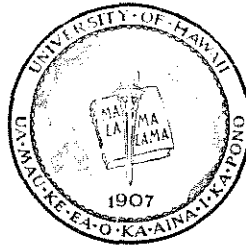


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LEGISLATIVE COMMISSION OF HAWAII

TERMINOLOGY OF HAWAII

THE SALES TAX:
HOW IT APPLIES TO HAWAII



Report No. 1 - 1948

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THE SALES TAX: HOW IT APPLIES TO HAWAII

by

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LEGISLATIVE REFERENCE BUREAU

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Summary

Sales taxes, first widely adopted in the United States during the depression of the 'thirties, are now imposed by twenty-seven states and the Territory of Hawaii, and provide the largest single source of state revenues. Eleven states, however, have nullified or abandoned this form of taxation, four after popular referenda.

Sales taxes include those based on gross business income, as in Hawaii, as well as levies solely upon retail sales. Most of the general sales tax laws limit the tax base to retail sales of tangible goods, but several also include amusements and sales of utilities and other services within the scope of the tax. Sales taxes may also apply to manufacturing, wholesaling, and contracting while a few, as the Washington and West Virginia occupations taxes and the Hawaii and Indiana gross income taxes, reach most business activities. Rates vary from 1 to 3 per cent, with eighteen states taxing at the rate of 2 per cent.

Numerous statutory exemptions and the problem of dealing with constitutionally exempt interstate commerce have complicated administration of state sales taxes. The latter difficulty has been partially solved by the widespread enactment of use taxes, based upon the privilege of storing or using products which have escaped sales taxation. Another administrative problem, collecting a tax amounting to a fraction of a penny, has been met by issuing tax tokens, or more commonly now, by the use of tax brackets.

Highly controverted, retail sales taxes have been attacked as regressively heavy upon low-income groups, but defended for their productivity in all stages of the business cycle. Applied to Hawaii, a retail sales tax would overlap or duplicate the present general excise (gross income) tax. On the tax base of 1947, a 2 per cent retail sales tax would yield approximately \$9.4 million annually; less if it engendered an increased degree of tax avoidance and evasion. A retail sales tax of about $5\frac{1}{3}$ per cent would be required to replace the revenue from the Hawaii gross income tax.

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THE SALES TAX: HOW IT APPLIES TO HAWAII

General sales taxes have become the largest source of state revenues in the post-war period. First adopted on a wide scale during the depression of the 1930's to provide "stop-gap" funds for the emergency needs of the states, sales taxes remained in the fiscal structures of twenty-three states in 1938. This number remained constant during the war, but in 1947 four additional states -- Connecticut, Maryland, Rhode Island, and Tennessee -- enacted retail sales taxes.

With the dollar volume of transactions rising to unprecedented heights in the current inflationary period, receipts from taxes on sales have steadily mounted. In fiscal 1944, the states collected \$721 million from general sales, gross receipts, and use taxes, according to the Bureau of the Census.¹ By 1945 this total had risen to \$776 million; to \$900 million in fiscal 1946; and to \$1,179 million in the fiscal year which ended June 30, 1947, accounting for more than one-fifth of total state revenues from all taxes.² As of September, 1947, each of twenty-two sales tax states reporting showed gains over the preceding year, the increases in tax receipts varying from 6 to 34 per cent.³

Despite their high yields, several states adopted sales taxes, only to drop them by legislative action or vote of the people. After brief experiments with the sales tax during the 'thirties, Kentucky, New Jersey, and Vermont

¹Sources of State Tax Revenue in 1947 (State Finances: 1947, No. 5).

²Ibid. Exclusive of unemployment compensation tax payments.

³Tax Administrators News, October, 1947, p. 119. The average increase over 1946 for fifteen states reporting collections for November, 1947 was 19.5 per cent. (Tax Administrators News, December, 1947, p. 143.)

repealed their levies, while those of Maryland, New York State, and Pennsylvania were allowed to expire. The Minnesota sales tax was vetoed by the governor in 1935, while similar measures were defeated in popular referenda in Idaho, Maine, New Hampshire, and Oregon. Again in October, 1947, the voters of Oregon rejected a proposed sales tax, thereby incurring heavier personal income taxes.⁴⁸

Structure of Sales Taxes: Base, Rates, Exemptions

The levies grouped together as sales taxes actually are of two overlapping types: general sales taxes and gross receipts taxes. Most of the states imposing general sales taxes restrict the tax base to retail sales of tangible personal property. Occasionally, as Appendix 1 shows, certain categories of goods are taxed at a lower rate, but the common practice is to levy a uniform rate, varying from 1 to 3 per cent, on sales at retail. The most prevalent rate is 2 per cent, with eighteen of the twenty-seven state sales taxes currently set at this percentage. Frequently amusements, utilities, and other services are also included in the scope of the general sales tax, but manufacturing, wholesaling, and other sales for resale are usually excluded.

Gross receipts taxes (in some states called gross income, general excise, or occupation taxes), in addition to reaching retail sales, may apply to products of farms and mines, as in Arizona; to wholesalers, as in Indiana, Mississippi, and North Carolina; to manufacturers, contractors, and members of various professions, as in New Mexico. Washington and West Virginia levy separate taxes on retail sales and upon business occupations, while Indiana has combined features of both sales and income taxes in her gross income tax, which

⁴⁸Chapter 540 of the 1947 Oregon Session Laws made larger personal exemptions from the income tax contingent upon approval by the people of a new 3 per cent sales tax. The defeat of the sales tax proposition automatically decreased personal exemptions from \$900 to \$500 for single persons, and from \$1,800 to \$1,000 for married couples.

applies to wages and salaries as well as business income, but also grants personal exemptions. The Hawaii general excise (gross income) tax reaches all forms of business income, but excludes wages and salaries, assessed under the compensation-dividends tax.

Rates applied against manufacturing, processing, and wholesale distribution are, with few exceptions, a fraction of those on retail transactions, as indicated in Appendix 1. Under the Mississippi law, for example, wholesalers are taxed $\frac{1}{8}$ of 1 per cent upon their gross receipts, compared with 2 per cent on retail sales. The Indiana levy applies a $\frac{1}{4}$ of 1 per cent rate to wholesalers and jobbers, half of the retail tax rate.⁵ The Hawaii general excise partially deviates from this pattern, imposing a tax of 1 per cent on the gross receipts of wholesalers, $1\frac{1}{2}$ per cent on manufacturing and producing, while taxing retail sales and income from professional work, amusements, and other services at a rate of $2\frac{1}{2}$ per cent. Gross income of sugar companies, canneries, and contractors, however, is also taxed at $2\frac{1}{2}$ per cent.

All but four of the sales-tax states⁶ include in their tax base sales of electricity, gas, or water by public utility companies, and approximately two-thirds reach the amusement industry by sales or gross income taxes upon admissions. While services, such as those furnished by laundries, barbershops, and undertaking parlors, are usually not taxed, some states, including Missouri, Oklahoma, Utah, and Wyoming, do attempt to collect taxes upon certain classes of services.

⁵Manufacturers, however, pay 1 per cent upon their gross income.

⁶California, Illinois, Louisiana, and Tennessee. Public utility companies are exempted in Alabama, Ohio, and Washington, if the state utility tax has been paid, as they are in Hawaii in respect to net income taxed under the Public Utilities Tax (Chapter 106 of the Revised Laws of Hawaii 1945).

Every state exempts some types of sales from taxation, and a complete catalogue of these exemptions would virtually run the gamut of economic activities. Several, however, appear frequently enough in the tax statutes to warrant mention. All but seven of the twenty-seven sales tax states, for example, favor specified charitable, educational, scientific, religious, and other non-profit institutions by lifting the sales tax upon their purchases or sales. Another common exemption, as shown in Appendix 2, is that afforded farmers upon the purchase of certain agricultural supplies. As a general rule, sales for resale are excluded from the tax base. Casual or isolated sales are tax free in all but five states, usually on condition that the seller does not hold himself out as engaged in retail trade. Food, medical supplies, newspapers, and advertising are also exempted under the general sales tax laws of several states, while most states explicitly exempt sales to their departments and subdivisions, as well as sales to the United States or its agents.⁷ Taxation of goods in interstate commerce is prohibited by the commerce clause of the Federal Constitution.

Use Taxes

The inability of the states under the Constitution to tax sales arising from interstate transactions had led to the widespread adoption of consumption or use taxes. Designed to stem avoidance of the sales tax by purchasers, rather than as a revenue-raising measure, the use tax has been added as a sales tax

⁷Although sales to the United States government and its instrumentalities have been regarded as immune from taxation by the states under the doctrine established by McCulloch v. Maryland (1819), 4 Wheaton 316, cost-plus contractors working for the federal government have usually been held liable for payment of sales and use taxes. (Alabama v. King & Boozer, [1941] 314 U. S. 1.) Contrary court decisions have, however, been rendered in some states. (Lytle Co. v. Carpenter, [1942], Colo. Dist. Court, El Paso County).

complement by all but six of the sales-tax states. (See Appendix 1.) In every instance, the use tax rate is identical with that upon retail sales.

Based upon the privilege of using or storing commodities, the scope of the use tax is usually as wide as that of the sales tax, except that it is generally restricted to tangible goods, while the sales tax often extends to amusements and charges for services. Under the compensating use tax laws, transactions already assessed under the sales tax or specific excise taxes of the state are exempt. The major class of taxable goods, therefore, consists of those bought outside the state, though strict interpretation of the use tax law would subject to taxation all intrastate purchases, unless specifically exempted.

One of the earliest use taxes in this nation, it may be noted, was adopted by the Territory of Hawaii in 1935. The consumption tax law then passed and still part of the Hawaii tax system,⁹ is complementary to the general excise tax and is designed to reach imports constitutionally exempt from taxation while passing in interstate commerce. Its rate has been revised upward to equal that on retail sales imposed by the general excise tax. Under the law, the purchase during any month of goods valued up to \$100 is exempt from the consumption tax. Similar exemptions of specified amounts are found in the use taxes of Louisiana, Michigan, and Oklahoma.

Another tax auxiliary to the territorial general excise was added by the 1947 legislature in the form of a compensating tax.¹⁰ This levy was enacted to prevent avoidance of the general excise tax by means of purchases from dealers not licensed under the general excise tax law through manufacturers' representa-

⁸Criz, Maurice, The Use Tax, p. 3.

⁹Chapter 99 of the Revised Laws of Hawaii 1945.e

¹⁰Chapter 98.01 of the Revised Laws of Hawaii 1945.

tives, brokers, purchasing agents, etc. The rate, except on purchases by contractors, is again equal to the retail tax under the general excise.

Sales Tax Administration

A long and growing list of Supreme Court cases illustrates the legal complexities inherent in the administration of state sales taxes in a federal form of government. A large portion of court cases have arisen over the interstate commerce clause of the Constitution,¹¹ and application of the tax to purchases by federal instrumentalities or contractors working for the United States government.

In addition to such problems arising from federal-state relationships, the administration of the sales tax has been further complicated by the numerous exemptions provided in the tax statutes, some of which are outlined above. (Page 4.) In particular, exemptions granted to services, intangibles, and sales for resale have created difficulties for the tax official charged with the task of applying revenue laws to complex and changing forms of business organization. The length and detailed nature of sales tax regulations promulgated in many states attests to these difficulties.¹²

It is difficult if not misleading to judge the efficiency of a tax by the costs of administering it. A tax department content to collect only from

¹¹For a discussion of such cases decided up to 1945, see State Sales and Use Taxation and the Commerce Clause, Federation of Tax Administrators, Research Memorandum 237, April, 1945.

¹²In taxing sales involving both tangible property and services, such as purchases from tailors, shoe-repairers, optometrists, etc., regulations of the taxing agency usually entirely exempt the transaction if the service is considered the more important part of the sale, and fully tax the sale if the service furnished is merely incidental. Where the property and service ingredients are both held important, the tax is sometimes apportioned.

the most compliant taxpayers will be able to report a much lower cost of administration per dollar of yield than will the agency which attempts to prevent any evasion, and thus finds it necessary to spend a large part of the revenue extracted from the most recalcitrant taxpayers. Using percentage cost figures is especially inconclusive in the case of sales taxes, where the initial collection is made by business firms, their expenses being reimbursed in some states by allowance of a "discount" from the tax proceeds remitted to the state,¹³ or, as in Illinois, by setting the tax base at 98 per cent of gross receipts, permitting the retailer to retain the tax upon the other 2 per cent.

Data that is available, however, indicates that the cost of administering state sales taxes are "moderately but not conspicuously low", ranging from 1.61 per cent to 4.30 per cent of state sales tax revenue, according to one study.¹⁴ Professor James W. Martin reported in 1944 that the average cost among sales-tax states was approximately 2 per cent.¹⁵ In Hawaii, the expenditures of the Gross Income and Consumption Tax Bureau of the Tax Commissioner's Office amounted to less than 1 per cent of its collections during 1946. Even if the proportionate share of general administrative expenses were to be added--amounts ascertainable only under detailed cost accounting--it appears that this cost ratio would remain conspicuously low.

Collection of Sales Taxes: Tokens and Brackets

One of the knotty problems peculiar to low percentage taxes on retail

¹³As in Alabama, Arkansas, Colorado, Louisiana, Maryland, Missouri, North Carolina, Ohio, Oklahoma, Tennessee, and Utah. Vendors are permitted to exclude \$50 of gross sales each month from taxation under the 3 per cent Michigan sales tax, thus receiving approximately \$18 annually to cover their costs of handling tax receipts.

¹⁴Quoted in Groves, Harold M., Financing Government, rev. ed. p. 315.r

¹⁵"Costs of Tax Administration: Statistics of Public Expense", Bulletin of the National Tax Association, February, 1944, p. 134.

sales is the difficulty of equitably and conveniently collecting taxes of a fraction of a penny. Since taxes of 1, 2, or 3 per cent frequently result in taxes accurately measurable only in mills, the states taxing sales at retail have been compelled to adopt means of splitting the penny between purchaser and the merchant acting as tax collector.

One such device is the sales-tax token, supplementary "money" issued by the state government for the purpose of paying taxes of less than one cent. During the depression, several states adopted mill-tokens, including small aluminum coins, plastic and fiber disks, and milk-top covers. In a majority of these states, however, the tokens were withdrawn from circulation, leaving but six states which still use this method of collecting less-than-penny taxes.¹⁶ Ohio prints tax coupons which are purchased by the retailer, who in turn issues them to customers in receipt for sales tax payments. These coupons, however, are of penny and not mill denominations, and are designed to expedite collection of the tax, not to provide for fractional taxes.¹⁷

Most of the sales-tax states now depend on bracket systems to determine the amount of tax due on purchases totalling less than one or two dollars. Such bracket systems, specifying the amounts of taxable sales upon which one, two, or three cents shall be collected, have been adopted either by legislative action,¹⁸ or by regulation of the administrative agency. In Maryland, to use a recent example, the 1947 sales tax law provides that the 2 per cent tax shall be collected according to the following schedule: no tax upon sales up to nine

¹⁶Arizona, Mississippi, Missouri, New Mexico, Utah, and Washington.

¹⁷Ohio also employs these coupons to increase compliance with the tax law, by encouraging taxpayers to turn in their receipts to charitable, fraternal, and religious organizations. These groups are permitted to redeem the coupons from the state government at 3 per cent of their face value.

¹⁸Alabama, Colorado, Connecticut, Maryland, Ohio, Rhode Island, and Wyoming.

cents; one cent upon sales from nine to fifty cents; two cents upon sales from fifty-one cents to a dollar and one cent; one cent for each additional fifty cents of taxable sales.

Incidence of the Sales Tax

Among the states which base their sales taxes upon the privilege of engaging in business, the law holds the vendor liable for payment of the tax, but commonly requires him to pass it on to the consumer, or at least prevents him from representing that the tax is not shifted to the customer. In those states which impose the tax on the transaction, rather than on the vendor, the legal incidence is deemed to be upon the purchaser.¹⁹ Under such laws the vendor acts as collector of the levy in behalf of the state, and here also is often required by law not to represent that he will absorb the tax.²⁰

The economic incidence of sales taxation, however, may not coincide with the legal incidence as provided by statute or regulation. Over a short period of time merchants may find it necessary to absorb part or all of the tax, if they believe that a price increase would cause a disproportionately large decline in the amount of goods sold. Since sales taxation is in practice seldom universal, but usually provides exemption for certain categories of sales (as outlined above on page 4), there may be a tendency for firms selling goods which compete with exempted products partially to absorb the tax.²¹ Thus

¹⁹State Sales Taxes, Federation of Tax Administrators, Research Memorandum 236, April, 1945, p. 5.

²⁰California, Colorado, Iowa, Kansas, Missouri, North Carolina, North Dakota, South Dakota, Washington, and West Virginia all prohibit licensed vendors from stating that the price of taxable commodities has not been increased by the amount of the sales tax.

²¹This is clearest in the case of merchants competing with untaxed mail-order houses or doing business near a state borderline, when sales across the line are not taxed by the neighboring state. The use tax is in part intended to allow borderline merchants to collect the sales tax without losing patronage, but it has been proven extremely difficult to impose the use tax on small purchases.

proprietors of restaurants in Ohio, in setting their prices, which are subject to sales taxation, must take into consideration the exemption of food sold for home consumption. These considerations would apply still more strongly to taxes of a larger magnitude than the 2 per cent levy typically imposed by sales tax states. Such would be the case, for example, if a $2\frac{1}{2}$ per cent retail sales tax were added to the present $2\frac{1}{2}$ per cent excise on retail sales under the Hawaii gross income tax.

In general, however, the concensus among economists is that most, or even all of the state sales taxes are shifted to consumers.²² Regardless of its legal form, if billed directly to the ultimate buyer or included in the cost of goods, the sales tax is largely borne by the retail purchaser, whether or not he is made conscious of the fact by separate statement of the amount of tax paid. Legal requirements of shifting, it may be generalized, are in fact usually achieved, statutory provisions merely requiring what would take place even in their absence.

Pros and Cons Concerning the Sales Tax

Since its widespread adoption during the depression of the 'thirties, the sales tax has been one of the most controverted levies in the fiscal system of the states. Its proponents have stressed its high productivity, its universality in reaching every family, its administrative feasibility. Viewing the entire economy, they recommend the sales tax as a curb against inflation and a counterbalance against a federal tax system based upon a progressive income tax.

Opponents of the general sales tax admit its productivity, but point out that low-income groups contribute a disproportionately large share of the yield.

²²von Mering, Otto, The Shifting and Incidence of Taxation, p. 179. This generalization assumes competition among buyers and the lapse of sufficient time for price adjustments to be made following imposition of the tax.

They argue that a general sales tax, among the more regressive fiscal devices,²³ should not be adopted by state governments which already have tax structures that bear heavily upon small and medium incomes. High revenue yields achieved by taxing low-income groups, they also point out, while serving to check inflation during boom periods, will accelerate and lengthen the downward phase of the business cycle by reducing purchasing power.²⁴

The arguments concerning sales taxes ultimately center around social policy and considerations of equity. Authorities and partisans to both sides of the question agree on the facts: the state sales tax is lucrative, feasible if not easy to administer, and regressive. The controversy hinges on the desirability, in each jurisdiction and in the nation as a whole, of adding to or lessening the tax burden of middle and low income groups.

Addition of a Retail Sales Tax to Hawaii's Tax System

The addition of a retail sales tax to the current fiscal system of Hawaii would result in a multiple tax burden upon the purchases of goods for consumption. Unless accompanied by repeal of the levy upon retail sales incorporated in the general excise tax, consumers would pay directly or indirectly a double tax upon each dollar's worth of goods purchased -- two and one-half cents under the territorial general excise tax, plus the amount of the sales tax. If a multi-stage sales tax reaching manufacturers, wholesalers, jobbers, and

²³Specific excises, such as those imposed by most states upon tobacco and alcoholic beverages, are even more regressive, since they do not vary with the price of the article. (Thus the cheapest and the most expensive liquors of each type usually bear identical state taxes.) Sales taxes, imposed ad valorem, are regressive only because taxable purchases typically represent a much greater part of small incomes than of large. Under the Hawaii tax laws, taxes upon sales under the general excise tax, and excises on liquor and tobacco are of the same order of regressiveness, since all are imposed ad valorem.

²⁴Hansen, Alvin H. and Perloff, H. S., State and Local Finance in the National Economy, pp. 64-67.

contractors in addition to retailers were to be enacted, the degree of overlap between such a levy and the current general excise tax would be virtually complete.²⁵

A sales tax, then, would constitute a duplication of the existing general excise tax, the amount of duplication depending upon the scope of the sales tax. If it followed the pattern of a majority of state sales taxes and were imposed only upon retail sales of tangible goods, the tax revenue would be about half of that from a multiple-stage gross income levy, as is shown in Appendix 3. Such a retail sales tax, if levied at the rate of 1 per cent, would have yielded approximately \$4.7 million during the calendar year of 1947. With a rate of 2 per cent, retail sales tax receipts would have approximated \$9.4 million, while revenues of about \$11.6 million or \$14.1 million would be forthcoming at tax rates of 2½ and 3 per cent, respectively. These yields may be compared with the \$25.3 million which it is estimated would have been collected under the general excise tax during 1947, had the current rates been in effect throughout the year. (See Appendix 4.). As the sales tax base is widened to include production, wholesaling, and other activities, revenues would approach those under the general excise, as Appendix 3 indicates.

It should be emphasized that these estimates assume that the tax base under a new sales tax would be identical with the retail sales component of the general excise tax, now levied on retail sales at the rate of 2½ per cent. Such an assumption, however, appears unwarranted, for the imposition of an additional tax of 1, 2, or 3 per cent on top of the existing tax would certainly increase

²⁵Income from professional services is taxed under the Hawaii general excise (gross income) tax, though not under any of the general sales taxes of the several states. (Indiana, New Mexico, and Washington, however, do include professional income within the scope of their gross income levies.) Receipts from service and amusement business also are reached under the present Hawaii general excise tax, as they are under many of the sales tax laws of the states. (See page 3, above.)

the incentive for tax evasion and avoidance. Problems of enforcement and cost of effective administration may be expected to increase with the rate of taxation.

In addition, the effect of an additional tax on consumption may well be to lower the economic base for both the sales and general excise levies. If, as has been suggested above, most or all of retail sales taxes are shifted to the buyer, a heavy tax may divert expenditures from commodities subject to taxation to those upon which taxes have not been increased (e.g., tobacco, liquor and gasoline) or to services not included in the sales tax base. Thus, if a family allocates \$100.00 per month to the purchase at retail of taxable commodities under the current law, it would have to pay about \$102.50 for the same goods following enactment of a $2\frac{1}{2}$ per cent retail sales tax. Unless either the family income or its desire to buy these commodities increased, fewer goods would be purchased, the tax base would be reduced, and therefore tax collections would rise by less than $2\frac{1}{2}$ per cent.

Allowing for the factors of increased evasion, avoidance, and reduction in the tax base, the above figures must be considered as maximum yields, rather than those which would actually be forthcoming under a sales tax imposed on the 1947 tax base. Changes in the level of economic activity may, of course, result in increases or decreases in tax receipts of a magnitude far greater than those considered in this connection.

Substitution of a Retail Sales Tax for the General Excise Tax

Considered as a replacement for the present general excise (gross income) tax of Hawaii, the retail sales tax has certain advantages and disadvantages, but in general would not result in a basic fiscal change.

A multiple-stage tax such as the gross income levy may, it is true, be pyramided as the commodity is taxed in the hands of the manufacturer, wholesaler,

and retailer. By increasing the price of the goods at each step of the distribution process, a multiple-stage tax may impose a larger total cost upon the consumer than if an equally heavy retail tax were imposed upon the final sale alone.²⁶

The relative "painlessness" of an excise tax included in the sales price is also cited as a shortcoming (or political virtue!) of gross income taxes. A retail sales tax, on the other hand, is usually stated separately and so increases the awareness of the customer that he is bearing part of the cost of government.

A positive advantage of a retail sales tax over the general excise levy arises from their different treatment under the federal income tax. Since the legal incidence of the general excise is upon the vendor, he and not the consumer may claim deduction of the territorial tax when computing his taxable income. The consumer, who ultimately pays the tax in the form of higher prices, is allowed no such deduction. He would be, however, under a retail sales tax separately stated and so explicitly passed on by the vendor.²⁷

The chief merit of Hawaii's gross income tax, as compared with a tax on retail sales, is that it expands the tax base to cover the entire production and

²⁶"A tax imposed upon the manufacturer and added to his price increases the cost of goods when they reach the wholesaler, the jobber, and retailer; if each calculates his customary percentage of profit or 'mark-up' on this augmented base, the ultimate consumers will pay considerably more in increased prices for goods than the government receives. It is the merchants who receive the difference, and, so to speak, make a profit on the tax. Of course, given time and perfect competition, pyramiding, except to pay for interest advanced as taxes for the consumer, could not exist. But one or the other of these conditions is often absent." Groves, Harold M., Financing Government, revised edition, p. 314.

²⁷A person earning \$4,000 annually and spending one-half of his income for goods taxed by Hawaii, now unable to claim as deductions any general excise tax payments, would be able to deduct about \$50 for taxes paid under a 2½ per cent retail sales tax.

distribution process, as well as services and professional income. Most important, since the legal incidence of the general excise is upon the vendor and not the buyer, it enables the Territory to tax goods shipped to the mainland--such as sugar and pineapple products--which might not be reached under a retail sales tax. Taxation of these goods, technically before they enter interstate commerce, enables the Territory to reach overseas shipments exceeding \$100 million annually. Furthermore, a larger degree of stability in tax revenues may result from this diversification of the tax base, as well as a smaller degree of evasion, than if only retail sales were taxed. By furnishing the tax commissioner with data concerning transactions at all levels of business activity, the general excise tax may permit more rigid enforcement than would be possible under a retail sales tax.

Having considered some of the merits and demerits of a retail sales tax as opposed to the general excise tax, it still must be concluded that changing from one levy to another would not basically modify the Hawaiian tax system. In large, the tax burden under a retail sales tax would fall upon consumers of various income levels in about the same manner as under the gross income tax, for there is little difference in the magnitude of regressiveness inherent in the two taxes. Aside saving a few dollars on his federal income tax and the more certain knowledge that he was helping finance the territorial government, the average consumer would be little affected by the substitution of a retail sales tax for the general excise tax.²⁸

²⁸Doctors, attorneys, and members of other professions now taxed under the general excise levy, would benefit if exempted under a sales tax, possibly passing on part of this reduction in expenses by lowering their fees. Their patrons, by and large, along with the other consumers, would have to pay larger amounts of tax on purchases of tangible goods, if revenues equal to those under the general excise tax were to be forthcoming.

Since the base of a retail sales tax would be but a fraction of that reached under the Hawaii multiple-stage gross income tax (\$472 million out of \$1,201 million for 1947), a retail tax rate must be proportionately higher to yield the amount of revenue now forthcoming from the Hawaii gross income tax. During 1947, for example, it would have required a retail sales tax of almost 4 per cent to raise the \$18.7 million collected under the general excise (gross income) tax law. Under the rates which became effective July 1, 1947, the annual yield of the general excise levy would approximate \$25 million. (See Appendix 4.) To equal this revenue a retail sales tax would have to be set at about $5\frac{1}{3}$ per cent, a rate far higher than any now imposed in the United States.

APPENDIX 1

STATE SALES AND COMPENSATING USE TAXES¹

	<u>Base</u>	<u>Rate</u>	<u>Yield: Fiscal 1947</u> <u>(in thousands)</u>	<u>Year</u> <u>Adopted</u>	<u>Use</u> <u>Tax</u>
Alabama	Retail Sales	2% ^a	\$ 22,304	1936	2%
Arizona	Gross Receipts	2% ^b	13,494	1933	none
Arkansas	Gross Receipts	2%	17,190	1935	none
California	Retail Sales	2½% ^c	241,373	1933	2½%
Colorado	Retail Sales	2%	20,993	1935	2%
Connecticut	Retail Sales	3%	-----	1947	3%
Illinois	98% of Retail Sales	2%	142,514	1933	none
Indiana	Gross Income	½% ^c	53,919	1933	none
Iowa	Retail Sales	2%	40,603	1934	2%
Kansas	Retail Sales	2%	28,808	1937	2%
Louisiana	Retail Sales ^d	1%	16,734	1936	1%
Maryland	Retail Sales	2%	-----	1947	2%
Michigan	Retail Sales	3%	160,567	1933	3%
Mississippi	Gross Income	2% ^e	20,434	1930	2%
Missouri	Retail Sales	2%	58,227	1934	none
New Mexico	Gross Receipts	2% ^f	12,041	1933	2%
North Carolina	Gross Sales	3% ^g	35,482	1933	3%
North Dakota	Retail Sales	2%	8,591	1935	2%
Ohio	Retail Sales	3%	104,245	1934	3%
Oklahoma	Retail Sales	2%	29,901	1933	2%
Rhode Island	Retail Sales	1%	-----	1947	1%
South Dakota	Retail Sales	2%	7,988	1933	2%
Tennessee	Retail Sales	2%	-----	1947	2%
Utah	Retail Sales	2%	11,162	1933	2%
Washington	Retail Sales	3% ^h	83,997	1933	3%
West Virginia	Gross Receipts	2% ⁱ	44,210	1921	none
Wyoming	Retail Sales	2%	3,894	1935	2%
HAWAII	Gross Income	2½% ^j	18,670 ^k	1935	2½%

(Footnotes on following page.)

¹Sources: Tax Systems of the World, Tenth Edition; "State Sales Tax Activity", Tax Policy, April, 1947; State Tax Collections in 1947, U. S. Bureau of the Census, August, 1947; statutes of various states and Territory of Hawaii.

^a $\frac{1}{2}\%$ on automobiles.

^b $\frac{1}{4}\%$ on manufacturing; 1% on mining.

^cOn retail sales. $\frac{1}{4}\%$ on wholesalers; 1% on others.

^dAnd business rentals.

^eOn retailers. $\frac{1}{8}\%$ on wholesalers. 1 to 2% on utilities; 1% on automobiles.

^fOn retail sales. $\frac{1}{8}\%$ on wholesalers; $\frac{1}{4}\%$ on manufacturers; 1% on minerals and automobiles.

^gOn retail sales. $\frac{1}{20}\%$ on wholesalers.

^hAlso occupations tax on gross receipts varying from $\frac{1}{100}$ to $\frac{1}{2}\%$.

ⁱAlso occupations tax on gross receipts varying from 0.195 to 7.8%.

^jOn retail sales, sugar processing, canneries, services amusements, contractors, business, and professions. 1 per cent on wholesalers; $1\frac{1}{2}$ per cent on others.

^kCalendar 1947.

TERRITORY OF HAWAII

CHIEF EXEMPTIONS UNDER STATE SALES TAX LAWS¹

	<u>Sales for Resale</u>	<u>Casual or Iso- lated Sales</u>	<u>Food</u>	<u>Medical Supplies</u>	<u>Newspapers or Adver- tising</u>	<u>Certain Farm Supplies</u>	<u>Certain Non-Profit Organi- zations</u>
Alabama	X	X	--	X	X	X	--
Arizona	--	X	--	--	--	--	--
Arkansas	X	X	--	--	X	--	X
California	X	X	X	X ^c	--	X	--
Colorado	X	--	--	--	X	X	X
Connecticut	X	X ^a	X	X	X	X	X
Illinois	X	X ^a	--	--	--	--	--
Indiana	--	--	--	--	--	--	X
Iowa	X	X ^a	--	--	--	X	X
Kansas	X	X ^a	--	--	--	X	X
Louisiana	X	X ^a	--	--	X	X	--
Maryland	X	X ^a	X ^b	X	X	X	X
Michigan	X	X ^a	--	--	X	--	X
Mississippi	X	X	--	--	--	X	X
Missouri	X	X ^a	--	X	--	X	X
New Mexico	X	X ^a	--	--	X	X	X
North Carolina	X	X ^a	X	X	--	X	X
North Dakota	X	X ^a	--	--	--	--	X
Ohio	X	X ^a	X ^b	--	X	X	X
Oklahoma	X	--	--	--	X	--	X
Rhode Island	X	X	--	--	X	--	X
South Dakota	X	X ^a	--	--	--	X	X
Tennessee	X	X	--	--	X	X	--
Utah	X	X ^a	--	--	X	--	X
Washington	X	X	--	--	X	--	X
West Virginia	X	X	X ^b	--	--	--	--
Wyoming	X	--	--	--	--	X	X
HAWAII	--	--	--	--	--	--	X

¹Sources: Statutes of the various states and the Territory of Hawaii; State Tax Guide Service, Commerce Clearing House.

^aProvided seller does not hold himself out as engaged in retail trade.

^bFor off-premise consumption.

^cOphthalmic supplies only.

APPENDIX 3

MAXIMUM YIELDS FROM A HAWAII SALES TAX

The following estimates of the maximum yields which might be forthcoming under a general sales tax in Hawaii are based on the assumption that the tax base would be identical with that under the present general excise (gross income) tax for 1947. This assumption in turn implies that:

1. There will be no exemptions other than those provided under the general excise tax by Sections 5459 and 5460 of the Revised Laws of Hawaii 1945;
2. There will be no additional tax avoidance or evasion, despite the greater incentive under a combined sales and excise tax;
3. The added tax would not lower the economic base of sales taxation.

Since adoption of a further tax on the purchase of goods and services is likely to encourage avoidance and evasion and reduce the tax base (see page 11 above), it must be emphasized that these are estimates of maximum tax receipts at the recent level of business activity. A continued rise in the dollar volume of sales above the 1947 level would, of course, increase tax collections, while a drop in the value of transactions would reduce both tax base and receipts.

Following the practice of those states which tax manufacturing, contracting, producing, and wholesaling, these business activities are assumed to be taxed at a lower rate. For illustrative purposes, the levy on such transactions has been assumed to be half of the retail tax rate.

Maximum sales tax yields
(in thousands)

Tax Base ¹	1% tax	2% tax	2½% tax	3% tax
A. Retail sales only	\$4,722	\$ 9,444	\$11,806	\$14,166
B. A and wholesaling ²	6,109	12,218	15,274	18,327
C. B and producing ²	6,961	13,922	17,404	20,883
D. C and manufacturing ²⁰	7,111	14,222	17,780	21,333
E. D and contracting ²	7,477	14,955	18,684	22,432
F. E and services, professional income ³	8,345	16,689	20,853	25,033
G. All gross income ⁴	9,263	18,525	23,149	27,788

[Footnotes on following page.]

1/Base for gross income tax during calendar year 1947, as reported by Office of the Tax Commissioner. (See Appendix 4.)

2/Wholesaling, producing (including sugar processing and pineapple canning), manufacturing, and contracting taxed at one-half rate on retail sales.

3/Services (including amusements) and professional income taxed at same rate as retail sales.

4/Under present general excise tax.

APPENDIX 4

ESTIMATED REVENUE FROM HAWAII GENERAL EXCISE (GROSS INCOME) TAX
(in thousands)

	<u>Tax Rate</u> ¹	<u>1947 Base</u> ²	<u>Annual Revenue</u> ³
Retail	2½%	\$ 472,242	\$11,806
Sugar Processing	2½%	83,540	2,089
Producing	1½%	25,779	387
Wholesaling	1%	277,462	2,775
Manufacturing	1½%	30,063	451
Printing and Publishing	2½%	8,241	206
Canning	2½%	61,083	1,527
Services	2½%	72,351	1,809
Contracting	2½%	72,325	1,809
Amusements	2½%	14,389	360
Interest, Com- missions, Rents	2½%	65,480	1,637
Blind Vendors	1%	31	---
Other	2½%	18,098	452
<hr/> TOTAL		<hr/> \$1,201,084	<hr/> \$25,308

Source: Reports of Office of the Tax Commissioner.

¹Tax rates are those which became effective July 1, 1947.

²Base is that reported for 1947 taxes, but since lower tax rates were in effect during first six months of year, ³actual yields were below those shown here.

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