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DEPT. COMM. NO. 339

January 26, 2026

VIA EMAIL

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

VIA EMAIL

The Honorable Nadine K. Nakamura
Speaker, House of Representatives
415 South Beretania Street
Hawaiʻi State Capitol, Room 431
Honolulu, Hawaiʻi 96813

Re: *Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai'i Revised Statutes*, Report No. 26-03

Dear President Kouchi and Speaker Nakamura:

Please find attached Report No. 26-03, *Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai'i Revised Statutes*, along with a copy of the Auditor's Summary. The review was performed pursuant to Section 23-71 et seq., Hawaiʻi Revised Statutes.

The report is accessible through our website at:
https://files.hawaii.gov/auditor/Reports/2026/26-03.pdf.

The summary is also accessible through our website at:
https://files.hawaii.gov/auditor/Overviews/2026/26-03AuditorSummary.pdf

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

Very truly yours,

Leslie H. Kondo
State Auditor

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

Auditor's Summary

Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai'i Revised Statutes

Report No. 26-03



PHOTO: ISTOCK.COM

This report reviews seven tax provisions 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.

Specifically, for 2024 and every tenth year thereafter, Section 23-77, HRS, requires the review of the following tax provisions:

- Amounts received by condominium associations, homeowners associations, and nonprofit community associations in reimbursement for common expenses (Section 237-24.3(2), HRS);
- Amounts received by an exchange or board of trade for transaction fees, membership fees, and other fees charged to members and to companies listed on the exchange (Section 237-24.5, HRS);
- Amounts received by the seller of tangible personal property to any state-chartered credit union (Section 237-25(a)(3), HRS);
- Amounts received by financial institutions, trust companies, trust departments, or financial corporations acting as interbank brokers (Section 237-24.8, HRS);

We determined that five GET exemptions and one Use Tax exemption were achieving their purposes and should be retained. We also determined that one GET exemption was not meeting its purpose and should be repealed.

- Gross proceeds received by contractors and subcontractors for performing work involving scientific facilities under contract with the United States, and gross proceeds of certain sales to those contractors and subcontractors in connection with the same (Section 237-26, HRS);
- Amounts pertaining to the use of property, services, or contracting exempted by Section 237-26, HRS (Section 238-3(j), HRS); and
- Amounts received by a petroleum refiner from the sale of any petroleum product that is further refined by another refiner (Section 237-27, HRS).

We determined that five GET exemptions and one Use Tax exemption were achieving their purposes and should be retained. We also determined that one GET exemption was not meeting its purpose and should be repealed: Section 237-24.5, HRS, which allows an exchange to exempt transaction fees charged to its members from GET. The provision has not achieved its intended purpose – establishment of a stock, commodities, or futures exchange in Hawai‘i – but is still being claimed by tax filers. We recommend DOTAX review claims under the exemption and recommend to the Legislature whether this exemption should be retained, modified, or repealed.

Link to the complete report:
Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai‘i Revised Statutes
https://files.hawaii.gov/auditor/Reports/2026/26-03.pdf

Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai‘i Revised Statutes

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

Report No. 26-03
January 2026



OFFICE OF THE AUDITOR
STATE OF HAWAI‘I

OFFICE OF THE AUDITOR
STATE OF HAWAIʻI

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

PHOTO: ISTOCK.COM

Foreword

This report assesses certain exemptions under Hawai‘i’s General Excise Tax. Section 23-71 et seq., Hawai‘i Revised Statutes, require the Auditor to review GET and Use Tax provisions annually on a 10-year recurring cycle. We express our appreciation to the Department of Taxation; Legislative Reference Bureau; and Department of Business, Economic Development and Tourism for their assistance in providing data and other information for this report.

Leslie H. Kondo
State Auditor

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PHOTO: ISTOCK.COM

Review of General Excise and Use Tax Provisions Pursuant to Section 23-77, Hawai‘i Revised Statutes

Introduction

THIS REPORT assesses certain incentives that reduce a tax filer's General Excise Tax (GET) and Use Tax liability. Specifically, we report the costs and performance of GET and Use Tax exemptions for:

- Amounts received by condominium associations, homeowners associations, and nonprofit community associations in reimbursement for common expenses (Section 237-24.3(2), Hawai‘i Revised Statutes (HRS));
- Amounts received by an exchange or board of trade for transaction fees, membership fees, and other fees charged to members and to companies listed on the exchange (Section 237-24.5, HRS);

The information in this report may be used by lawmakers in evaluating whether an incentive should be retained, amended, or repealed. This report is to serve as a tool for informed policymaking.

- Amounts received by the seller of tangible personal property to any state-chartered credit union (Section 237-25(a)(3), HRS);
- Amounts received by financial institutions, trust companies, trust departments, or financial corporations acting as interbank brokers (Section 237-24.8, HRS);
- Gross proceeds received by contractors and subcontractors for performing work involving scientific facilities under contract with the United States, and gross proceeds of certain sales to those contractors and subcontractors in connection with the same (Section 237-26, HRS);
- Amounts pertaining to the use of property, services, or contracting exempted by Section 237-26, HRS (Section 238-3(j), HRS); and
- Amounts received by a petroleum refiner from the sale of any petroleum product that is further refined by another refiner (Section 237-27, HRS).

The information in this report is intended to serve as a tool for informed policymaking. It may be used by lawmakers in evaluating whether any particular incentive should be retained, modified, or repealed.

Section 23-71, HRS, requires the Auditor to review a variety of tax incentives identified in later sections of the chapter and outlines what, substantively, the Auditor is to analyze. Section 23-77, HRS, identifies the specific incentives to be reviewed in 2024. 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 incentives discussed in this report are to be revisited pursuant to a 10-year review cycle under Section 23-77, HRS.

Background

Hawai‘i’s GET applies to nearly all business activities in Hawai‘i. According to the Department of Taxation (DOTAX) Annual Report for FY2024, GET and Use Tax revenues totaled $4.48 billion and accounted for 40.5% of total tax collections.

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, notes that such provisions reduce revenue to the State. Such reduction of revenue results in a need for all tax filers, including filers who do not directly benefit from those tax breaks, to compensate for the

reduced revenue or requires the State to reduce spending on programs and other initiatives. Despite the loss of revenue, the Legislature has stated that certain tax exemptions, exclusions, and credits are worthy of continuation for equity, efficiency, and economic and social policy purposes.

Accordingly, the Legislature found the Auditor's periodic 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 legal 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 the performance of each provision. Our mandate under which we conduct these reviews instructs us to determine the extent to which each provision achieves its purpose – a task made difficult (and often impossible) when the statutes fail to specify a purpose or a means by which to measure whether the purpose has been achieved.

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.

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 realize some financial benefit from business operations in the state. For the privilege of doing business in Hawai‘i, entities as well as individuals must pay GET, the largest source of state tax revenue, and which is separate from and additional to income tax. Unlike income tax, GET is a flat tax, meaning the rate of tax is not based on, and does not change with, income level. It is also a tax on product values, gross sales proceeds, and gross income 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 out-of-state business transactions. That is where Use Tax applies.

Use Tax complements GET by taxing goods and services imported for use in Hawai‘i. Without Use Tax, imported goods and services, which are not subject to GET, would have a cost advantage over local goods and services, which are subject to GET. Use Tax "levels the playing field" by taxing imported goods and services similarly to how GET taxes local goods and services. One distinction between GET and Use Tax is that sellers pay GET whereas purchasers or importers pay Use Tax.

Reporting for GET and Use Tax is accomplished via the filing of 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, businesses and individuals subject to GET or Use Tax must file a periodic General Excise/Use Tax Return, 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 over the course of the year. The higher a taxpayer's gross income, the more the taxpayer will likely owe and the more frequently the tax filer should have to file Form G-45. 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 whose GET liability is more than $4,000 in a given year. We are unaware of any law or guidance requiring electronic filing for filers owing $4,000 or less, though DOTAX has announced it may phase in more electronic filing mandates in the future. Electronic filing of Form G-45 is accomplished via DOTAX's Hawai‘i Tax Online system.

The G-49 (Annual Return):
At the end of the tax year, all businesses and individuals subject to either GET or Use Tax file a General Excise/Use Tax Annual Return and Reconciliation, Form G-49. The amount reported on the annual return and reconciliation is a summary of the taxpayers' activity for the entire year.

Electronic filing is mandated for general excise taxpayers whose annual liability exceeds $4,000 for the taxable year. Electronic filing of Form G-49 is accomplished via DOTAX's Hawai‘i Tax Online system.

There are ancillary GET and Use Tax forms beyond Forms G-45 and G-49 that must be filed under certain circumstances. An important one, for purposes of this review, is General Excise/Use Tax Schedule of Exemptions and Deductions, Schedule GE on which tax filers claim their exemptions.[1] It is a schedule that a filer must attach to Form G-45 or Form G-49 and failing to include it will result in disallowance of the exemption. A tax filer includes on Part I of Schedule GE all exemptions claimed, reporting the amount of each exemption and other information specific to the exemption, including an "ED Code," or exemption/deduction code, that corresponds to

[1] Exceptions exist; not all exemptions are claimed on Schedule GE. Exemptions for certain financial income earned by financial institutions, for example, are not claimed on any form because financial institutions do not file General Excise Tax returns.

the law allowing the exemption. Tax forms other than Schedule GE and Forms G-45 and G-49 are beyond the scope of our current review.

DOTAX's position is that an exclusion applies to revenue that was never meant to be taxable. As GET is a tax on the privilege of doing business in the State, revenues that are not from business activities are typically excluded – either by default or under a specific exclusion enacted toward that end. Tax filers generally do not report excluded amounts to DOTAX, and for that reason, DOTAX does not compile related information. Consequently, DOTAX does not report data on exclusions.

Rates at a Glance

While GET is a tax on business income, it resembles a consumption tax or sales tax in that businesses typically pass on the amount of the excise tax to consumers. Still, GET remains 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 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 vendor selling mangoes to buyers for their consumption is a retail transaction, and the revenue is taxed at the retail rate. Wholesaling generally involves the sale of goods or services to another person or entity for resale. If the mangoes are sold to a store owner who then resells the fruit to the store's customers, the transaction between the vendor and store owner is a wholesale one, and the vendor's revenue from the sale is taxed at the wholesale rate.

For the years reviewed, 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
- 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 property, commissions (except insurance commissions), theaters and amusements, and all other business income.

For the years reviewed, Use Tax rates were as follows:

Wholesale-to-Wholesale
0.0 percent (no tax) on the use of goods or value of services imported by GET-licensed wholesalers.

Wholesale-to-Retail and Certain Others
0.5 percent on the use of goods or value of services imported by GET-licensed manufacturers and retailers.

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.

County Public Transportation Surcharges

Since 2007, the City and County of Honolulu has imposed a 0.5 percent GET and Use Tax surcharge to help fund its public transportation system. Hawai‘i, Kaua‘i, and Maui counties have also each adopted 0.5 percent surcharges. There is no surcharge on revenues exempt from GET or Use Tax. Hence, in addition to reducing overall state revenue, exemptions and exclusions reduce county tax revenue.

How We Got GET
General Excise Tax in Hawai‘i

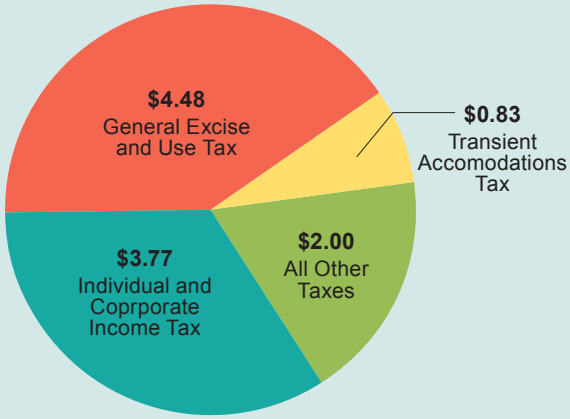
HAWAI‘I’S GET, like most sales taxes across the country, is a product of the Great Depression. While the Territory of Hawai‘i did not experience the level of unemployment and economic distress experienced by more industrialized areas of the United States, falling land values during the early 1930s led to a drop in real and personal property tax revenue, which were then the mainstays of the Hawai‘i tax structure. The 1932 Territorial Legislature cut real property tax rates and repealed the levy on personal property, and to make up for the lost revenue adopted a business excise tax on 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.[2] 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. 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 $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.

Recent statistics show that the retailing and service industries continue to be the largest sources of GET revenue for the State. For FY2024, DOTAX reported that retailing had a tax base of $48.14 billion, or 33.4 percent of the total tax base, with services at $21.02 billion, or 14.6 percent.

2024 Tax Collections reported by DOTAX
(in billions)



Source: DOTAX Annual Report for fiscal year 2023-2024.

According to DOTAX, in FY2024, the State General Fund, which is the State’s chief operating fund, realized $9.57 billion of a total of $11.08 billion in tax collections. Most of that revenue came from two taxes: GET and income tax. GET and Use Tax, the fund’s largest tax revenue source, accounted for $4.45 billion of General Fund deposits, or 46.5 percent of total General Fund revenues.

[2] *Hawai‘i’s General Excise Tax*, Report No. 2, 1963, Legislative Reference Bureau, State of Hawai‘i, p. 8.

Analysis of Reviewed Tax Provisions

What did we review?

This report reviews a total of seven tax provisions: six GET exemptions and one Use Tax exemption.

In performing our review, we examined DOTAX annual collections reports, letter rulings, brochures, and articles. We also reviewed taxpayer records under authority provided by Section 231-3.3, HRS. That section requires the Auditor to protect confidential taxpayer information, with limited exceptions. Ultimately, we were able to calculate tax expenditure values from DOTAX data, but not the extent to which many of the incentives affect the economy. We were often able to determine the cost, but not the benefit, of an incentive.

We relied on data from annual DOTAX reports on General Excise and Use Tax Exemptions. Amounts in these reports are expressed to the nearest $1,000.

What did we find?

In some cases, the statutes that created the exemptions identified the purposes of the exemptions, but where a purpose was not stated, we inferred purpose based on House and Senate committee reports and other sources of legislative history. Section 23-71, HRS, specifies that the purpose of an incentive may be "reasonably identified by the auditor."

We determined that five GET exemptions and the Use Tax exemption appear to be achieving what we understand to be their intended purposes. One GET exemption does not appear to be meeting its purpose.

We note that the statute requiring us to conduct these reviews 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 individual GET and Use Tax exemptions. The following Table 1 summarizes our results.

Table 1. Summary of Results

HRS Section	Incentive Type	Subject Matter Covered	Achieves Purpose?	Recommendation
237-24.3(2)	GET exemption	Homeowner maintenance fees	Yes	Retain
237-24.5	GET exemption	Exchange and exchange member transaction fees	No	Repeal
237-25(a)(3)	GET exemption	Tangible personal property sales to state-chartered credit unions	Yes	Retain
237-24.8	GET exemption	Income to financial institutions, trust companies, trust departments, and corporations acting as interbank brokers	Yes	Retain
237-26*	GET exemption	Scientific contracts with the U.S.	Yes	Retain
238-3(j)*	Use Tax exemption	Scientific contracts with the U.S.	Yes	Retain
237-27	GET exemption	Petroleum refiner income from other refiners	Yes	Retain

* Note: The GET exemption and Use Tax exemption for scientific contracts with the U.S. were analyzed together, as they are reported under a singular DOTAX exemption/deduction code (ED Code) and are tracked by DOTAX as one.

Assessment Challenges:

Few Metrics on Purpose Achievement and No Data on Economic Impact

A significant challenge we encountered was the lack of criteria by which to quantify or otherwise assess whether an incentive is meeting its purpose and how it is affecting, if at all, the State economy. Section 23-71, HRS, requires that, with respect to any incentive enacted to create an economic or employment benefit, the Auditor quantify the benefit and comment on whether the benefit outweighs the cost of the exemption. However, businesses are not required to provide information on jobs created or other economic impact information to DOTAX.

Lack of Forecasting Tools and Data

Lack of current data and forecasting tools also hindered our ability to predict future tax expenditures. We are required not only to review past performance of each incentive, but also to estimate the tax expenditure of each incentive for the current and next two calendar years. We do not have the necessary economic modeling software or similar tools. Proving causality between an incentive and

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 income subject to taxation. Thus, there should be a record of each exemption claimed.

EXEMPTIONS COME AT A COST. Allowing certain taxpayers to reduce the amount of gross income that is subject to GET decreases 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.

a rise or decline in any particular economic activity is not feasible without identifying and eliminating other potential causes. Regarding job creation, for example, there is no readily available data proving or disproving that a business would have created new jobs irrespective of any exemption. Businesses are not required to report job creation corresponding to any particular exemption, and we are not able to use Department of Labor and Industrial Relations data to correlate job growth to any particular industry. Likewise, there is no data readily available regarding the economic impact of businesses ineligible to claim a particular incentive, or eligible businesses that elect not to claim an incentive to which they are entitled.

Use of Statutory Formula for Low-Income Resident Calculations

An additional concern is that we analyzed the impact of tax incentives on "low-income residents" using a statutorily required formula that may not result in an accurate representation of how an incentive truly affects such residents. We question whether the calculations represent the "value" that a repeal of a particular tax provision would have for low-income residents. Although money generated from repealing a particular exemption or exclusion will likely increase tax revenues, the impact of the additional funds might confer a direct benefit not simply upon low-income residents, in particular, but upon all residents. Further discussion on "low-income resident" calculations, as well as our calculations which are based on the number of low-income households, can be found in Appendix B.[3]

Undefined Terms

The term tax *expenditure* is not defined in Hawai‘i law, including Section 23-71, HRS, which mandates this review, and Sections 237-1 and 238-1, HRS, which define key GET and Use Tax terms. The sidebar on this page explains how tax exemptions generally work, but 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, regardless of who would have paid the amount forgone or for what purpose the incentive is intended. See "Tax Expenditures: At What 'Cost'?" on page 12.

[3] Section 23-71, HRS, requires us to estimate the "annual cost of the exemption [or] exclusion ... per low-income resident of the State." We received data from the Department of Business, Economic Development, and Tourism (DBEDT) on the number of low-income households. (This number, reported by DBEDT from the U.S. Census Bureau's decennial American Community Survey, was last updated in 2020. We believe this to be the best and most accurate data available for this purpose.)

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 the 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 shoulder 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 those activities. The American Institute of Certified Public Accountants has opined that 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 do so. That mandate implies a need to consider 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.

Tax Expenditures: At What "Cost"?

AS DOTAX EXPLAINS in its 2022 *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%, respectively), and lists exemptions that DOTAX does not consider to be tax expenditures, but which may represent forgone opportunities to shift tax burdens to non-residents.

There are also certain exemptions that DOTAX does not consider to be "tax expenditures" and for which it therefore does not include tax expenditure amounts in its report. For example, there are GET exemptions for worker wages, stock and bond sales, bad debts, and fee simple land sales. These items, DOTAX states, are not traditionally included in the base of a sales or excise tax. According to DOTAX, they are not properly part of a broad-based tax on consumption and would not be subject to a sales or excise tax. Thus, as per DOTAX, no actual tax is forgone, meaning there is no associated tax expenditure.

DOTAX acknowledges that the assumptions underlying its classification scheme 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. The implicit assumption is that, without the exemption, all business-to-business taxpayers would pay GET at the wholesale rate. We question DOTAX's assumption, as at least some claims derived from business-to-business transactions were actually made at the retail rate, signaling that the taxpayers consider the underlying transactions retail, and not wholesale.

Another concern is that, as DOTAX's 2023 *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 provide 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 must account for the potential substitutional and behavioral effects of repealing an exemption.*

Tax Pyramiding

The wholesale rate, the retail rate, and tax "pyramiding"

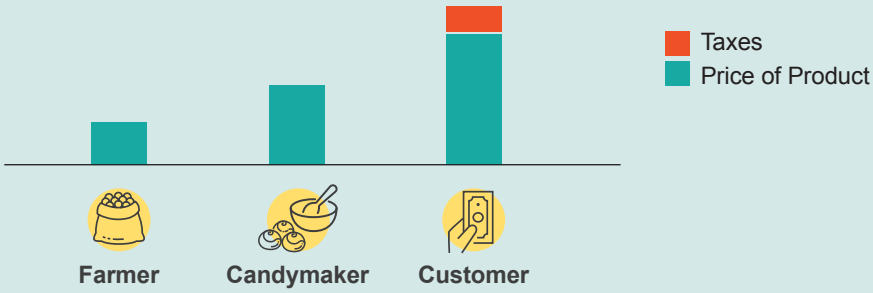
HAWAI'I'S GET is applied against receipts from business activities in the state, including both wholesale and retail transactions. GET is imposed on goods or services of each separate entity involved in the chain of production and distribution starting with revenue from the sale of the raw materials 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.

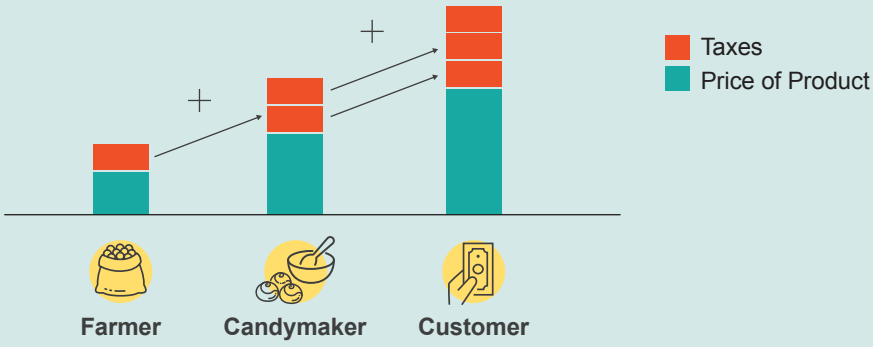
In order to reduce the effects of tax pyramiding, Hawai'i imposes a lower GET rate (0.5 percent) on wholesale, or business-to-business, transactions of goods or services intended for resale. The retail GET rate (4.0 percent) is generally applied only at the consumer level.

The Effect of Pyramiding Under a General Excise Tax

Sales Tax on Final Consumption



General Excise Tax



General Excise Tax Exemption for Homeowner Maintenance Fees (Section 237-24.3(2), HRS)

SECTION 237-24.3(2), HRS, allows an association of a condominium property regime, established under Chapter 514B, HRS (the Condominium Property Act) or a nonprofit homeowners association or a nonprofit community association, established under Chapter 414D, HRS, the Hawaii Nonprofit Corporations Act to exempt amounts received for reimbursement of common expenses from GET. The exempted revenue is reported to DOTAX as maintenance fees.

Exemption at a Glance (2023)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Household	Meeting its Purpose?
				
Unable to Determine*	**Unable to Determine***	**Unable to Determine***	**Unable to Determine***	**Yes***

* Exemption amounts claimed under Section 237-24.3(2), HRS, are aggregated with those claimed under Section 237-24(16), HRS, and include amounts received by cooperative housing corporations in reimbursement for lease rentals, real property taxes, and other operating and maintenance expense. Consequently, we cannot determine the amount attributed to this exemption.

Legislative History

Section 237-24.3(2), HRS

1967
Act 297, SLH 1967, created the exemption under Section 117-21(s), Revised Laws of Hawai‘i (RLH). The exemption applied only to horizontal property regimes under Chapter 170A, RLH.

1979
Section 117-21(s), RLH, was recodified as Section 237-24(21), HRS.

1988
Act 65, SLH 1988, replaced the terms “horizontal property regime” and “Horizontal Property Act” with “condominium property regime” and “Condominium Property Act,” respectively.

1992
Act 107, SLH 1992, expanded the exemption to nonprofit homeowners and community associations, as defined in then-Chapter 415B, HRS.

2007
Act 239, SLH 2007, expanded the exemption to submanagers of applicable property regimes.

2008
Act 28, SLH 2008, eliminated the word “apartment” from the exemption, clarifying that the exemption applies to owners of condominiums that are not apartments.

Incentive Summary

What is the purpose of the incentive?

In 1967, the Legislature exempted condominium property regimes and cooperatives from paying GET on amounts collected for common expenses. In creating this exemption, the Legislature noted that it was placing condominiums and cooperatives on a parity with owners of other types of real property interests. The incentive is also consistent with the general tax principle that payments received by an organization from its constituents to be used to further the organization's purpose are not business income and should not be subject to GET.[4]

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Expenditure
2023	Unable to Determine*	Unable to Determine*	Unable to Determine*	Unable to Determine*
2022	Unable to Determine*	Unable to Determine*	Unable to Determine*	Unable to Determine*
2021	Unable to Determine*	Unable to Determine*	Unable to Determine*	Unable to Determine*
2020	Unable to Determine*	Unable to Determine*	Unable to Determine*	Unable to Determine*

* Exemption amounts claimed under Section 237-24.3(2), HRS, are aggregated with those claimed under Section 237-24(16), HRS, and include amounts received by cooperative housing corporations in reimbursement for lease rentals, real property taxes, and other operating and maintenance expenses. Consequently, we cannot determine the amount claimed under this exemption.

Are there additional key qualification requirements or limitations applicable to the incentive?

Income received by the association from rentals of parking stalls, interest, commissions, vending machines, coin operated laundry facilities, and other miscellaneous income are not exempt from GET. That income is taxed at the rate of 4 percent.

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

Unable to determine due to insufficient data. We note the incentive is not intended to provide an economic or employment benefit.

[4] See Section 237-20, HRS. "The reimbursement of costs or advances made for or on behalf of one person by another shall not constitute gross income of the latter."

Is the incentive meeting its purpose?

Yes. The exemption aligns the application of GET to maintenance fees with the general principle that reimbursements to an organization by that organization's constituents to cover payments incurred in furtherance of the organization's purpose are not revenue to the organization and should not be subject to a business privilege tax.

Should the incentive be retained without modification, amended, or repealed?

Retain. The exemption is meeting its purpose.

General Excise Tax Exemption for Stock Exchange[5] Transactions (Section 237-24.5, HRS)

SECTION 237-24.5, HRS, allows an exchange to exempt transaction fees charged to its members from GET. The provision also allows exchange members to exempt proceeds from sales of their exchange memberships and amounts received for executing securities or product transactions on an exchange, provided that those amounts were received from a broker or dealer registered with the Securities and Exchange Commission, the Commodities Futures Trading Commission, or a similar regulatory authority outside the United States. An "exchange," for purposes of the exemption, is any organization, association, or other group that constitutes, maintains, or provides a marketplace or facilities for bringing together sellers and purchasers of securities, or which otherwise performs activities commonly understood to be those of a securities exchange. "Exchange member" means an individual or firm qualified as such by an exchange and paying dues to be able to trade securities or other products on the exchange.

Exempted transaction fees include, but are not limited to, those for:

- security purchases and sales;
- order book executions;
- exchange membership;
- trade processing and recordkeeping;
- securities listing;
- communications services; and
- document provision services.

Exemption at a Glance (2023)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Household*	Meeting its Purpose?
$1,782,000	13	$71,000	$0.41	No

* Cost per low-income household is the tax expenditure divided by 174,328 low-income households. (This number, reported by DBEDT from the U.S. Census Bureau's decennial American Community Survey, was last updated in 2020.)

Source: DOTAX 2023 Hawai'i General Excise and Use Tax Exemptions report.[6]

Legislative History

Section 237-24.5, HRS

- **1988**
  Act 295, SLH 1988, created the exemption. The exemption was to sunset one year later.
- **1989**
  Act 118, SLH 1989:
  - broadened the scope of the exemption to apply to purchases and sales of commodities, futures contracts, options contracts, and "similar rights," as well as to fees charged for keypunching, record keeping, post cashiering, and notarization;
  - expanded the definition of "exchange" to include commodities and futures exchanges;
  - specified that exchange members may claim the exemption only with respect to fees received from brokers or dealers; and
  - repealed the sunset provision.

[5] During the 2025 Legislative session, the Legislature passed House Bill 1369, H.D. 1, S.D. 1, C.D.1 (2025 Regular Session), which would repeal the provision. The bill, however, was vetoed by the Governor. (See Governor's Message No. 1403 (2025 Regular Session)).

[6] The Office of the Auditor performed some calculations using DOTAX data.

What is the purpose of the incentive?

To incentivize the establishment of a stock, commodities, or futures exchange in Hawai‘i to promote Hawai‘i as a financial center. Beneficiaries of the tax exemption would be financial service firms which make large transactions or trades on behalf of out-of-state institutional investors.

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Expenditure
2023	13	$1,782,000	$71,000	$0
2022	9	$3,214,000	$129,000	$0
2021	Suppressed*	Suppressed*	Suppressed*	Suppressed*
2020	Suppressed*	Suppressed*	Suppressed*	Suppressed*

* It is DOTAX policy to withhold the number of taxpayers claiming an incentive when that number is five or fewer to protect confidential taxpayer information. That is to prevent readers from being able to identify any particular taxpayer and thus protect confidential taxpayer information.

Are there additional key qualification requirements or limitations applicable to the incentive?

Yes. With respect to fees earned by exchange members, such fees are exempt only if received from a broker or dealer registered with the Securities and Exchange Commission, the Commodities Futures Trading Commission, or a similar regulatory authority outside the United States. Additionally, an exchange member must pay membership dues to its respective exchange to be eligible for the exemption.

Is there an economic or employment benefit to Hawai‘i, and if so, do the benefits outweigh the costs of the incentive?

None. See Other Comments section.

Is the incentive meeting its purpose?

No. The exemption has not led to the establishment of a stock, commodities, or futures exchange in Hawai‘i.

Should the incentive be retained without modification, amended, or repealed?

Repeal. The purpose of the exemption, created almost 40 years ago, was to promote Hawai‘i as a financial center through the establishment of a stock, commodities, or futures exchange in Hawai‘i. Committee

reports from the time indicate the purpose of Act 118 (SLH 1989), was to "provide temporary favorable income tax treatment for certain categories of financial services in order to attract such services and assist the development of Hawai'i as a regional financial center." According to a 2012 report by the Department of Commerce and Consumer Affairs titled "Hawai'i Exchange for Local Investment," the Honolulu Stock Exchange was formed in 1898 and closed its doors in 1978 primarily because of a lack of trading activity. The 2012 report notes efforts to resurrect the exchange in the 1980's did not materialize. We were unable to find information verifying the establishment of a permanent stock, commodities, or futures exchange in Hawai'i subsequent to the 2012 report.

Other Comments

We note that the exemption is being claimed in the absence of any stock, commodities, or futures exchange in Hawai'i and assume that the amounts claimed likely should not have been exempted from GET. The exemption may be claimed only by exchange members selling to brokers or dealers; however, based on our communications with staff at DOTAX, most claims appeared to be by natural persons exempting commissions from executing trades for clients. We recommend DOTAX review the claims under this exemption and recommend to the Legislature whether it should retain, modify, or repeal this provision.

General Excise Tax Exemption for Tangible Personal Property Sales to State Credit Unions (Section 237-25(a)(3), HRS)

SECTION 237-25(A)(3), HRS, exempts from GET amounts received from sales of tangible personal property to state-chartered credit unions.[7]

Exemption at a Glance (2023)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Household	Meeting its Purpose?
				
Unable to Determine*	Unable to Determine*	Unable to Determine*	Unable to Determine*	Yes

* Exemption claims for state credit unions are aggregated with exemption claims for sales to the United States, as both are codified within Section 237-25(a), HRS, and both reported to DOTAX under ED Code 141. We are unable to determine how much of each claim amount is from sales to state credit unions.

Legislative History

Section 237-25(a)(3), HRS

- **1994**
  Act 274, SLH 1994, created the exemption.

What is the purpose of the incentive?

To provide the same tax treatment to sales of tangible personal property to state-chartered credit unions as sales of tangible personal property to federal credit unions.

Under federal law, sales to federal credit unions are generally exempt from state taxation. Federal law, however, does not exempt sales to state credit unions. The exemption "levels the playing field" by exempting sales to state credit unions.

[7] Section 237-25(a)(3), HRS, also exempts amounts from sales to federal credit unions and to the U.S. government. The statute that requires the Auditor to review the incentive references sales to state credit unions only (see Section 23-77(c)(3), HRS).

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Expenditure
2023	Unable to determine*	Unable to determine*	Unable to determine*	Unable to determine*
2022	Unable to determine*	Unable to determine*	Unable to determine*	Unable to determine*
2021	Unable to determine*	Unable to determine*	Unable to determine*	Unable to determine*
2020	Unable to determine*	Unable to determine*	Unable to determine*	Unable to determine*

* Exemption claims for sales to state credit unions are aggregated with exemption claims for sales to federal credit unions and to the United States, as all are reported to DOTAX under ED Code 141. We are unable to determine how much of each claim amount is from sales to state credit unions.

Are there additional key qualification requirements or limitations applicable to the incentive?

Sales made via vending machines and similar devices do not qualify for the exemption, nor do sales made in connection with a service business or calling. "Service business or calling" includes all paid-for rendering of services, including professional and transportation services.

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

Unable to determine. The primary beneficiaries are state-chartered credit unions and tax filers selling to those credit unions. However, claims under this exemption are aggregated with claims to exempt receipts from sales to federal credit unions and the federal government, all reported under a single exemption code.

Is the incentive meeting its purpose?

Yes. The exemption extends the same tax treatment to sales of tangible personal property to state credit unions as similar sales to federal credit unions.

Should the incentive be retained without modification, amended, or repealed?

Retain. The exemption appears to be meeting its purpose.

General Excise Tax Exemption for Financial Institutions (Section 237-24.8, HRS)

SECTION 237-24.8, HRS, allows a GET exemption for certain amounts received by financial institutions, trust companies, trust departments of financial institutions, and financial corporations acting as interbank brokers.

Specifically, the GET exemption exempts revenue that is taxed by Hawai‘i’s franchise tax. Exempted revenue include amounts received by financial institutions from interest, discounts, points, commitment fees, loan fees, loan origination charges, loan sales and servicing, annual percentage rate finance charges for the use of money, deposit administration charges, passive foreign currency gains, and personal property leasing; and amounts received by trust companies from trust agreements, custodial agreements, retirement plans with trust department fiduciaries, and the servicing of fiduciary and custodial accounts; and any activity, with respect to a financial corporation acting as an interbank broker.

Exemption at a Glance (2023)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Household	Meeting its Purpose?
				
No Data*	No Data*	No Data*	No Data*	No Data*

* According to our communications with staff at DOTAX, DOTAX does not track usage of this exemption.

Legislative History
Section 237-24.8, HRS

- **1992**
  Act 106, SLH 1992, created the exemption.
- **2010**
  Act 84, SLH 2010, clarified terms and made non-substantive revisions.
- **2011**
  Act 43, SLH 2011, further clarified terms and made non-substantive revisions.

What is the purpose of the incentive?

To exempt revenue subject to the franchise tax.

In Hawai‘i, banks and other financial institutions are subject to the franchise tax in lieu of the general excise and corporate income tax. Act 106 (SLH 1992) which created the exemption noted the purpose of the Act was “to revise the manner in which financial institutions are taxed to provide for a more equitable method of taxation.” We infer from the language of Act 106 that a purpose of the exemption was to avoid taxing banks and other financial institutions under both the franchise tax law and the general excise tax law.

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Expenditure
2023	No Data*	No Data*	No Data*	No Data*
2022	No Data*	No Data*	No Data*	No Data*
2021	No Data*	No Data*	No Data*	No Data*
2020	No Data*	No Data*	No Data*	No Data*

* According to our communications with DOTAX, the franchise tax return form (DOTAX Form F-1) does not require taxpayers to list or report income separately based on the exemptions listed in Section 237-24.8, HRS. Accordingly, DOTAX does not track amounts claimed or the number of claims relating to this exemption.

Are there additional key qualification requirements or limitations applicable to the incentive?

None.

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

This exemption is not intended to generate an economic benefit. We infer from the language of Act 106 that a purpose of the exemption was to avoid taxing banks and other financial institutions under both the franchise tax law and the general excise tax law.

Is the incentive meeting its purpose?

Yes. The exemption eliminates double taxation by ensuring that revenue from financial services are not taxed under both GET and the franchise tax.

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

Retain. The exemption appears to be meeting its purpose.

General Excise and Use Tax Exemptions for Scientific Contracts with the United States (Sections 237-26 and 238-3(j), HRS)

The GET Exemption

SECTION 237-26, HRS, exempts from GET amounts that a contractor or subcontractor receives for performing certain "scientific work" for the federal government. More precisely, the revenue must be for services relating to "the research and development for, or the design, manufacture, instrumentation, installation, maintenance, or operation of aerospace, agricultural, astronomical, biomedical, electronic, geophysical, oceanographic, test range, or other scientific facilities."

The exemption also applies to revenue from the sale to the contractor or subcontractor of materials or other tangible personal property that will become an integral part of the scientific facility or which is to be entirely consumed by the contractor or subcontractor during the performance of its work.

The Use Tax Exemption

SECTION 238-3(j), HRS, excludes from the application of Use Tax the use of property, services, or contracting that is exempt from GET under Sections 237-26 and 237-29, HRS.

Exemption at a Glance (2023)

Amount claimed	Number of Claims	Tax Expenditure	Cost Per Low-Income Household*	Meeting its Purpose?
$439,229,000	153	$16,729,000	$95.96	Yes

* Cost per low-income household is the tax expenditure divided by 174,328 low-income households. (This number, reported by DBEDT from the U.S. Census Bureau's decennial American Community Survey, was last updated in 2020.)

Source: DOTAX 2023 Hawai'i General Excise and Use Tax Exemptions report.[8]

Legislative History

Sections 237-26 and 238-3(j), HRS

1965
Act 201, SLH 1965, created both the GET and Use Tax exemptions.

1970
Act 180, SLH 1970:
- added the requirement that revenue from sales of tangible property be from property affixed to, or an integral part of, a scientific facility or to be consumed through scientific work;
- specified that "maintenance" of a scientific facility includes housekeeping functions in providing certain nonscientific logistic and support services; and
- amended the Use Tax exemption to refer to the GET exemption with regard to determinations of what may be exempt.

1971
Act 4, SLH 1971, removed scientific contracts with national banks from application of the exemption.

1988
Act 163, SLH 1988, modified the definition of "scientific work," and added "agricultural," "astronomical," and "biomedical" to the types of facilities covered.

1999
Act 70, SLH 1999, specified that the Use Tax exemption (Section 238-3(j), HRS) applies not only to amounts from property sales, but also to amounts paid for services exempted under the GET exemption (Section 237-26, HRS).

2000
Act 198, SLH 2000, specified that the Use Tax exemption applies not only to property and services, but also to "contracting" exempted from GET under Section 237-26, HRS or Section 237-29, HRS.

[8] The Office of the Auditor performed some calculations using DOTAX data.

What is the purpose of the incentive?

The gross income earned by a contractor or subcontractor from certain scientific contracts with the federal government are exempt from the GET. The sales of tangible personal property to the contractor or subcontractor also are exempt from the GET. The tangible personal property must be affixed to, become a physical or integral part of the scientific facility, or entirely consumed during the performance of the service required by the contractor or subcontractor. While no purpose for this provision is explicitly stated in the legislative history we reviewed, we infer that the exemption is primarily to prevent state tax from applying to federal activities, to level the playing field for Hawaii businesses doing business with the federal government.

Section 238-3(j), HRS, excludes from the application of Use Tax the use of property, services, or contracting that is exempt from GET under Sections 237-26 and 237-29, HRS.

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Forgone Taxes*
2023	153	$439,229,000	$16,729,000	$16,729,000
2022	152	$211,014,000	$7,799,000	$7,799,000
2021	153	$250,866,000	$9,738,000	$9,738,000
2020	143	$286,555,000	$11,110,000	$11,110,000

*According to the 2022 DOTAX Hawaii General Excise & Use Tax Exemptions report, the GET and Use Tax exemptions corresponding to Sections 237-26 and 238-3(j), HRS, are reported together under ED Code 142 and do not qualify as tax expenditures but are exemptions that may represent a lost opportunity to export taxes to nonresidents.

Are there additional key qualification requirements or limitations applicable to the incentive?

Tangible personal property sold to the contractor or subcontractor must be entirely consumed during the performance of the scientific work or must be affixed to, or become a physical and integral part of, a scientific facility. For example, P is engaged in the building supply business and sells electrical parts to ABC Corporation, a contractor with the United States, to be incorporated into a scientific facility. P may claim the sales of the electrical parts to ABC Corporation as exempt sales under Section 237-26, HRS. In another example, XYZ is an electrical contractor and is awarded a subcontract by ABC Corporation to install an electrical

wiring system in a federal scientific facility. XYZ may claim the contract income from ABC Corporation as exempt income. (See DOTAX Tax Information Release No. 35-17 dated July 28, 1971.)

Is there an economic or employment benefit to Hawai‘i, and if so, do the benefits outweigh the costs of the incentive?

The extent to which the exemptions may benefit employment or the economy of Hawai‘i cannot be determined. While the purpose of the exemptions is not economic improvement, contractors, subcontractors, and suppliers, in certain circumstances, may claim the exemption.

Is the incentive meeting its purpose?

Yes. The exemptions by their operation serve to exempt from GET and Use Tax revenues from contracts or subcontracts and tangible personal property furnished in conjunction with the performance of any scientific contract with the United States as well as the cost of imported goods and services relating to any scientific contract with the United States from taxation. We infer that the exemption is primarily to level the playing field for Hawaii businesses, specifically contractors, subcontractors, and suppliers doing business with the federal government.

Should the incentive be retained without modification, amended, or repealed?

Retain. As noted above, we infer that the exemption serves to level the playing field for Hawai‘i businesses contracting with the federal government.

General Excise Tax Exemption for Petroleum Refining (Section 237-27, HRS)

SECTION 237-27, HRS, allows petroleum refiners to exempt from GET amounts received for petroleum products that are to be further refined by another refiner. Refining, for purposes of the exemption, means either (a) applying heat to a petroleum product to alter its properties, or (b) combining a heat-altered product with an unaltered one.

Petroleum products include:

- petroleum;
- any distillate, fraction, or derivative of petroleum;
- natural gas or its components;
- gas manufactured from a petroleum product; and
- any product derived from the gas or from the manufacture thereof, such as benzene, xylene, toluene, acetylene, tars, components of tars, and ammonia.

Exemption at a Glance (2023)

Amount claimed	Number of Unique Claims	Auditor's Estimated Tax Expenditure	Cost Per Low-Income Household*	Meeting its Purpose?
$90,226,000	5	$451,000	$2.59	Yes

* Cost per low-income household is the tax expenditure divided by 174,328 low-income households. (This number, reported by DBEDT from the U.S. Census Bureau's decennial American Community Survey, was last updated in 2020.)

Source: DOTAX 2023 Hawai'i General Excise and Use Tax Exemptions report.[9]

Legislative History
Sections 237-27, HRS

1953
Act 274, SLH 1953, established the exemption.

What is the purpose of the incentive

The 1951 Senate Committee on Ways and Means noted the oil refining industry in the Territory of Hawai'i required special treatment for purposes of GET. The Committee noted, since no petroleum is produced in Hawai'i, a local refiner must purchase all oil from mainland oil companies and that, in some cases, the refiner who purchases the oil, after a partial refining process, must sell it to another refiner who has facilities to refine the product further before final sale. The Committee noted "this results in the imposition of two additional taxes which would not accrue if one refiner owned all the facilities necessary for the production of the finished product." The Committee stated this "represents an additional pyramiding of taxes not borne by other manufacturers in the Territory."

[9] The Office of the Auditor performed some calculations using DOTAX data.

What were the numbers of claims and amount claimed?

Year	Number of Claims	Amount Claimed	Auditor's Expenditure	DOTAX Expenditure
2023	5	$90,226,000	$451,000	$451,000
2022	7	$94,147,000	$471,000	$471,000
2021	Suppressed*	Suppressed*	Suppressed*	Suppressed*
2020	14	$1,745,000	$66,000	$9,000

* It is DOTAX policy to withhold the number of taxpayers claiming an incentive when that number is five or fewer. That is to prevent readers from being able to identify any particular taxpayer and thus protect confidential taxpayer information.

Are there additional key qualification requirements or limitations applicable to the incentive?

Both the refiner seeking to claim the exemption and the refiner to which the first refiner sells must each meet the exemption's statutory definition of "refiner." That means each must be a legal person (including a company) who, in Hawai‘i, engages in refining petroleum products and is subject to GET on sales of petroleum products. A business engaged in both petroleum refining and another activity may claim the exemption with respect to its petroleum refining activities only.

Is there an economic or employment benefit to Hawai‘i, and if so, do the benefits outweigh the costs of the incentive?

Yes. According to a committee report from 1953 "The situation with respect to the oil refining industry in the Territory requires special treatment in connection with the application of the general excise tax. In some cases … before finally disposing of the product, the refiner who purchases the oil, after a partial refining process, must sell it to another refiner who has facilities not possessed by the first refiner who further processes the product and then resells all or a portion of the initial refiner who then in many cases process the product further before final sale. This results in the imposition of two additional taxes which would not accrue if one refiner owned all the facilities necessary for the production of the finished product, and represents an additional pyramiding of taxes not borne by other manufacturers in the Territory." We infer from the language of the committee report(s) the purpose of the exemption is to avoid tax pyramiding. See "Tax Pyramiding: The wholesale rate, the retail rate, and tax 'pyramiding'" on page 13.

Is the incentive meeting its purpose?
Yes.

Should the incentive be retained without modification, amended, or repealed?
Retain. The exemption appears to be meeting its purpose.

Other Comments
Claims for the exemption in 2022 and 2023 were $94 million and $90 million respectively, a significant increase from 2020 (see chart at page 28). Detailed information about amounts claimed is not available since DOTAX does not require a claimant to substantiate that qualifying sales were to other refiners for further refining or that the claimant is a "refiner" for exemption purposes. We recommend DOTAX review exemption claims and recommend if the exemption should be retained, modified, or repealed.

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
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.

Report Date	HRS Ref.	Statute to be reviewed	Notes
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 sanitaria
		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 kokuas 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 Households and Hawai‘i Residents

Section 23-71, HRS, also requires us to estimate the "annual cost of the exemption [or] exclusion ... per low-income resident of the State." The statute defines "low-income resident" as a state resident who is (1) the only member of a family of one and has 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. We received data from the Department of Business, Economic Development, and Tourism (DBEDT) on the number of low-income households. (This number, reported by DBEDT from the U.S. Census Bureau's decennial American Community Survey, was last updated in 2020. We believe this to be the best and most accurate data available for this purpose.) We provide the cost per low-income household in the table below.

We also include in the table below the cost of each exemption per Hawai‘i resident, regardless of income level. Such cost is calculated using Hawai‘i's 2022 resident population of 1,440,196 people. The results in the table below follow and include the Auditor's tax expenditure estimates only; they do not factor in DOTAX expenditure estimates.

Cost of Tax Provisions Per Resident and Per Low-Income Household

HRS Section	Matter	Auditor's Cost Estimate	Cost Per DBEDT "Low-Income Household"	Cost Per Hawai‘i Resident
237-24.3(2)	Common expense reimbursements from condominium owners associations and nonprofit homeowners and community associations	Unable to Determine*	Unable to Determine*	Unable to Determine*
237-24.5	Exchange and exchange member transaction fees	$71,000	$0.41	$0.05
237-25(a)(3)	Tangible personal property sales to state-chartered credit unions	Unable to Determine**	Unable to Determine**	Unable to Determine**
237-24.8	Income to financial institutions, trust companies, trust departments, and corporations acting as interbank brokers	No Data***	No Data***	No Data***
237-26 and 238-3(j)	Scientific contracts with the U.S.	$16,729,000	$95.96	$11.62
237-27	Petroleum refiner income from other refiners	$451,000	$2.59	$0.31

* Exemption amounts claimed under Section 237-24.3(2), HRS, are aggregated with those claimed under 237-24(16), HRS. Consequently, we have no way of knowing how much of each entry stemmed from one exemption as from the other.

** Exemption claims for state credit unions are aggregated with exemption claims for sales to the United States, as both are codified within Section 237-25(a), HRS, and both reported under ED Code 141. We are unable to determine how much of each claim amount stemmed from sales to state credit unions as opposed to stemming from other sales.

*** DOTAX does not track usage of this exemption.