HAWAII TAX SYSTEM: GET

TAX REVIEW COMMISSION

Tax Research & Planning, DOTAX

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State of Hawaii
Department of Taxation
Hawaii is Open for Business
Our mission is to administer the tax laws for the State of Hawaii in a consistent, uniform, and fair manner.

HAWAII SYSTEM OF TAXATION

GENERAL PRINCIPLES OF TAXATION

- Economic Efficiency
  - Impose the smallest possible distortion on behavior (If distortion is intended, it should distort in the desired direction)

- Fairness
  - Horizontal Equity—taxpayers with the same ability to pay have the same tax liability
  - Vertical Equity—tax liability rises as ability to pay increases
    - Progressive, regressive, neutral
  - Alternative—tax liability is based on the benefits received

- Compliance and Administrative Burdens
  - Cost imposed on private sector to comply with law
  - Cost government bears to collect taxes

MEASURING PROGRESSIVITY

- Regressive – lower income people pay a higher percentage of their income in taxes
- Neutral – everybody pays the same percentage of income in taxes
- Progressive – higher income pay a larger percentage of their income in taxes

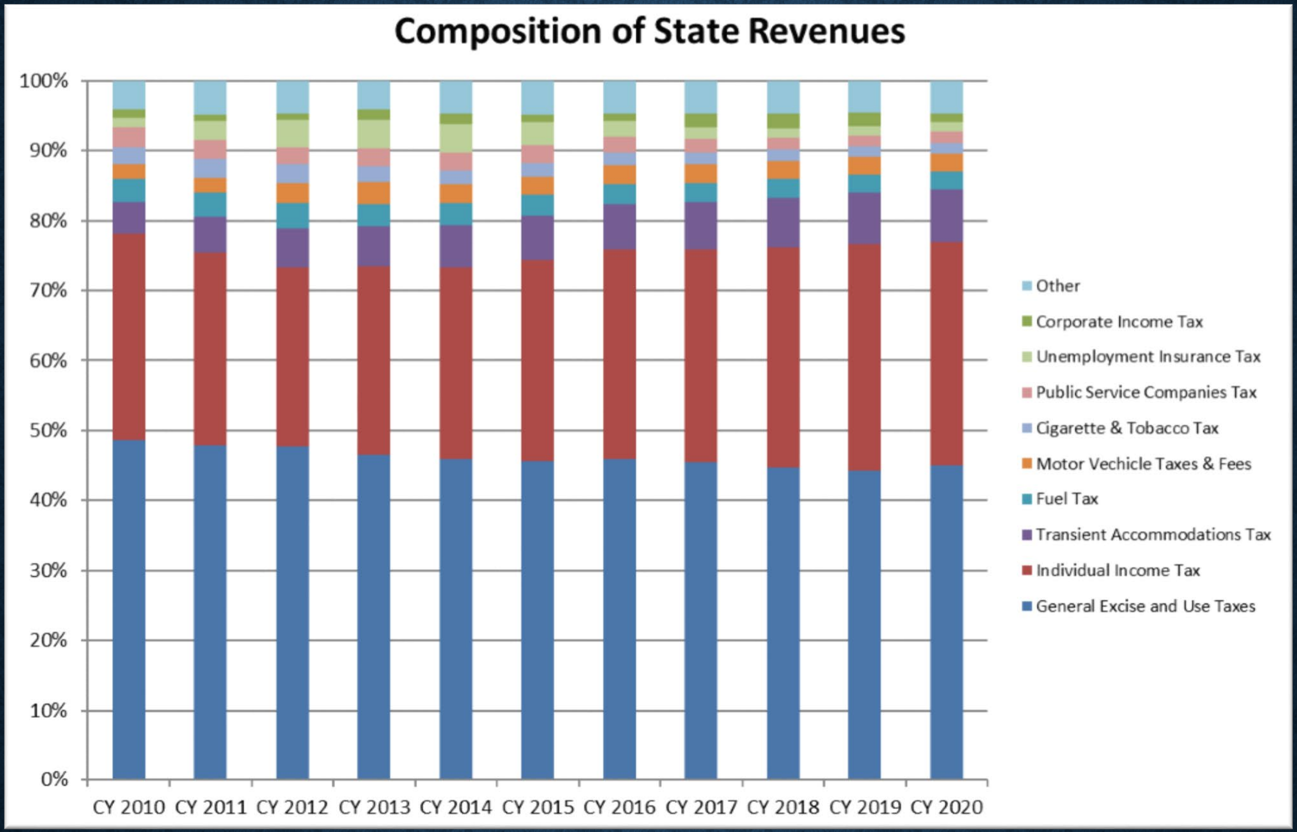
$$\% \text{ Tax Burden} = \frac{\text{Tax}}{\text{Income}}$$

% Tax Burden

Low Income High Income

ATTRIBUTES OF HAWAII

- Isolated and distant from other economies
- Exporter of services (tourism)
- Small land/ small population with narrow economic base (tourism and government)
- High cost of doing business

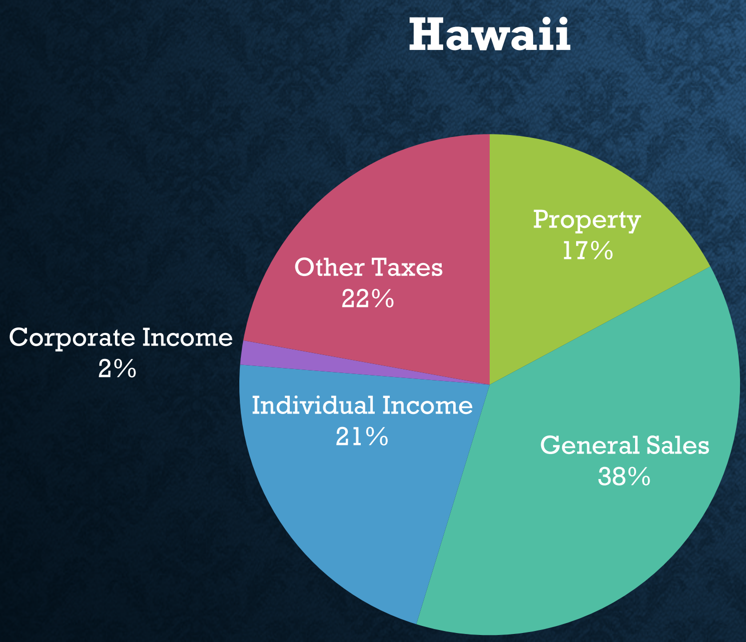


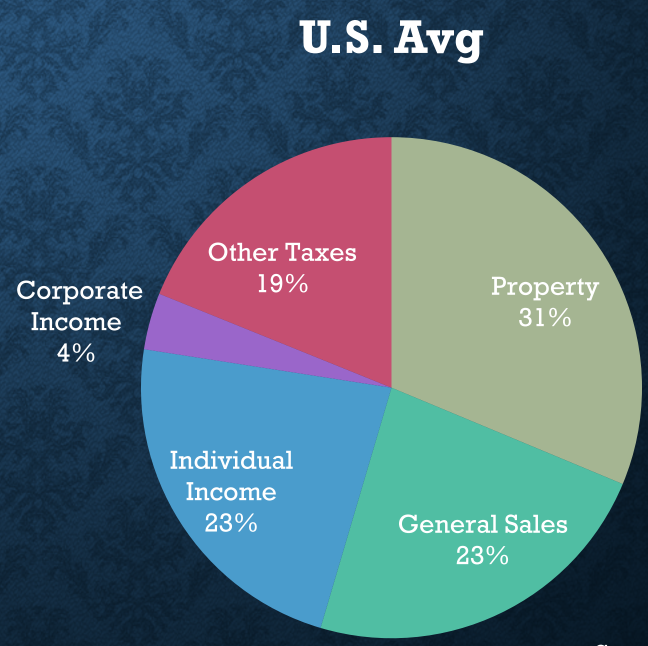
GET AND IIT COMPRISE THREE QUARTERS OF STATE REVENUE

AT A GLANCE: HAWAII TAX SYSTEM

- Hawaii receives significantly more revenue from sales tax and less from property tax than most states

Composition of state and local taxes





Source: Tax Foundation

HAWAII TAX COLLECTIONS ARE HIGHLY CENTRALIZED

- Hawaii collects more of its tax revenues at the state level than at the local level when compared with other states
- These rankings may overstate Hawaii's tax burden, because Hawaii may be able to export more of its taxes:
  - Federal government (income tax deduction)
  - Tourists and non-resident Military

State tax collections Per capita 2015

State	Collections per Capita	Rank
N.D.	$ 7,583	1
Vt.	$ 4,861	2
Hawaii	$ 4,530	3
Minn.	$ 4,452	4
Conn.	$ 4,438	5
Wyo.	$ 4,020	6
Mass.	$ 3,976	7
N.Y.	$ 3,952	8
Calif.	$ 3,862	9
Del.	$ 3,715	10
N.J.	$ 3,524	11
Md.	$ 3,305	12
Ark.	$ 3,086	13
Maine	$ 3,057	14
Ill.	$ 3,055	15
R.I.	$ 3,026	16
W.Va.	$ 3,018	17
Wis.	$ 2,949	18
Iowa	$ 2,942	19
N.M.	$ 2,882	20
Wash.	$ 2,879	21
Pa.	$ 2,821	22
Mont.	$ 2,753	23
Mich.	$ 2,717	24
Kans.	$ 2,708	25
U.S.	$ 2,694	

State-Local Tax Burden as a Share of State Income 2012

State	%	Rank	Total Tax Burden (per Capita)
N.Y.	12.7%	1	$ 6,993
Conn.	12.6%	2	$ 7,869
N.J.	12.2%	3	$ 6,926
Calif.	11.0%	6	$ 5,237
Ill.	11.0%	5	$ 5,235
Wis.	11.0%	4	$ 4,734
Md.	10.9%	7	$ 5,920
Minn.	10.8%	8	$ 5,185
R.I.	10.8%	9	$ 4,998
D.C.	10.6%	10	$ 7,541
Mass.	10.3%	12	$ 5,872
Ore.	10.3%	10	$ 4,095
Vt.	10.3%	11	$ 4,557
Del.	10.2%	16	$ 4,412
Hawaii	10.2%	14	$ 4,576
Maine	10.2%	13	$ 3,997
Pa.	10.2%	15	$ 4,589
Ark.	10.1%	17	$ 3,519
US	9.9%		$ 4,420
N.C.	9.8%	20	$ 3,659
Ohio	9.8%	19	$ 3,924
W.Va.	9.8%	18	$ 3,331
Utah	9.6%	21	$ 3,556
Ind.	9.5%	22	$ 3,585
Kans.	9.5%	23	$ 4,131
Ky.	9.5%	24	$ 3,298
Mich.	9.4%	25	$ 3,631

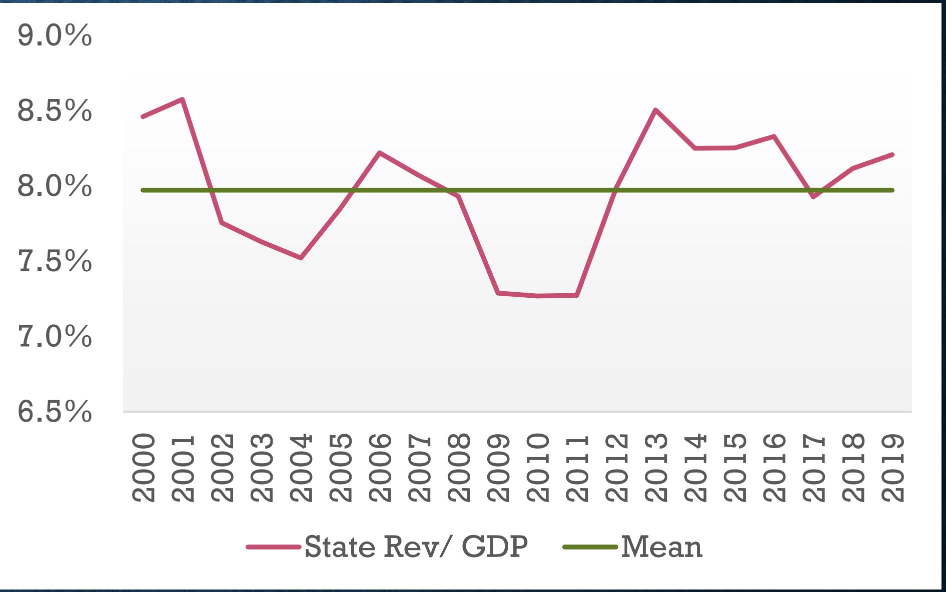
Source: Tax Foundation

ABILITY TO RAISE REVENUE

Short-run tax adequacy	• Does the system produce the required revenue during the current budget period?
Long-run tax adequacy	• Does the system produce the required revenue over the long term?
Stability	• Does the system provide stable revenues over the economic cycle?

HAWAII'S TAX SYSTEM IS RELATIVELY STABLE AND RESILIENT OVER THE LONG TERM

- State revenues as a percentage of Gross State Product is the same in 2019 as it was in 2007 and slightly lower as a percentage of Total Income
- State revenues were negatively affected by the Great Recession (implying less stability of tax system)



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	AVG
State Rev/ GDP	8.1%	7.9%	7.3%	7.3%	7.3%	8.0%	8.5%	8.2%	8.3%	8.3%	7.9%	8.1%	8.2%	8.0%
State Rev/ TPI	9.9%	9.4%	8.5%	8.7%	8.6%	9.4%	10.1%	9.6%	9.6%	9.7%	9.4%	9.7%	9.8%	9.4%

HAWAII'S REVENUE SYSTEM IS STABLE RELATIVE TO OTHER STATES

Tax Revenue Volatility Score
Pew Charitable Trust

	State Name	1998-2017 Volatility Score		State Name	Score
1	Alaska	37.6	27	Hawaii	5.6
2	North Dakota	16.1	28	South Carolina	5.4
3	Wyoming	13.6	29	Kansas	5.3
4	Vermont	10.4	30	North Carolina	5.0
5	California	8.6	31	US	5.0
6	New Mexico	8.4	32	Maine	4.9
7	Colorado	8.4	33	West Virginia	4.7
8	Arizona	8.1	34	Alabama	4.6
9	Louisiana	7.4	35	Indiana	4.5
10	Florida	7.1	36	Rhode Island	4.4
11	Oklahoma	7.1	37	Tennessee	4.3
12	Connecticut	7.0	38	Washington	4.3
13	Delaware	6.9	39	Ohio	4.3
14	Mass.	6.8	40	Mississippi	4.2
15	Utah	6.5	41	Missouri	4.1
16	Idaho	6.3	42	Nebraska	4.0
17	Montana	6.2	43	Wisconsin	4.0
18	Oregon	6.2	44	Iowa	4.0
19	New York	6.1	45	New Hampshire	3.9
20	Minnesota	6.1	46	Michigan	3.8
21	Texas	5.9	47	Pennsylvania	3.7
22	Nevada	5.8	48	Arkansas	3.7
23	Illinois	5.8	49	Maryland	3.4
24	Georgia	5.7	50	Kentucky	2.7
25	Virginia	5.7	51	South Dakota	2.7
26	New Jersey	5.6			

GENERAL EXCISE & USE TAX

GENERAL EXCISE AND USE TAX: WHAT IS IT?

- General Excise and Use Tax
  - The GET is a gross receipts tax that is imposed on the privilege of doing business in the State of Hawaii. The Use Tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales to Hawaii
- Vs Sales Tax
  - A sales tax is levied on the customer but collected by business. The GET is levied on the business
  - A sales tax is usually limited to retail sales of tangible goods whereas the GET is levied on almost all business activity
- Vs Value Added Tax (VAT)
  - A VAT only taxes the value added by business. The GET taxes the gross receipts of the business, so it taxes some business-to-business transactions

GENERAL EXCISE AND USE TAX: WHAT IS IT?

- Provides slightly less than half of Hawaii's general fund revenue
- The GET is levied on the "gross income" or "gross proceeds of sale" derived from the sale of tangible personal property or services
  - Very broad coverage. Economic activities that are not taxed must be explicitly cited in the law
- Two-tiered Rate System:

Wholesaling, manufacturing, producing, wholesale services	0.5%
Retail and all others	4.0%

- Few exemptions
  - (e.g. exports, financial transactions, core activities of non-profits)
- Tax is levied on the business
  - Can visibly be passed onto customer
- Use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales to Hawaii
  - Applied to the wholesale and retail rate

EXEMPTIONS/ DEDUCTIONS REDUCE TAX ON B2B SALES AND MAKE GET MORE LIKE A VAT

- Broad Tax Base
  - Hawkins (2002)--problems of cascading are less of a problem for small states with broad tax base
- Wholesale is taxed at a lower rate (0.5%)
- Exemption of exports
- Exempts taxes on insurance premiums and Public Utility Companies (But these items are subject to alternative taxes.)
- Exempts cost of subcontractors
- Refundable income tax credit for GET paid on the purchase of capital goods by businesses
- Does not tax SNAP (Supplemental Nutrition Assistance Program)

WHAT IS NOT COVERED BY THE GET: TOP TEN EXEMPTIONS

Deduction/ Exemption (2019)	Exempted Amount $ millions	Exemption Cost $ millions	Rationale
Foreign Trade Zones	6,199	0	Usually not taxed
Non-profit Organizations	5,985	239.4*	Social
Subcontract Deduction	3,715	18.8	Reduce pyramiding
Taxes Passed On	3,221	0	Reduce pyramiding
Out of State Sales	2,041	0	Usually not taxed
Prescription drugs and prosthetics	2,074	83.0	Social
Sales to Federal Government	1,478	0	Usually not taxed
Maintenance Fees	1,421	7.1	Usually not taxed
Affordable Housing	1,352	54.1	Social

* See 2019 General Excise and Use Exemption Report

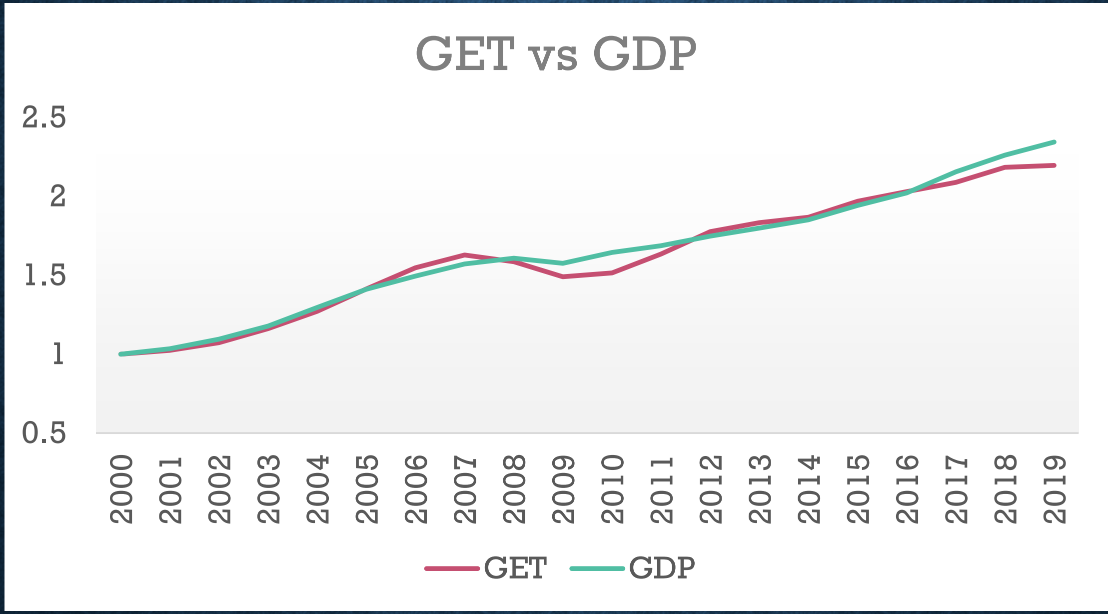
COMPARISON OF CONSUMPTION TAXES

	GET	Sales	VAT
Taxpayer (statutory)	Business	Consumer	Business
Coverage	Broad	Narrow	Broad
Activity taxed	Gross receipts	Cost of taxable goods	Value-added
Inputs taxed	Yes (kind of)	No	No
Administrative Burden	Low	Medium	High

THE TRADEOFFS OF THE GET

Pros	Cons
• Low administration cost • Imposes little in the way of market distortion • Broad based tax and low rates • Hard to avoid • Exportable	• Regressive* • Tax pyramiding *

GET REVENUES ARE STABLE AND CLOSELY CORRELATED WITH ECONOMIC PERFORMANCE



GET revenue is closely correlated to GDP, but it is less correlated during periods of sharp economic downturns

GET RAISES SIGNIFICANT REVENUE THROUGH A LOW RATE AND A BROAD BASE

Amongst the lowest sales tax rates in the country

State	State Tax Rate	Rank	Avg. Local Tax Rate	Combined	Rank
La.	5.00%	33	4.98%	9.98%	1
Tenn.	7.00%	2	2.46%	9.46%	2
Ark.	6.50%	9	2.80%	9.30%	3
Ala.	4.00%	40	5.01%	9.01%	4
Wash.	6.50%	9	2.42%	8.92%	5
Okla.	4.50%	37	4.36%	8.86%	6
Ill.	6.25%	13	2.39%	8.64%	7
Kans.	6.50%	9	2.12%	8.62%	8
N.Y.	4.00%	40	4.49%	8.49%	9
Calif.	7.25%	1	1.00%	8.25%	10
Hawaii	4.00%	40	0.35%	4.35%	45

Highest per capita collections of any state

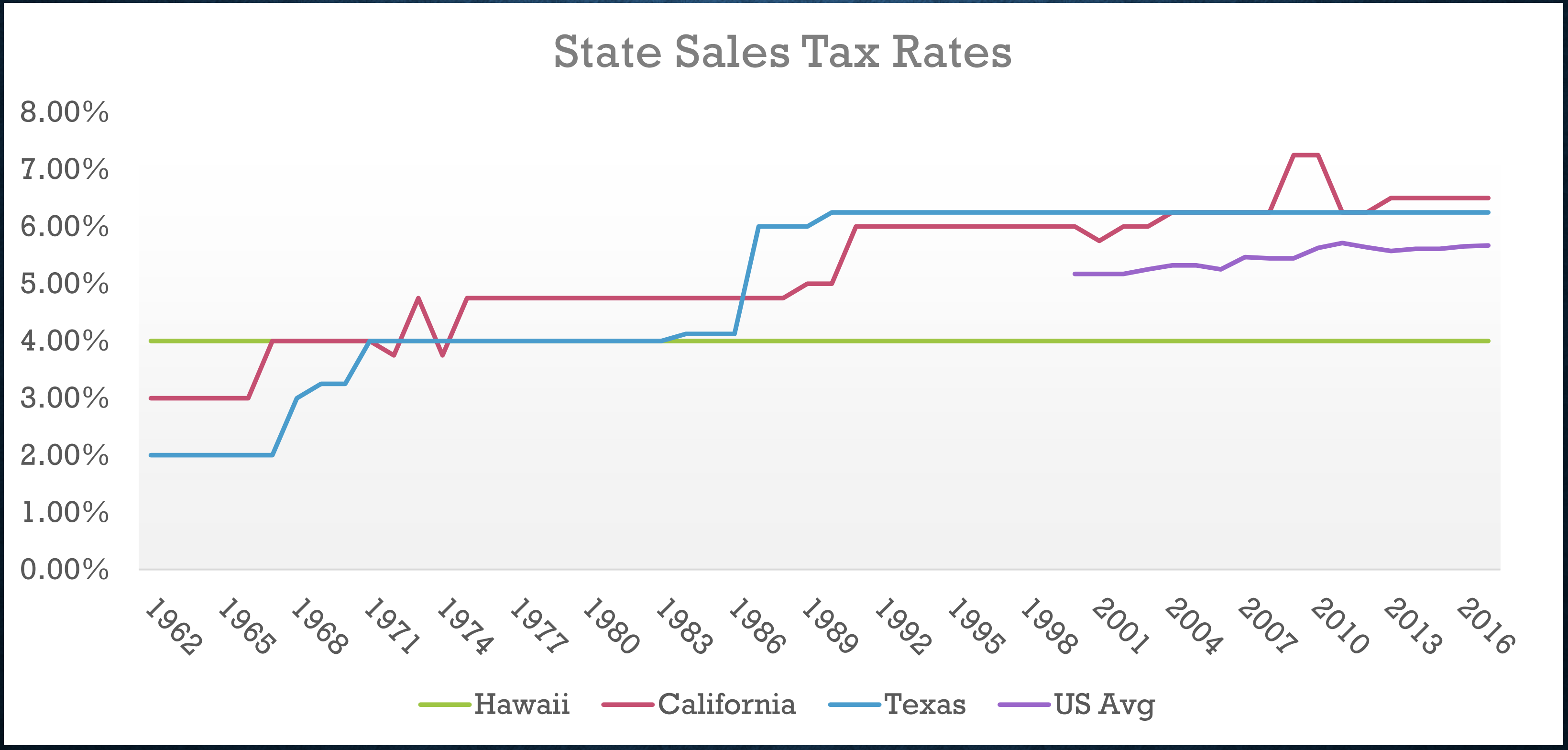
State	Collections per Capita	Rank
Hawaii	$ 2,090	1
N.D.	$ 1,835	2
Wash.	$ 1,746	3
Nev.	$ 1,412	4
Wyo.	$ 1,384	5
Tex.	$ 1,226	6
Miss.	$ 1,144	7
Conn.	$ 1,137	8
S.D. (b)	$ 1,131	9
Ind.	$ 1,100	10
N.M. (b)	$ 1,082	11
Fla.	$ 1,075	12
Ark.	$ 1,069	13
Kans.	$ 1,049	14
Ohio	$ 1,025	15

Broadest scope of sales tax of any state

State	Sales Tax Breadth	Rank
Hawaii (a)	104%	1
N.D.	73%	2
S.D. (a)	65%	3
Wyo.	62%	4
N.M. (a)	59%	5
Nev.	49%	6
Miss.	47%	7
Ark.	43%	8
Tex.	42%	9
Maine	41%	10
Ariz.	41%	11
Fla.	40%	12
Ind.	40%	13
Idaho	38%	14
Wash.	38%	15

Source: Tax Foundation

HAWAII'S GET RATE HAS BEEN REMARKABLY STABLE RELATIVE TO THE RATES OF SALES TAXES IN OTHER STATES



A SIZABLE PERCENTAGE OF THE GET GETS EXPORTED TO NON-RESIDENT TAXPAYERS

- Studies have found that around 30% of the GET tax is paid by non-residents.
  - Mainly tourists and non-resident military

Miklius et al (2003) 2003 TRC Report	32.9%
Tax Research & Planning (2006) 2007 TRC Report	37.9%
Colby 2019	28.2%
Average	**33.3%**

TAX PYRAMIDING IS BAD

- What is the problem with tax pyramiding?
  - A layering of taxes- a tax on a tax
  - The effective tax rate becomes higher than the statutory rate
  - Sectors are taxed unequally-disfavors sectors highly reliant on inputs
  - Loss of transparency- taxes are hidden

Tax Pyramiding of Aloha Shirts

Gross Receipts Tax

	Price	Value Added	Tax Rate	Tax
Fabrics	$100	$100	2.0%	$2
Wholesale	$200	$100	2.0%	$4
Retail	$400	$200	2.0%	$8
Subtotal		**$400**		**$14**

Nominal Rate		2.0%
Effective Rate	$14/$400	3.5%
Pyramiding		150%

BUSINESS TO BUSINESS TAXES RAISE THE EFFECTIVE TAX RATE BUT NOT BY MUCH

The Tax Pyramiding of the GET is minimized through the wholesale rate and other exemptions

Study	Effective Rate
TRP (2007), Study on the Progressive or Regressive Nature of Hawaii's taxes	4.5%
Colby (2018)	4.7%

PYRAMIDING RATES FOR SELECT GROUP OF AGGREGATED INDUSTRIES

	Tax Liability $millions	GET Pyramid $millions	Business Share	Consumer Share	% Pyramiding (Effective rate/ Nominal Rate)	GET/ Final Taxable Consumption
State Level*	**2,777**	**451**	**15%**	**85%**	**18.0%**	**4.72%**
Industry						
Agriculture	20.65	6.38	31%	69%	44.7%	5.79%
Mining and Construction	282.31	26.99	10%	90%	10.6%	4.42%
Food Processing	27.44	9.97	36%	64%	57.1%	6.28%
Other Manufacturing	175.23	61.51	35%	65%	54.1%	6.16%
Information	60.14	9.51	16%	84%	18.8%	4.75%
Wholesale Trade	147.68	27.04	18%	82%	22.4%	4.90%
Retail trade	283.96	21.11	7%	93%	8.0%	4.32%
Professional services	87.92	17.11	19%	81%	24.2%	4.97%
Business services	50.62	13.47	27%	73%	38.3%	5.45%
Arts and Entertainment	41.22	3.03	7%	93%	7.9%	4.32%
Accommodation	257.99	20.33	8%	92%	8.6%	4.34%
Eating and Drinking	156.96	16.18	10%	90%	11.5%	4.46%

- Industries with lower-value added experience higher levels of pyramiding
- Business and professional services experience higher tax pyramiding since many inputs are not at wholesale rate

*Includes the $29.6M Capital Goods Income Tax Credit

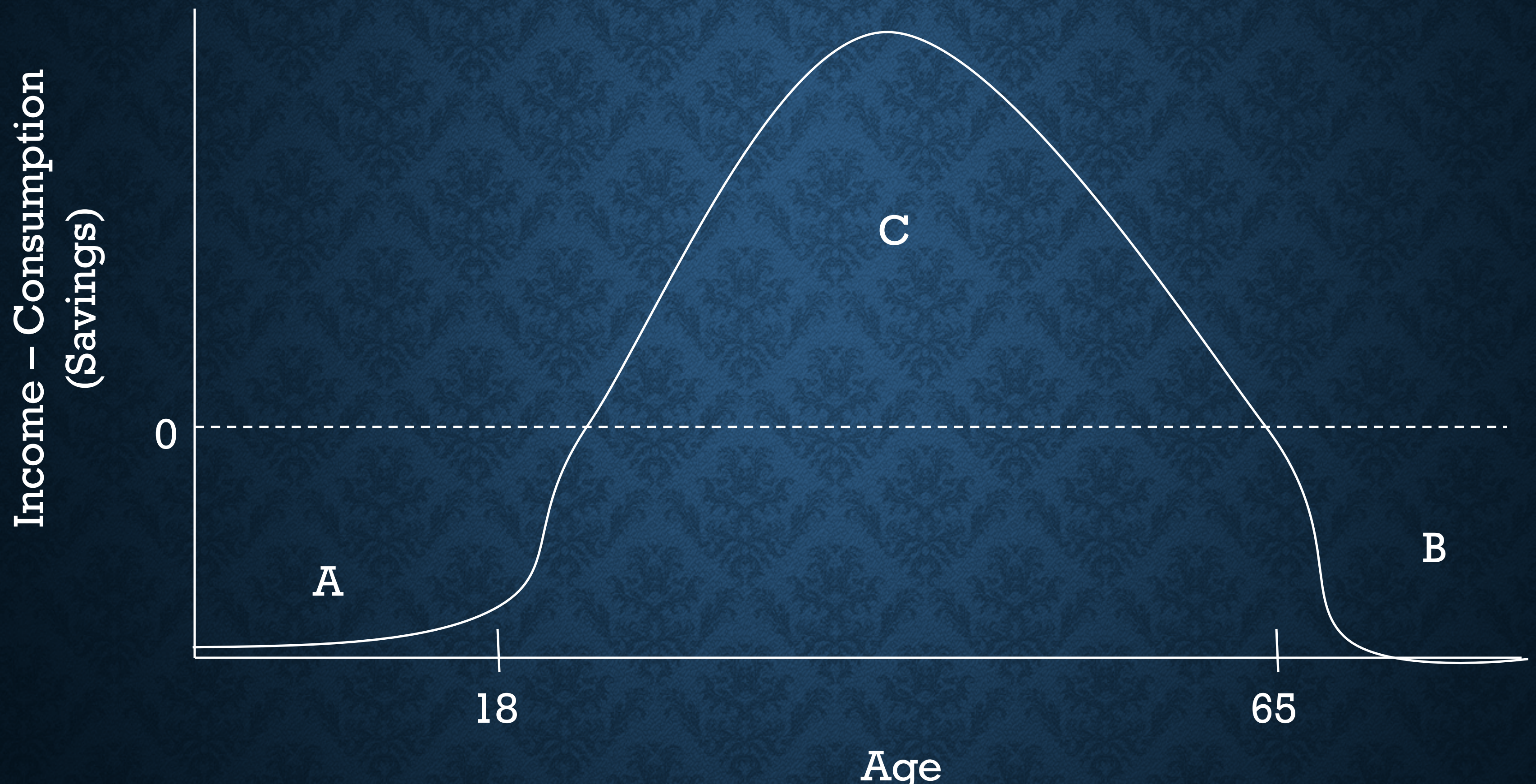
GET IS LESS REGRESSIVE THAN HEADLINE NUMBERS SUGGEST

- **Lower income people spend a larger portion of their income on consumption**

- **Studies tend to overstate the regressivity of consumption taxes because:**
  - People have different consumption patterns over their lifetime
    - Elderly people and young adults (students living at home) often consume more than their income.
    - Middle aged households are saving for retirement, so they are consuming less

- **Low-income populations receive benefits from the government, which do not count as income.**
  - EITC, food stamps, low-income rental credit, low-income food credit

LIFETIME SAVINGS PATTERNS

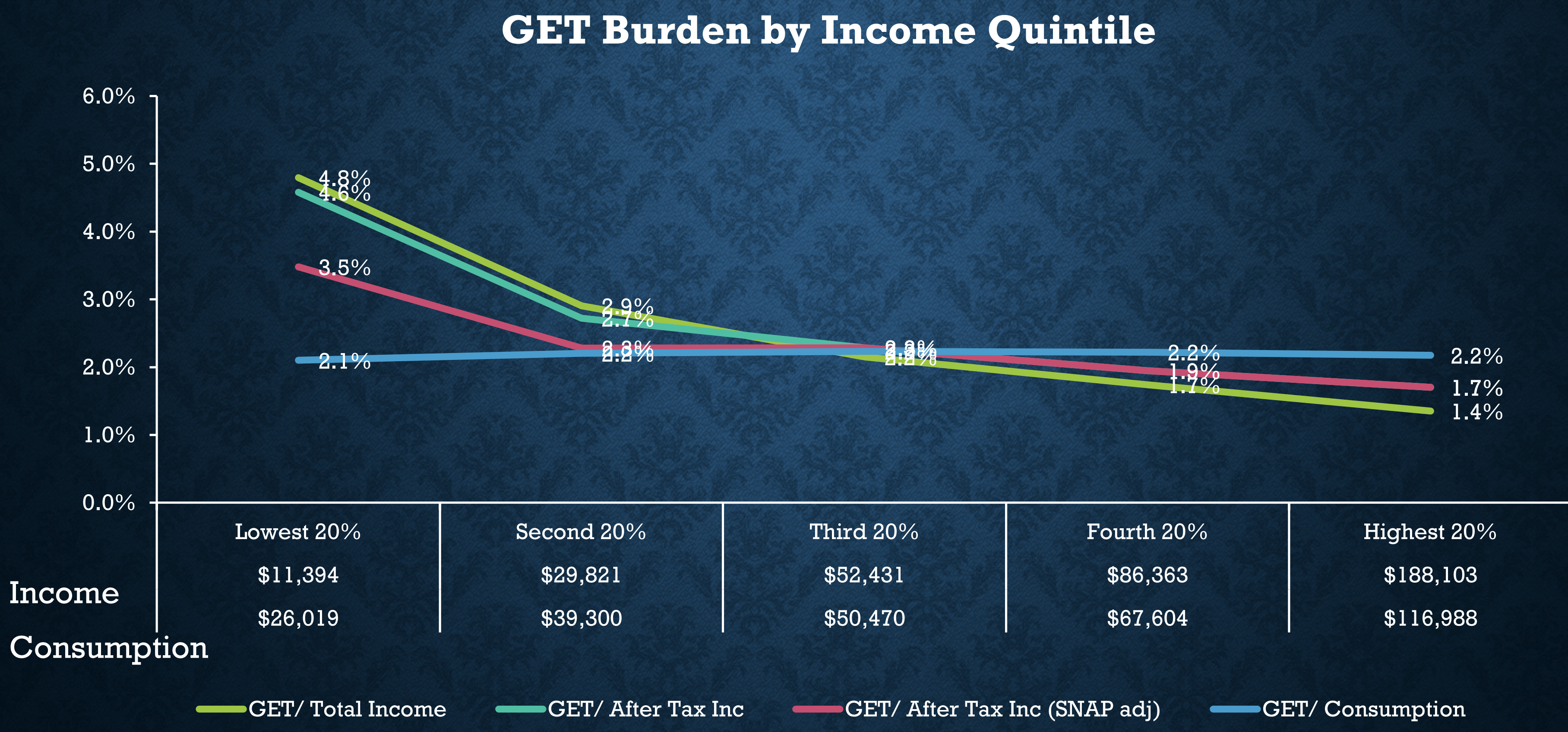


Over a lifetime, all income is consumed!   A + B = C

People's income varies over a lifetime, but consumption patterns much more stable

This implies that GET is NOT regressive but neutral over a lifetime

THE GET IS LESS REGRESSIVE UPON CLOSER INSPECTION



Source: Author's Calculations (Consumer Expenditure Survey)

Assumption: GET on rents is born by capital owner

IS THE GET REGRESSIVE?

- Depends on Time Scale
  - One year: YES, lower income households consume more of their income than higher income households
  - Over life-time: NO, all income is consumed, so everybody pays same amount of tax on consumption
-
- Consumption is more important metric of welfare than income
  - Lower-income households consume more than their income
    - Due to government in-kind transfers (social safety net)
    - Using savings when income is low (Retirees, Entrepreneurs)
    - When GET tax rate is larger than 4.0% of income, implies that household is consuming more than they earn

HOW DOES GET AFFECT HOUSING COSTS?

Low income HH are more likely to rent

- Housing is significant portion of HH spending (especially in HI)
- More than 30.9% HHs spend more than 35% on mortgage in HI vs 22.3% in US
- More than 47.1% of HHs spend more than 35% of income on rent vs 41.4% in the US

Low income HH are more likely to spend more of their income on housing

HH Income	<50,000	50,000-100,000	100,000 +
Household income	28,491	74,730	150,763
Shelter	12,323	18,526	35,879
Shelter/ Income	43.3%	24.8%	23.8%

Source: DBEDT

GET DISFAVORS RENTERS OVER OWNERS BUT TAX IS MOSTLY BORN BY PROPERTY OWNERS

- **Homeowners:**
  - The GET does not tax financial transactions (i.e. mortgage payments), so homeowners do not pay GET on shelter.
    - Regressive tax policy since higher income households are more likely to own than rent
- **Renters:**
  - GET taxes rents which disproportionately affects low- income households (since they are more likely to rent).
  - HOWEVER, GET is primarily paid by property owners versus renters.
    - The housing stock is fixed in the short term, so prices are mainly driven by demand and renter's ability to pay
  - THUS, assuming a partial pass through, GET is slightly regressive when it comes to housing consumption
  - Additionally, low-income rental credit reduces tax burden

SMALL CHANGES IN THE GET RATE CAN HAVE LARGE IMPACTS ON REVENUE COLLECTIONS

GET headlines numbers and revenue Implications
(thousands)

Rate	3.50%	4.00%	4.50%	5.00%
Rev Collection (millions)	3,007	3,436	3,866	4,295
Net Impact (millions)	-430	0	430	859
% of General Fund	-6.4%	0.0%	6.4%	12.8%

Year 2020

Every 0.5% change roughly equates to a 6.4% change in General Fund revenues

ASSESSING THE GET

Economic Efficiency	• The broad base and targeted exemptions keep tax pyramiding relatively low • There is still some tax on most business-to-business transactions, which increases the cost of doing business • Broad scope does not favor or disfavor a particular sector (low distortions)
Fairness	• Short term: Regressive because lower income people spend a larger percentage on taxed consumption • Long-term: Not regressive
Administrative Burden	• Low compliance costs and low administrative costs by the government
Stability	• GET revenue is closely correlated with GDP growth but falls more significantly during economic downturns

THANK YOU