

**REAL
PROPERTY
TAX
EXEMPTION
IN HAWAII**

LEGISLATIVE REFERENCE BUREAU

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STATE OF HAWAII

REAL PROPERTY TAX
EXEMPTION IN HAWAII

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PREFACE

How far the State of Hawaii should go in exempting various classes, owners, and users of real property from the burden of paying real property taxes has been a subject of some controversy in recent years. Questions have arisen as to whether property owned by unions should be exempted; whether lands surrendered to the state as forest reserves should be surrendered for longer than a one-year term; whether cooperative apartment owners are entitled to a home exemption if living in their apartments; whether institutional buildings used partly for exempt and partly for commercial purposes should receive a prorated exemption; whether exemptions for new industries encourage industrial development. Tens and even scores of exemption bills have been introduced in every recent regular session of the legislature. Several of these bills have passed and a few have been vetoed.

The granting of exemptions to particular owners and users of property involves drawing lines between various uses and determining that one results in sufficient benefit to the public to justify the granting of an exemption while another use does not. What the state does when it grants an exemption is to relieve a specific property owner or user of a liability which he would otherwise incur. The functioning of certain institutions, such as hospitals or schools, which are the beneficiaries of tax exemption provisions of the law, undoubtedly results in reducing the need for governmental expenditures. Frequently the "saving" in governmental expenditures exceeds the amount of the tax exemption, but the saving may occur at the state level while the county suffers the loss of tax revenue. In other instances the tax exemption results in a saving to a property owner or user who does not provide a governmental-type service, and thus the real property tax base is reduced without any specifically identifiable compensating reduction in the necessity for governmental expenditures. The effect of an exemption also may be to raise the property tax rate for all who are not exempted, given a fixed or increasing total property tax levy.

Exempting a taxpayer from the property tax has the same effect as appropriating public funds for his use. Subsidizing private activities which promote public good is a perfectly reasonable function of government; but it is important in pursuing this course of action to make sure that the treatment of various groups of taxpayers is consistent, fair, and in the public's interest. This report, prepared at the request of the house of representatives (house resolution 125), is concerned with whether or not the present legal provisions and administrative practices relating to the exemption of real property from real property taxation are consistent and fair, and, as far as may be judged, in the public's interest.

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The Growth and Importance of Property Tax Exemptions

The granting of an exemption from property taxes to a particular group of property users represents an important public policy determination that it is desirable to use the taxing power of the state to encourage that property use. The number of such exemptions in Hawaii has increased over the years as policy changes have been made and more property devoted to exempt purposes. Exempt property now represents a large, though unknown, part of the real property tax base.

The Development of Property Tax Exemptions in Hawaii

The history of property tax exemptions is as old as the property tax itself, as the 1884 statutory provision governing exemptions in the Hawaiian Kingdom illustrates:

"Real property belonging to the King or Queen, to the Government, to the Board of Education for the use of schools, to incorporated or private schools, to the Queen's Hospital, to religious societies for church sites and burying grounds, such church sites and burying grounds not to exceed five acres in extent, shall be exempted from taxation . . . Provided always that the tax of three quarters of one per cent, hereinbefore imposed on property shall be collected only upon property in excess of the value of three hundred dollars, be the same real or personal."

Furthermore, the diplomatic agents of foreign countries and their attaches were exempt from all internal taxes.

There has been some liberalization of exemption provisions over the years and some granting of exemptions to individual institutions as opposed to classes of institutions; but, in general, there has been no history of indiscriminate free and easy giving-away by the government of real property tax exemption privileges. Many of the exemptions, such as those for homeowners, physically disabled individuals, industrial development, public property, and forest reserves originated during the days of the Kingdom or the Republic or in the

early years of the Territory. In fact in some respects the exemption policy of the Kingdom was more liberal than the one followed today. Schools were exempt whether they were profit-making institutions or not, and all taxpayers, not just homeowners, were entitled to a basic tax exemption.

The first exemption for privately owned forest reserve lands was added in 1892; public library associations were exempted in 1897; the applicability of the \$300 exemption was restricted in 1896; and the first industrial development exemptions granted in 1903. By 1915 several institutions including the Leahi Home, the Y.M.C.A., and the Salvation Army, in addition to Queen's Hospital, were specifically exempted by name and a general provision was added exempting hospitals which maintained free wards. Subsequent legislation modified the three basic institutional exemptions--hospitals, schools, and religious societies; modified the home exemption; defined public property exemptions more precisely; added exemptions for certain physically disabled persons; exempted the property of public utilities; and, most significantly of all, exempted a large number of individual institutions by name. By 1945 there were almost 60 individual exemptions. In 1949 general provisions exempting cemeteries, non-profit homes for the aged and infirm, community associations not operated for profit, and veterans' organizations were added to the law. Several specific institutional, industrial development, and individual disability exemptions have been added since 1949 and many existing exemptions modified, but no major or comprehensive changes have been enacted.

Recent Executive Vetoes of Legislative Proposals to Extend Exemptions

The legislature, during recent sessions, has passed several bills which would have granted exemption from property taxes to particular institutions or

groups of institutions. Except for Act 12, Session Laws of Hawaii 1960, which permits the division of a property for the purpose of granting a tax exemption on that part of it which is used for exempt purposes, the governor vetoed each of the bills passed during the thirtieth territorial legislature and the first state legislature.

One bill (S. B. 50) passed in 1959 exempted the Young Men's Institute of Hilo, the I.L.W.U. Memorial Association, Unity House, non-profit corporations, and the International Brotherhood of Electrical Workers, while a second bill (S. B. 612) exempted the McCully Daishi-Do, the United Visayan Community of Waipahu, the Honpa Hongwanji Mission, the Musicians' Association, and Local 1414, International Brotherhood of Electrical Workers. The governor in his veto messages stressed that these bills were unfair to other similar organizations which owned real property and were not being exempted.

The first state legislature passed a bill (H. B. 114) which exempted from property taxation property which was: (1) owned and used by a labor union or government employees' association or owned by such an organization and leased to a non-profit association, organization, or corporation; (2) owned by the Young Men's Institute of Hilo; (3) owned by the United Visayan Community of Waipahu; and (4) owned by Locals 1260 and 1414 of the International Brotherhood of Electrical Workers. This bill also contained a section almost identical to that included in S. B. 41 which became Act 12, S.L.H. 1960. The governor vetoed this bill because he believed it denied equal protection of the laws by permitting some but not all non-profit corporations or associations to retain the exemption on property leased to other non-profit organizations which did not qualify for an exemption. The governor suggested that the legislature

". . . should avoid trying to bestow tailor-made tax exemptions. They usually are invalid. We would be far better off with a uniform policy of exemption by class, where the chances are

agencies or organizations which in their operation relieve the state of some part of the burden of performing its public functions. Such exemptions are usually limited to religious, educational, charitable, and scientific institutions."

Constitutional and Legislative Control of Property
Tax Exemptions and Administration

It is the state government in Hawaii, as in the other states, which enacts the constitutional and statutory provisions governing the exemption of property and the administration of the property tax. All but five of the states refer to tax exemptions in their state constitutions. More than a fifth provide that laws exempting property other than that specified in the constitution are void while almost half the states forbid private, local, or special legislation exempting property. A few constitutions, such as Louisiana's, include extensive provisions describing the property which is exempt, while almost all include either clauses describing exempt property or granting the legislature power to exempt property from the property tax. In Hawaii, however, the only constitutional provision governing exemptions (section 9, article 14) requires that property owned by the United States be exempt unless the United States consents to such taxation. Thus all exemptions from taxation in Hawaii, except the one referred to above, are the result of legislative action.

In mainland states the administration of the tax, including discovering, listing, and appraising property, adjudicating appeals, setting tax rates, and collecting, are the responsibility of various units of local government, though there has been an increasing amount of state supervision exercised in recent years. In Hawaii, except for setting tax rates, all these functions are the responsibility of the state government. Further, in Hawaii the taxation of property is limited to real property, while in most mainland jurisdictions both

real and personal property are subject to the tax. Both in Hawaii and in mainland states, however, the real property tax is one of the important sources of local tax revenue. Its potential magnitude depends on several factors, one of which is the amount of property exempted from taxation.

The Fiscal Impact of Real Property Tax Exemptions

To measure the fiscal impact of real property tax exemptions accurately, it would be necessary to know the assessed value of exempt property. The department of taxation's annual tabulation of real property tax valuations and tax rates, a portion of which appears in the following table, showed that of the total 1960 assessed value of \$3.2 billion, \$1.3 billion or 41 per cent was listed as exempt. These data, however, should be accepted and used cautiously. While state law requires that the value of non-taxable real property shall be determined and assessed, for informative and statistical purposes, in the same manner as taxable property, it would be unrealistic to think that as much attention has been devoted to assessing exempt property as taxable property. The situation in Hawaii with respect to the accuracy and comparability of assessments of taxable and totally exempt non-taxable property is as follows: (1) small parcels of exempt land located among taxable parcels are assessed on the same basis and at the same level as neighboring taxable parcels; (2) exempt improvements initially are assessed at the valuation recorded on the building permit; (3) large parcels of exempt land, especially those used for different purposes than adjoining parcels are underassessed compared to neighboring taxable parcels; (4) exempt government land and improvements, especially large properties owned by the federal government, are greatly underassessed; and (5) valuation of homes eligible for home exemptions and property owned by qualifying physically disabled individuals are comparable to the valuation of homes not qualifying for the

REAL PROPERTY TAX VALUATION,
EXEMPT AND TAXABLE

State of Hawaii
1960

	<u>Value</u>	<u>Per Cent of Total</u>
<u>Assessor's Gross Valuation</u>		
Land	\$ 1,829,141,236	57.63
Improvements	1,344,931,806	42.37
Total -	3,174,073,042	100.00
<u>Exemptions</u>		
United States	584,062,998	18.40
State	261,467,960	8.24
Counties	132,462,300	4.17
Homes - Fee	153,982,058	4.85
Homes - Leasehold	19,266,501	.61
Public Utilities	46,281,730	1.46
All Others*	112,820,417	3.55
<u>Total Exemptions</u>	\$ 1,310,343,964	41.28
<u>Assessor's Net Taxable Valuation</u>	\$ 1,863,729,078	58.72

Source: Department of Taxation.

*Includes exemptions for qualifying institutions, physically disabled individuals, forest lands surrendered to the government, set-backs, and lands occupied by the state or counties but to which title has not yet been secured.

exemption. It has been suggested that because of the major shortcoming inherent in the present system of valuing exempt property, the limited use which can be made of the resulting data, and the costliness of correcting these deficiencies, it would be better to assign nominal values to totally exempt properties, especially those owned and used by the federal, state, or county governments.

The existence of exempt property clearly reduces the size of the tax base, but by how much is not clear. The state cannot, under existing federal law, tax federal property, nor would much purpose necessarily be served by taxing state and county property used for governmental purposes except to effect transfer payments. The state may affect the size of the effective tax base by modifying the law granting exemptions, but it would be rash indeed to maintain that the cost of most of these exemptions in terms of lost tax revenue may be reasonably estimated from available data. Furthermore, little is known about how much money is saved because some of the exempt institutions perform governmental functions or whether any of these institutions would cease to function if the exemption were removed. When it comes to estimating the financial impact of most of the real property tax exemptions, one needs to be cautious of most estimates.

Existing Property Tax Exemptions

It is important to distinguish among the several basic classes of properties and property owners and users which may be accorded tax exemption privileges in order to analyze the present pattern of exemptions adequately and evaluate the desirability of changes in the existing law. These basic exemption classes are: (1) exemption of institutional property devoted to the accomplishment of public purposes; (2) exemptions benefiting an individual; (3) exemptions of private property held for profit but devoted to the accomplishment of public

purposes; (4) exemption of government property; and (5) exemption of property taxed in a different manner. The qualifications which a property or an owner or user should meet and the reasons for granting the exemption are different for each of these classes.

Exemption of Institutional Property

Institutional property in Hawaii, in general, is exempt from property taxation if the use of the property: (1) results in an appreciable amount of social benefit to the public or some reasonably large portion thereof; (2) does not contemplate nor result in private gain or profit; and (3) is not primarily for the immediate benefit of a restricted and limited membership. The primary reasons put forth in justification of granting tax exemptions to such institutions are that they promote and encourage desirable activities such as religious activities or youth programs and/or that the jobs performed by these institutions would have to be performed and paid for by the government if private institutions such as homes for the indigent aged and schools did not exist. It is also maintained that these institutions frequently grace the communities in which they are situated (e.g., art museums), furnish emotional satisfaction (e.g., cemeteries), and provide some economic advantage in attracting business (e.g., cultural museums). The granting of an exemption to an institution thus does not depend on ownership of the land but rather on the purpose of the organization, the use of the land, and the financing arrangements. It should be noted, however, that leased property used for one of the tax exempt purposes is not exempt from taxation unless the term of the lease is for one year or more and the document is recorded.

Education. The general exemption for private, non-profit schools and the specific exemptions for cultural institutions such as library associations,

museums, and historical sites, result in exempting from taxation those non-profit institutions dedicated to improving the minds of portions of the public by spreading knowledge and culture. The exemptions are limited (with one exception, which is noted later) to property which is being used for education, or in a few instances, other charitable purposes.

Cure of Disease and Promotion of Health. Hawaii law exempts the property of hospitals, the net earnings of which do not inure to the benefit of private individuals, so long as the property is used for hospital purposes. Care of the sick, relief of pain, and promotion of health are commonly accepted as activities resulting in public benefit.

Maintenance and Propagation of Religion. The granting of exemptions to religious societies and churches is based on the belief that the maintenance and propagation of religion are of positive social benefit to society. The Hawaii law exempts religious societies from the tax on properties used by them for "religious, educational, hospital, community, governmental or character building purposes, including parsonages, camp sites, and burying grounds not operated for profit, such camp sites and grounds not to exceed twelve acres in area." Thus property used by a religious society may be eligible for exemption on the basis of one of several uses. The specific exemptions, which do not exceed the limits of the general exemption, are primarily concerned with providing exemptions for detached parsonages or for churches that lease lands for which a deed has not been recorded.

Burial and Cremation. Corporations, associations, or trusts which maintain cemeteries in Hawaii are exempt from taxation on land used for burial and cremation purposes up to twelve acres in area, provided that none of their net earnings inure to the benefit of private individuals. Further, cemeteries

maintained by religious societies, as noted above, are also exempt. Thus it is accepted in Hawaii that social advantage results from the decent disposition of the remains of deceased persons and the care of their graves. Under present law, however, profit-making cemeteries may transfer the title to sold plots to non-profit subsidiary corporations and thus qualify for exemption on that portion of the cemetery property held by the non-profit corporation. The department of taxation has interpreted this provision to mean that only that percentage of the total property owned by the profit-making corporation may be taxed.

Relief of Poverty. The state has a substantial interest in preventing want and suffering on the part of human beings and in providing food, clothing, shelter, and the other necessities of a comfortable and beneficial life to those who are in want. Thus it is that Hawaii exempts property of organizations which is used as a home for aged and indigent persons as long as none of the net earnings inure to the benefit of an individual. Specific exemptions are provided for individually designated settlement houses, social agencies, and boarding homes, the Salvation Army, the Humane Society, and many homes for the aged and indigent, which are covered by the general exemption.

Governmental Purposes. The property of non-profit community associations in Hawaii which is "used for educational, religious, community, hospital or governmental purposes" is exempt from property taxation. These organizations use their property to promote a safer, more comfortable community life by providing citizens with advantages similar to those furnished by local governments.

Veterans Organizations. The property of any organization of veterans of the armed services of the United States which is used for educational, religious, community, hospital, or governmental purposes is exempt from property

taxation in Hawaii. Specific exemptions are provided for all property used by four veterans organizations--American Legion, Club 100, 442nd Veterans' Club, and Veterans of Foreign Wars--without restriction as to the use which is made of the property. The department of taxation has chosen to apply the broad exemption allowed the four organizations to all veterans groups but this is not provided for in the law. While it is common to exempt the property of veterans organizations, they do not appear to share with the other classes of property discussed the same degree of adherence to the three criteria noted at the beginning of this section.

Recreation. The law specifically exempts the property of the Maui County Fair and Racing Association which is used for county fair and racing purposes and Moanalua Gardens and Golf Course, held by the S. M. Damon Trust, as long as the gardens are open to the public without charge and the revenues derived from the golf course are devoted exclusively to its maintenance. The exemptions may be justified on the basis that if these recreational opportunities were not being provided to the public by non-profit organizations, then the government itself would have to furnish such activities and facilities.

Mutual and Fraternal Benefit Societies. Non-profit associations or societies organized under the law as medical indemnity or hospital service associations and/or societies are exempt from all taxes except unemployment compensation. No exemptions from property taxation have been claimed as yet under this provision of the law.

Multiple-Purpose Organizations. The property owned and used by the Young Men's or Young Women's Christian Associations would qualify for exemption at least in part on the basis of being used for educational, religious, and recreational purposes and property used by the boy scouts and girl scouts would

qualify on the grounds of use for educational and recreational purposes. In Hawaii specific exemptions are provided to these organizations. A large number of the properties, it should be noted, fall principally within one of the exemption classes listed above, but could qualify as a member of more than one class.

Others. There are a few specific exemptions which do not fit in any of the above categories. Exemptions are granted to: (1) the King's Daughters Home, a non-profit organization providing a home for its older members; (2) Mamalahoa Chapter No. 2, Order of Kamehameha in Hilo; and (3) the Daniel Paul Rice Isenberg Estate for the Isenberg Memorial Lot in Lihue. This last exemption has been allowed in spite of a ruling by the attorney general that the exemption was invalid.

Exemptions Benefiting an Individual

Three types of exemptions benefiting individuals are employed in Hawaii: (1) the home or homestead exemption granted to individuals living in their own homes; (2) the exemptions granted to physically disabled individuals; and (3) the exemption of certain types of property in determining the total valuation of a parcel. The state, in each of these instances, desires to discriminate in favor of certain individuals in order to encourage the adoption of particular courses of action and/or to mitigate the burden of the property tax, a tax which the individuals would otherwise have to pay.

Homes. The home exemption applies to: (1) real property owned and occupied as a home by an individual; (2) real property held under an agreement to purchase and occupied as a home by an individual or family; and (3) a residential building located on land leased for five years or longer by the individual or family who occupies and owns the home, provided the lease has been recorded

and the lessee has agreed to pay all taxes. Persons occupying the cooperative apartments they own are not entitled to home exemptions as the law is presently written.

A home is exempt upon that portion of the value up to \$1,500 and upon half the portion over \$1,500 but not exceeding \$5,000. There are provisions requiring that evidence of ownership be recorded; limiting the claim to one home per taxpayer; forbidding exemptions to partnerships and corporations; controlling the use which may be made of the exempted property if it is to continue to be entitled to the exemption; and making it possible for individuals who own land in common to qualify for the exemption.

The home exemption is designed to mitigate the effect of property taxation on the homeowner and thus to encourage what is believed to be a desirable social objective, namely, home ownership. It also serves to make the property tax somewhat less regressive by reducing the burden on those individuals who are believed to be least able to pay and thus increasing the proportionate burden on corporate owners and others who hold their land for profit. It provides no relief, however, to similarly situated families who happen to rent their home.

Suggestions have been made, from time to time, that home exemptions should be repealed since: (1) it is doubtful whether home exemptions effectively stimulate home ownership; and (2) their existence substantially reduces the tax base. Only eleven other states grant homestead exemptions and all but one of these states initially enacted such exemptions during the thirties. Hawaii's exemption, however, was enacted in substantially its present form in 1920.

Physically Disabled Individuals. The exemption from property taxation of homes of totally disabled veterans represents a combination of a home exemption and an exemption for physically disabled individuals. All of the residential

real property owned (or held on an agreement to purchase) and occupied by such a veteran is exempt from taxation. The state also exempts property owned by blind persons or persons declared to be Hansen's disease sufferers, who are detained and confined or on temporary release, up to a taxable value of \$10,000. Each of these exemptions is based, at least in part, on the thesis that these individuals, through no fault of their own, have less opportunity than others to support themselves and thus deserve some assistance from the state.

Property Owned by Individuals. The law specifically exempts from being included in the taxable value of a home, the value of a water tank owned and used by a taxpayer for storing water for his own domestic use. A further exemption is provided for tanks and other storage receptacles which a government agency requires to be installed before water for home and farm use is supplied. This exemption has the effect of reducing the tax burden on an individual who must provide his own water storage facilities either as a result of the physical location of his property or a government order. Further, the provision of adequate private water storage facilities serves to reduce the burden on government during periods of water shortage.

Exemption of Private Property Held for Profit but
Devoted to the Accomplishment of Public Purposes

Three classes of property are exempted from taxation for limited periods of time in order to foster the dedication of private resources to the accomplishment of public ends. These exemptions are provided for real property which is: (1) utilized in the development of specific new products deemed important to the Hawaiian economy; (2) located in the watershed and forest reserve areas which are surrendered to the state for a period of time; and (3) located in

urban redevelopment areas and sold to private interests to be developed in accordance with an accepted plan.

Industrial Development. The state, from time to time, has provided that property used in the manufacture of specific products shall be exempt for a period of time, usually a five-year period subsequent to the enactment of the exemption. The only presently available industrial development exemption is for property used in the manufacture of pulp and paper from bagasse fibre, the exemption to run for a period of five years from the first of January following commencement of the construction of such a plant.

Exempting the property utilized in the manufacture of specific products is designed to encourage the development of new industries but in recent years and in spite of the availability of a number of exemption provisions, there has been only one application for an industrial development exemption. Property taxes are evidently not a significantly large enough factor in terms of the total costs of establishing and operating a new enterprise that eliminating them makes a difference in the decision of an entrepreneur.

Forest Reserves. The state exempts from taxation land surrendered to the state as forest or water reserve lands for a term of not less than 20 years under agreement between the department of agriculture and conservation and a property owner. The law provides certain restrictions with respect to the government's improving property and the surrendering party's paying for such improvements at the termination of the lease.

The exemption provision is designed to encourage private owners and lessees to surrender lands to the state which they do not need in the immediate future and which might be useful to the state for conservation purposes, though it would be a coincidence if the value of the land to the state and the value of

the tax exemption were always equal. The system of exempting such land, however, is the traditional way in Hawaii for the state to pay the landowner for the privilege of leasing his lands for forest reserve purposes. Prior to 1957 the exemption was granted on a year-to-year basis and more land qualified for the exemption than under the present arrangement.

Urban Redevelopment. Property acquired by a redevelopment agency and from which the agency is not receiving income is exempt for a term not exceeding two years from the date of acquisition. Further, the property of a redevelopment corporation which is used for residential purposes in a project that is predominantly residential and in which rents are reasonable, is exempt for ten years from the payment of taxes over and above the amount paid on the same property in the year prior to the initiation of the redevelopment project and for the succeeding fifteen years on fifty per cent of the assessed valuation. Other additional exemptions are provided if certain conditions have been met and earnings are less than a specified percentage.

Such exemptions exist to encourage the undertaking of urban redevelopment projects for residential purposes by redevelopment agencies and corporations. They may be further justified on the basis that little tax revenue is lost during the early years and greatly increased tax revenues will be received during later years since the value of the redeveloped area will be much greater than the value of the blighted area it replaces.

Exemption of Public Property

Public property--federal, state, and county--is exempt from property taxation in Hawaii as in other states. There are several reasons for such an exemption: (1) federal law forbids taxation of most federally owned property; (2) immunity from taxation is considered to be a mark of a sovereign state;

and (3) taxation of state property for local benefit would simply be taking money from one account and placing it in another. In Hawaii where much land is owned by the state and used for commercial purposes, it has been important to qualify the basic rule that public property is tax-exempt in order to avoid improper subsidy of private interests. Thus the law provides that state or county property held under a lease or any government property held under an agreement for conveyance shall be fully taxable. Only those leases which run for a term of one year or more or which are renewable for such period as to constitute a total term of a year or more are considered leases. Further, if a building or structure is occupied by two or more tenants or by the government and a tenant, the tenancy is not considered a lease irrespective of the term thereof. These definitions have the effect of excluding from taxation government property held for private use on revocable permits and all tenants of government buildings who are not the exclusive lessee of such structures.

Property subject to revocable permits was excluded from taxation because of the difficulty encountered in trying to keep track of and collect from persons holding permits covering the use of land condemned for highway purposes. Some of these parcels had several different tenants during a year, and the amount of time and effort spent in collecting the taxes was large and the amount of revenue frequently small. There are many other parcels, however, held on revocable permit, pending the negotiation of new leases, and as the law is presently interpreted they too are non-taxable. It should be noted that most large agricultural users are voluntarily paying the tax on land held by them on revocable permit, but taxes should not be a matter of choice.

The reason that buildings owned by the government and leased to two or more private tenants or only a part of a building leased to one tenant are

exempted from taxation is that there are some difficulties involved in dividing the assessment among the various tenants and then collecting the tax due. The present arrangement places the government in the position of competing unfairly with private landlords, penalizes the lessee who leases an entire building, and deprives the counties of revenue.

The law also excludes from taxation: (1) property leased by the state or counties; (2) property in possession of the state or counties which is the subject of eminent domain proceedings; (3) property to which the owner has granted to the state or county a right of entry and upon which the government has entered and taken possession and to which it plans to acquire title; and (4) portions of property rendered useless by virtue of a county set-back ordinance. Property owned by foreign governments and used for diplomatic purposes is exempt because of federal treaty provisions. The property on which the Philippine consulate is located is taxed, however, since the property is owned by a foundation and not by a foreign government. Ownership, in this instance, and not use seems to be the determining factor.

Exemption of Property Taxed in a Different Manner

Property owned by enterprises subject to a special tax is sometimes exempted from the property tax. Public utilities in Hawaii pay a gross income tax in lieu of the gross excise and property taxes. Such exemptions are provided when it is believed that a given industry may more justly be taxed using a method other than those normally employed in taxing commercial enterprises.

The Administration of Exemptions

The real property division of the department of taxation is responsible for administering the provisions of the law providing for tax exemptions. Procedures utilized in administering the tax exemption provisions and problems relating to exemption administration are discussed in the following sections.

Administrative Procedures

Hawaii law requires most property owners claiming an exemption to file a claim annually, thus providing the department of taxation with an opportunity to review each claimant's status annually and making it possible to avoid carrying a property as tax-exempt after eligibility for an exemption has expired. There are certain exceptions to this general rule: (1) claims for home exemptions need only be filed when first claiming an exemption and thereafter only when relevant conditions change; (2) Hansen's disease sufferers do not file individual claims but rather the department of health furnishes the department of taxation with a list of eligible individuals annually; (3) the department of agriculture and conservation furnishes a list annually of privately owned lands which are part of the forest reserves; and (4) property owned by the government is automatically exempted. The claims of blind individuals are initially filed with and passed on by the department of health and the local veterans administration officer reviews the claims of all totally disabled veterans. No provision has been made yet for the filing of exemption claims by redevelopment corporations eligible for urban redevelopment exemptions, but such organizations may be required to file annual returns. The department of taxation has a standing request with the land office, the harbor commission, and the aeronautics commission to provide it with copies of all leases so that it may place non-exempt government property on the tax toll. It

learns of leases executed by other agencies or by the counties as a result of field inspections or from other sources of information.

Claims are checked against records in the bureau of conveyances to ascertain that the pertinent deeds, agreements, or leases have been recorded and against assessment records to make sure that the property is being used as claimed. If a property does not appear to qualify, a letter is written to the claimant asking him to explain in more detail why he believes his property is eligible for an exemption. Then a determination is made by the department. A taxpayer may take an appeal to the board of review in his county or to the tax appeal court. This has occasionally happened. A decision by the review board or appeal court tends to stand from year to year, even though legally the assessor is obligated to assert his own judgment in such matters each year. Appeal cases seldom reach the supreme court; the recent case concerning the eligibility of owners-occupiers of cooperative apartments for home exemptions was an exception.

Present procedures, except with respect to notification of the leasing of government property, provide adequate opportunity for review of exemptions to insure that only eligible qualified claimants receive exemptions. Unfortunately however, the claims are not always adequately reviewed nor are claims forms necessarily completed by the claimants. Thus exemptions allowed in prior years sometimes are allowed in the current year, without any fundamental examination of whether or not the particular claim is legitimate under the law.

Administrative Problems

There are two significant shortcomings in the administration of the exemption provisions of the law. First, a number of institutions which do not appear to qualify have been granted exemptions; and second, there is no clear departmental policy with respect to borderline situations.

A number of institutions which do not appear to be entitled to exemptions as the law is presently written have been exempted administratively. Some of these exemptions were initially granted as a result of a decision by a board of review and the assessor has not desired to reverse that decision in subsequent years. A few institutions appear to have received exemptions because their purposes are identical with or closely related to the purposes of organizations which the law specifically exempts. Still others seem to have been exempted for long periods of time and no one has questioned the validity of the action. Most of these organizations would qualify for exemptions if the only requirement were that they be non-profit and that the use of the property result in an appreciable amount of social benefit to the public or some reasonably large segment thereof. Given the specificity of the law, however, they may not be technically included in the exemption provisions. The department of taxation apparently has attempted over the years to compensate for what might be considered to be inadvertent omissions in the law, but it is questionable if this is the proper method for correcting possible legal deficiencies.

Exemption administration is at best a difficult undertaking because of the great number of borderline cases. It is impossible to enact legislation granting exemptions which will automatically provide the answer to any claim. Thus, there is a need to supplement the statutory provisions with administrative regulations in order that the legal provisions may be applied as uniformly and as fully in accord with the intent of the law as possible. The law, for example, provides that property used for religious purposes is exempt. At what point in time is a parcel eligible for exemption--when it is purchased by a religious society which intends to construct a church, when the building

permit is granted, when construction begins, when the main building is half completed, or when the property is being used for worship? The department has made a determination that when construction begins the property becomes eligible for tax exemption. The formulation of such a rule is a reasonable administrative act and its uniform application is greatly to be desired.

There are other areas where similar guides are needed but do not exist. The law exempts property used by a non-profit school, but such property is limited to that used for buildings, campus grounds, campsites, and not more than 20 acres for agricultural purposes in connection with the activities of the school. Guides or rules are needed to answer such questions as what are the reasonable limits of a campus and may a campus include land which will be but is not currently used for school purposes?

The law exempts the property of non-profit community associations used for educational, religious, community, hospital or governmental purposes, but there has been no formal attempt to define what constitutes a "community association". Thus several exemptions have been granted to organizations on the basis that they qualify as community associations when actually it would take an extremely broad definition of the term for them to be so included.

Section 128-19(a), Revised Laws of Hawaii 1955, provides for exempting a portion of a building and a portion of the land included in a parcel which contains an exempt use and a functionally related but non-exempt use. An example of this problem might be the question, "Is the x-ray laboratory at the Kaiser Foundation Medical Center part of the hospital, or is it a service office for the doctors practicing at the Center?" Again administrative guides are necessary if fair and uniform interpretations are to be made as to what constitutes an exempt use and a functionally related but non-exempt use, and as to the valuation of land under a building as differentiated from land not under

a building. In each of these and other related cases the existence of some administrative regulations supplementing the statutory provisions would be of material assistance in providing for effective exemption administration.

Consideration of Suggested
Changes in Exemption Law and Administration

House Resolution 125 specifically requests that the legislative reference bureau and department of taxation "submit a report of their findings, together with any recommendations they may have . . ." concerning the exemption of real property from real property taxes. The suggestions which follow are submitted in response to this request. It is recognized that in the final analysis the decision to exempt a particular category of property represents a political value judgment that must be made by political bodies. Such political decisions, however, will have greater usefulness if they are reached after consideration of the desired purpose and structure of the tax exemption system rather than as the result of solely considering the merits of the services rendered by a particular organization or the convenience of collecting taxes from a particular group of land users. New exemptions should be granted with great care if only for the reason that once granted, an exemption is seldom retracted.

The suggestions which follow are based on the assumption that there is no desire to change the exemption system extensively, but rather that there is some need to improve the system by providing for consistent treatment of like taxpayers both in the statutes and in exemption administration.

Exemption of Institutional Property

The state has not indiscriminately granted exemption privileges to non-profit organizations which have thought themselves entitled to exemptions. Furthermore, the property of most of the organizations possessing a specific

exemption could also qualify for exemption under one of the general provisions. The implied criteria in Hawaii which institutional property must meet before being exempted, as noted earlier, are that the use of the property:

- (1) results in an appreciable amount of social benefit to the public or some reasonably large portion thereof;
- (2) does not contemplate nor result in private gain or profit; and
- (3) is not primarily for the immediate benefit of a restricted and limited membership.

It would be helpful if the law were amended to provide general exemptions for the various categories of institutional property uses which the state desires to exempt, and that in the future no new specific exemptions be granted to individual organizations. Such a policy would make it possible to: (1) treat various institutional property uses uniformly; (2) reduce the pressure on the legislature to grant specific exemptions; and (3) improve exemption administration. The suggestions made in the succeeding paragraphs are designed to apply the criteria generally and equitably, thus obviating the need for specific exemptions.

Education. If the existing general provision relating to education were broadened, it would encompass all property reasonably exemptible under the criteria when applied to education. Exemption of property used by non-profit organizations for the purpose of spreading knowledge and culture through schools, museums, art galleries, libraries, historical sites, and similar uses would accomplish this. Administrative regulations should specify that property held for future school use is not exempt. Consideration should also be given to repealing or modifying the blanket exemptions granted to St. Louis College and Punahou School which exempt all of their lands located in designated areas regardless of whether the land is used or not--a privilege

not granted to other educational and cultural institutions. It would be useful, too, to authorize the director of taxation to prescribe in administrative regulations how frequently non-profit cultural institutions must be open to the public without charge to qualify for an exemption.

Cure of Disease and Promotion of Health. The existing general provision relating to property used for hospital purposes should be extended to include property used as clinics or offices by non-profit organizations dedicated to the cure of disease and promotion of health as long as their services are available to the public or large segments thereof at nominal or no cost. In this way all health institutions could be treated alike.

Maintenance and Propagation of Religion. The present general provision exempting property used by religious societies is sufficiently broad to cover any religious activity of positive social benefit to society. The present understanding concerning the point in time at which a parcel of land being developed for religious use becomes eligible for the exemption should be reduced to writing, made applicable to all institutional exemption claims, and included in the administrative regulations. Some special provision may be required, however, to continue the exemption of property used by religious institutions in instances where a deed has not been recorded.

Burial and Cremation. The present law makes it possible to exempt the fractional portion of the property of a cemetery held by a non-profit subsidiary of a profit-making corporation. Consideration could be given to amending the law so that only those cemetery parcels held in their entirety by a non-profit organization are exempt from taxation.

Relief of Poverty. The property of a non-profit organization used as a home for aged and indigent persons is now exempt under a general provision of the law, while specific exemptions are provided for a number of individually designated organizations. Further, the department of taxation on its own has exempted the property of several other similar agencies. The existing general

exemption, if expanded to include the property of other non-profit organizations which are concerned with preventing want and suffering on the part of human beings and in providing food, clothing, and shelter, and other necessities to those in want, would clarify and legitimize the present situation.

Governmental Purposes. An exemption is presently provided for property owned by non-profit community associations which is used for educational, religious, community, hospital, or governmental purposes. It is under this clause that some of the questionable exemptions have been granted. It is suggested that the exemption be limited to the property of community associations serving limited geographical areas and used for governmental purposes unless the intent is clearly otherwise. In the latter case a similarly clear definition is indicated.

Veterans Organizations. The property used by four veterans organizations is specifically exempted from taxation regardless of the use made of the property, but the general exemption for veterans organizations applies only to property used for "educational, religious, community, hospital or governmental purposes." It is suggested that all veterans organizations should be treated alike.

Recreation. A general provision added to the law providing exemption for property used by non-profit organizations to furnish public recreation would clarify the present somewhat nebulous situation. Care must be taken, however, to make sure that exempted recreational facilities are truly open to the public on a basis similar to that used in public recreational facilities. Further, it may be desirable to provide that the government of the county in which such recreational areas or facilities are located must formally designate the property as a public recreation area prior to the granting of an exemption. Such an arrangement should result in exempting only those properties which the county actually desires to have utilized for recreational purposes.

Mutual and Fraternal Benefit Societies. There is little reason to change the present general provision exempting non-profit medical idemnity and hospital service organizations from the payment of all taxes except unemployment compensation.

Exemptions Benefiting an Individual

Few changes are suggested with respect to home exemptions and the exemptions provided Hansen's disease sufferers, totally disabled veterans, and blind persons. Whether or not it is in the public interest to continue granting home exemptions is a matter of political judgment. If home exemptions are continued, the question arises, however, as to whether or not the legislature and governor desire to extend the exemption privilege to cover the owners of cooperative apartments who live in the apartments they own. Further, consideration could justifiably be given to providing exemptions for disabled persons whose disability is not related to Hansen's disease, military service, or sight.

The law presently provides that the exemption for homes valued at more than \$5,000 is \$3,250 and for homes valued at \$1,500 or less is equal to the value; but for all homes falling within the \$1,500-\$5,000 bracket, an individual calculation must be made as to the size of the exemption. It would expedite the administrative processes, including tabulating machine operations, if a bracket system was employed whereby, for example, all homes valued between \$1,501 and \$1,700 would receive an exemption of \$1,600.

Exemption of Private Property Held for Profit but
Devoted to the Accomplishment of Public Purposes

Exemptions for the purpose of encouraging the development of specific industries have done little identifiable good in the past. Present exemption policies relating to the surrender of privately owned forest lands are satisfactory if the desired public objectives are being achieved. It is still

too early to tell whether the exemption provisions relating to urban redevelopment projects adequately accomplish the purpose for which they were established.

Exemption of Public Property

The principle that state or county lands used for commercial purposes should be taxed is well accepted in Hawaii but the provisions of the law which exclude from taxation property held on revocable permits or tenants of government buildings who occupy less than an entire structure do violence to this principle. The suggestions which follow would correct this situation:

- (1) The department of land and natural resources should collect a fee-in-lieu of taxes, which would be equal to a set percentage of rent, on all properties purchased by the state for highway purposes but currently held on a revocable permit and used for residential, commercial, or other private purposes. Such fees should be turned over to the government of the county in which the property is located.
- (2) On all other property held on revocable permit, the permit holder should pay taxes on the parcel for that portion of the year during which he holds the permit.
- (3) The state government agency or county government which leases a building used jointly by the government and one or more tenants or used by two or more tenants should pay the property tax on that portion of the property used for private purposes. The leasing agency in turn may collect an equivalent fee from its clients in whatever manner it deems advisable.

Exemption of Property Taxed in a Different Manner

The exemption of public utilities from the property tax poses no particular problems in terms of tax exemption policies. It does result, however, in a reduction of potential income for the counties from property tax sources.

Administration of Exemptions

There are several improvements in exemption administration which would simplify this difficult task. First, it is suggested that the director of

taxation formulate administrative regulations which will supplement the statutory provisions relating to exemptions. The director, in fact, should be given statutory authority to make such regulations. Administrative regulations will eliminate many questions concerning eligibility for exemption while at the same time making it unnecessary to make the law unduly elaborate and long. Such regulations will also assist the director in explaining his position on a particular case in which an appeal is filed. Second, it is suggested that each year an official designated by the director of taxation should review the list of institutional exemption claims which have been approved by the four division assessors to make sure that each exemption qualifies under the law. Assessors in turn should insist that claimants file all information needed for making administrative determinations. Third, the director of taxation should receive from each state and county governmental agency leasing property, a list of all parcels or portions of parcels leased to private users for any period of time (excluding land held for highway purposes). Fourth, consideration should be given to repealing the provision of the law requiring that exempt property be assessed at its full value. The existing valuations, as noted earlier, are just accurate enough to be misleading and not accurate enough to be useful. Fifth, the assessor should not follow the decision of a board of review in subsequent years if he believes the decision to be incorrect.