed	Notes
2025 Session	23-77	237-24.3(2)	Reimbursements to associations of owners of condominium property regimes or nonprofit homeowners or community associations for common expenses
		237-24.5	Amounts received by exchanges or exchange members*
		237-25(a)(3)	Gross income received from tangible personal property sales to state-chartered credit unions
		237-24.8	Amounts received by financial institutions, trust companies, trust departments, or financial corporations acting as interbank brokers
		237-26	Gross proceeds of scientific contractors and subcontractors
		238-3(j)	The value of property or services exempted by Section 237-26, relating to scientific contracts
		237-27	Amounts received by petroleum product refiners from other refiners
	23-96	235-15	Credit for purchase of child passenger restraint system
		235-55.6	Credit for employment-related expenses for household and dependent care services
		235-55.7	Credit for a low-income household renter
235-55.85		Credit for food and excise tax	

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

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 sanitarium
		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 kokua 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”

One way to measure the effectiveness and impact of a tax incentive is to quantify its economic impact on low-income residents. How to do so, and that we must do so as part of our incentives review, are found in Section 23-71, HRS. Our statutory mandate requires us to estimate the annual cost of each incentive per low-income resident of the State. It defines “low-income resident” as a State resident who is either (1) the only member of a family of one and with 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 estimate that there were 480,801 low-income residents statewide in 2020, the latest year for which we have relevant data readily available, based on decennial census data provided by the Department of Business, Economic Development and Tourism.

The results of this evaluation follow and only include the Auditor’s tax expenditure estimate for the tax provisions with reportable data.

### Cost of Tax Incentives per “Low-Income Resident”

Statute	Tax Incentive	Auditor’s Cost Estimate	Cost per DBEDT “Low-Income Resident”
<b>Section 237-24.3(1), HRS</b>	Exemption for Amounts Received from the Loading, Transportation, and Unloading of Agricultural Commodities Shipped for a Producer or Produce Dealer on One Island to a Person, Firm, or Organization on Another Island	\$384,000	80 cents
<b>Section 237-24.3(3) (A),(B),(C), HRS</b>	Exemption for Amounts Received from: (A) the Loading or Unloading of Cargo from Ships, Barges, Vessels, or Aircraft; (B) Tugboat and Towage Services; and (C) the Transportation of Pilots or Governmental Officials to Ships, Barges, or Vessels Offshore	\$23,771,000	\$49.44
<b>Section 237-28.1, HRS</b>	Exemption of Certain Shipbuilding and Ship Repair Business	\$13,154,000	\$27.36

Source: Office of the Auditor

The following table contrasts GET data with Hawai'i's total 2020 population of 1,407,006 people. The results of this evaluation follow and only include the Auditor's tax expenditure estimate for the tax provisions with reportable data.

### Cost of Tax Incentives per Hawai'i Resident

Statute	Tax Incentive	Auditor's Cost Estimate	Cost per Hawai'i resident
<b>Section 237-24.3(1), HRS</b>	Exemption for Amounts Received from the Loading, Transportation, and Unloading of Agricultural Commodities Shipped for a Producer or Produce Dealer on One Island to a Person, Firm, or Organization on Another Island	\$384,000	27 cents
<b>Section 237-24.3(3) (A),(B),(C), HRS</b>	Exemption for Amounts Received from: (A) the Loading or Unloading of Cargo from Ships, Barges, Vessels, or Aircraft; (B) Tugboat and Towage Services; and (C) the Transportation of Pilots or Governmental Officials to Ships, Barges, or Vessels Offshore	\$23,771,000	\$2.68
<b>Section 237-28.1, HRS</b>	Exemption of Certain Shipbuilding and Ship Repair Business	\$13,154,000	\$9.35

Source: Office of the Auditor