

# Tax Foundation's Assessment of Hawaii's Tax Status is Wrong



Graphic illustration by Emily Metcalf

**EDITOR'S NOTE:** *Since this article was submitted, the national tax foundation corrected its mistakes and reissued a report on Hawaii. Hawaii's tax burden on residents is the third highest in the country - \$2,043 per person per year, as against an average of \$1,005 per person. Earlier this year, Professor John Mikesell of Indiana University estimated that 40 percent of personal income is subject to sales tax. In Hawaii, though, the percentage is significantly higher with 108 percent included in tax base. The Tax Foundation said Hawaii is astonishing because the tax base is larger than the economy, resulting in multiple taxation of the same product or service. They corrected their original report after being contacted by Lowell Kalapa, president of the Tax Foundation of Hawaii.*

**BY LOWELL L. KALAPA** - A recent review by the national Tax Foundation organization, which follows tax policy and tax changes at the federal, state and local levels recently commented that, "Among the states that do collect a statewide [sales] tax, the five with the lowest average combined rates are Hawaii (4.35 percent), Maine (5 percent), Virginia (5 percent), Wyoming (5.34 percent), and Wisconsin (5.43 percent)."

Woo hooo! The "sales tax" in Hawaii isn't that bad after all, or so mainland observers would believe. The problem with the observation is that it reflects the true ignorance of the observer that Hawaii has a "sales tax" like those found in the three and a half dozen other states which have a sales tax. Unfortunately, it seems these tax experts on the mainland refuse to accept the fact that Hawaii does not have a retail "sales tax!"

As a matter of fact, as the reader may have read in this column year after year, Hawaii's general excise tax is unique and while it looks like a sales tax, being imposed on every transaction, it is nothing like a retail sales tax found in some forty-four other states.

This is because it is not a tax that is paid by the consumer, but one that is imposed on the business for the "privilege of doing business in the state."

That's right, the general excise tax is on the business and not on the customer. If a customer in say, Chicago, walked out of the hardware store refusing to pay the sales tax, technically, the authorities could pick up the customer and throw him in jail.

On the other hand, if the customer walked out of the local City Mill in Hawaii refusing to pay the general excise tax, the business would still be held responsible by the state to pay the amount of tax on that sale.

Second, unlike the retail sales tax found in many mainland states, the general excise tax is imposed not only on goods but also on services, which make up more than half the transactions taking place in Hawaii.

So when my cousin in Austin, Texas calls the plumber to come out and unclog her drain, there is no 6.25% Texas sales tax on the bill she is given by the plumber. On the other hand, when my neighbor down the street calls the electrician to fix a short in his house, there is a 4% state general excise tax on the bill he is

handed by the electrician. These services represent about 60% of the tax base of the general excise tax in Hawaii.

As a result, if one wants to compare the tax rate of Hawaii's general excise tax and the retail sales tax rate found in other states, one would have to multiply the Hawaii rate 2.5 times to find an equivalent rate as it would take a minimum 10% sales tax rate to generate the same amount of tax revenues as does the more pervasive general excise tax.

As the national Tax Foundation report points out, California has the highest "retail sales tax rate" of 7.25% after a recent one percent rate reduction. So if one were to truly compare the impact of Hawaii's general excise tax if converted to a retail sales tax structure, the equivalent 10% rate Hawaii would need to generate the same amount of revenues would far out distance the front runner California's sales tax rate.

This is because not only is the tax imposed on services, but it is imposed multiple times as goods or services move through the production chain albeit at a lesser 0.5% rate.

While many states may have a local or city rate imposed on certain items, the state rate is usually imposed only at the point of consumption or retail. In the case of the general excise tax, the lesser rate is imposed on sales where the purchases of the goods or services are for resale or in the case of manufacturing or producing. In the latter case, farmers growing vegetables or fruits sell their produce to a supermarket and they must pay the 0.5% rate on the amount received from the supermarket or retailer. This does not occur on the mainland.

Hawaii's general excise tax is so pervasive that the tax base or "shelf price" is greater than the state Total Personal Income (TPI). This was the observation of a national guru on sales taxes.

In the 1989 study done for the Tax Review Commission and then again in a later article done for another publication, it was

reported that the base of the general excise tax was 144% of the state's TPI.

This compared to the California retail sales tax base, which was only about 51% of that state's TPI.

So, for the national Tax Foundation study to proclaim that Hawaii's general excise tax rate is the lowest of all the retail sales tax rates is misleading and uninformed.

That study truly did a poor job of investigating the differences between the two transaction taxes and pointing out that Hawaii's general excise tax achieves what many tax analysts believe is a good tax structure where there is a low rate because of a broad base.