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**A STUDY OF HAWAII'S GENERAL EXCISE TAX
ON WARRANTY PARTS AND LABOR**

By

LESTER J. ISHADO

Researcher

LEGISLATIVE REFERENCE BUREAU

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FOREWORD

This study on the application of the excise tax to credits received by car dealers from manufacturers for warranty work was prepared in response to Senate Concurrent Resolution No. 113 of the Eighth Legislature of the State of Hawaii, Regular Session of 1976.

Information obtained from the State Department of Taxation, the Hawaii Automobile Dealers Association, and the departments of taxation of the other states and the District of Columbia was most helpful in the preparation of this report and their contributions are gratefully acknowledged.

Samuel B. K. Chang
Director

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CHAPTER 1

INTRODUCTION

Senate Concurrent Resolution No. 113 (Appendix C), adopted by the Legislature at the Regular Session of 1976, requested the Legislative Reference Bureau to conduct a "study and analysis of the taxation of warranty parts and labor of automobiles". Pursuant thereto the following analysis, findings, and recommendations are submitted concerning the levying of the general excise tax on credits received by new car dealers from the car manufacturers for amounts expended in meeting the manufacturer's new car warranty.

The fact situation may be described as follows: a customer buys a new car from a dealer, and along with the car, the customer receives a warranty issued by the manufacturer valid for a certain period of time or mileage covered by the vehicle. The warranty is a guarantee by the manufacturer that the car is free from certain defects, and that if these defects arise, the manufacturer or someone acting for him will repair such defects. The dealer is usually required to do this under his franchise agreement. Thus, if within the stated time or mileage and subject to certain conditions being met (e.g., the defect was not caused by customer's negligence) a defect develops in the car, the customer can take the car to the dealer who will

repair it free of charge under the manufacturer's warranty. The manufacturer then credits the dealer for the parts and labor used in making these repairs. This credit is subject to the general excise tax, and it is this incidence of taxation which is being studied.

SUMMARY OF TAXES INVOLVED

In studying the levying of the general excise tax on the warranty credits in the given situation, it is necessary to understand the different types of taxes applicable in this area. Hawaii levies a general excise tax; other states levy a sales tax, or a gross income tax similar to the excise tax. The excise, sales, or gross income tax is usually complemented by a use tax designed to be applied where the excise, sales, or gross income tax does not apply. As the name implies, the sales tax is a tax on a retail sale of property paid by the final consumer at the time of the sales transaction. On the other hand, the general excise (or gross income) tax is a tax on the privilege of doing business which is paid by the business monthly or quarterly.¹ It is a tax on the gross income of the business. For example, the customer buys a car from the dealer. In a sales tax state, the customer is liable for the tax on the retail sale of the car and usually must pay the tax at the time of the sale to the dealer who then transmits it to the State. However, in a general excise or gross income tax state, the

dealer is liable for a tax for the privilege of engaging in the business of selling cars. The customer does pay a 4 per cent excise tax, but the dealer is liable for a tax based on the dealer's gross income. The gross income from this transaction includes both the price of the car and the amount paid by the customer as tax. The dealer is not allowed to deduct from his gross income the amount paid by the customer as tax.² Thus the dealer can never pass all of the excise tax directly on to the customer.

In another example, where the manufacturer sells parts to the dealer, because this is not a sale to the final consumer but rather a sale for a later resale to the final consumer (the customer), most sales tax states do not impose a sales tax on this transaction. The excise tax states, however, treat it like any other business transaction and impose a tax on the sale by the manufacturer (where the manufacturer does business in that state). It should be noted that in Hawaii the percentage of tax due varies from 1/2 of 1 per cent for manufacturers to 4 per cent for retailers, service businesses, etc.³

In the case where the dealer does repair work under the warranty, while in a sense, this is a sale of parts to the customer, because of various considerations; e.g., treating the parts sale as covered by the tax on the original sale of the car, this transaction is not taxed in many sales tax states. Hawaii and some gross income tax states treat this

repair work as a business transaction subject to the excise (or similar) tax. The important distinction between the sales tax and the excise tax is that the sales tax generally applies only to the sale of property whereas the excise tax is a privilege tax on the engaging of business, and this includes the sale of services (labor) as well as parts (property). Although the dealer cannot pass all of the general excise tax on to the customer directly, it may be that as good business practice this tax is passed on to the customer indirectly; e.g., in higher prices for nonwarranty repairs and in the price of a new car.

The use tax, based on the use of the product within the State, complements the sales or excise tax. The use tax is meant to apply where the sales or excise tax does not. For example, where the sale occurs outside the State, the sales or general excise tax does not apply, but if the object is brought into the State for use, it is subject to the use tax less any sales or use tax paid to other states.

CHAPTER 2

LEGALITY OF THE GENERAL EXCISE TAX

The legality of applying the excise tax to credits for car warranty repair has been established. In In re Tax Appeal of Aloha Motors, Inc. consolidated with In re Tax Appeal of Edward R. Bacon Co. of Hawaii, Ltd., 56 H.321 (1975), the Supreme Court of Hawaii held that certain credits for warranty work were reimbursements exempt under section 237-20, *Hawaii Revised Statutes*, from the excise tax. However the case also holds that, except as provided in section 237-20, *Hawaii Revised Statutes*, the excise tax may legally be applied to credits for warranty work. Section 237-20, *Hawaii Revised Statutes*, reads:

Sec. 237-20 Principles applicable in certain situations. A person or company having shareholders or members (a corporation, association, group, trust, partnership, joint adventure, or other person) is taxable upon its business with them, and they are taxable upon their business with it. A person or company, whether or not called a cooperative, through which shareholders or members are pursuing a common objective (for example, the obtaining of property or services for their individual businesses or use, or the marketing of their individual products) is a taxable person, and such facts do not give rise to any tax exemption or tax benefit except as specifically provided. Even though a business has some of the aspects of agency it shall not be so regarded unless it is a true agency. The reimbursement of costs or advances made for or on behalf of one person by another shall not constitute gross income of the latter, unless the person receiving such reimbursement also receives additional monetary considerations for making such costs or advances.

The Court limited the reimbursements exemption under section 237-20, *Hawaii Revised Statutes*, to warranty credits made to the dealer by the manufacturer for work done by an independent third party and not where the dealer supplied the parts or labor himself. Where the dealer performed the work, the Court held that a sale had occurred, the credits were not reimbursements within section 237-20, *Hawaii Revised Statutes*, and the credits were gross income subject to the excise tax. It should be noted that since section 237-20, *Hawaii Revised Statutes*, deals with exemptions, the Court strictly construed it against the taxpayer.

CHAPTER 3

FACTORS TO CONSIDER REGARDING THE EXCISE TAX

A. APPLICABILITY OF EXCISE TAX

The parties to the Aloha Motors case raised several issues which should be considered by the Legislature in deciding whether to change the law concerning the general excise tax. The first issue raised is whether the excise tax law (chapter 237, *Hawaii Revised Statutes*) applies to warranty work. The dealer argued that the excise tax is a tax on "business", defined as activity "with the object of gain or economic benefit",¹ and that since warranty work was nonprofitable; i.e., strictly limited to recovery of only costs, warranty work was not a business activity within the scope of the excise tax.² This argument does not appear to have merit. The excise tax law does not equate profit with gain or economic benefit. A business is subject to the general excise tax on the gross income and not just on profit or net income. The statute specifically prohibits deductions for costs, taxes, etc. from the taxable gross income.³ Gain or economic benefit is more than just making money; in fact the definition of "business" refers to indirect as well as direct economic benefit. For example, in the warranty situation where the dealer makes repairs free of charge, the dealer builds up customer goodwill for his business; this is an indirect economic benefit.

B. APPLICABILITY OF SECTION 237-20 EXEMPTION

The second issue, raised by the State in the Aloha Motors case is whether the exemption statute, section 237-20, *Hawaii Revised Statutes*, applies in any way to warranty work. The State argued that the exemption applied only where there were reimbursements of costs without any additional monetary consideration, and the exemption did not apply since the dealer was receiving additional compensation; i.e., an extra 25 per cent added on to the cost of parts.⁴ Although not raised by the parties in Aloha Motors, the same argument could apply to the reimbursements for labor. The dealer is reimbursed at either a set rate; i.e., the rate which would be charged by an average mechanic doing the same work, or at the dealer's warranty labor rate; i.e., a certain percentage of the mechanics' hourly wage plus fringe benefits. This set rate may involve additional compensation because the dealer is reimbursed for a certain number of labor hours even though the repair may have taken less time. The dealer's warranty rate may also involve additional compensation because the rate may be set to cover over 100 per cent of the hourly wage or because it allows for fringe benefits. This argument has some merit. The court did not specifically rule on this issue, but it did define costs as limited to direct costs. Since the extra 25 per cent was apparently intended to cover indirect costs such as overhead, this 25 per cent falls into the category of additional monetary consideration, thus

apparently taking the warranty work out of section 237-20,
Hawaii Revised Statutes.

C. DISTINGUISHING WARRANTY WORK BY DEALER AND BY
THIRD PARTY

In the Aloha Motors case, the Court held that a reimbursement exemption under section 237-20, *Hawaii Revised Statutes*, would apply to credits received by the dealer from the manufacturer for warranty work performed by a third party; i.e., where the dealer farms out the work to another party; however the exemption does not apply to credits for warranty work performed by the dealer himself. The dealer in Aloha Motors raised a third issue as to whether the distinction between warranty work by a third party and by the dealer can be justified.⁵ A possible basis for this distinction is the avoidance of double taxation for the same work. In the first situation where the dealer farms out the warranty work to the third party, the third party pays an excise tax on the work done, and thus there is some reason to exempt the dealer from paying the excise tax. But in the second situation where the dealer performs the work himself, there is no one else to levy an excise tax on.⁶

Another basis for this distinction is suggested by the exemption statute, section 237-20, *Hawaii Revised Statutes*, itself. The statute is apparently cast in terms of a system where the taxpayer merely acts as a conduit between the manufacturer and a third party as when the dealer farms out

the work to a third party. Although the Court in the Aloha Motors case held that a true agency was not required under section 237-20, *Hawaii Revised Statutes*, the section speaks in terms of agency; i.e., "...reimbursements of costs or advances made for or on behalf of one person by another...." (*emphasis added*) The statute seems to imply that this is a three party transaction; i.e., dealer pays third party on behalf of manufacturer, and the Court so held.

A third basis for the distinction between exempting work done by a third party and not work done by the dealer may be found by looking at the differences between the two party (dealer-manufacturer) transaction and the three party (dealer-manufacturer-third party) transaction. In the three party transaction where the dealer merely acts as a conduit between the manufacturer and the third party, the dealer is not really engaged in business, and the possibility of his seeking unintended exemptions is minimal. On the other hand, in the two party transaction where the dealer is engaged in the business of warranty repair, there is a possibility of tax exemption where none was probably intended. Costs and expenses are not deductible from the gross income.⁷

Thus, there appears sufficient basis for exempting as reimbursements warranty work credits for work done by the third party while not exempting for work done by the dealer because: (1) There is no double taxation on the two party transaction; (2) Section 237-20, *Hawaii Revised Statutes*,

implies a three party transaction; and (3) Limiting the exemption to three party transactions reduces the possibility that the taxpayer would seek to classify costs as reimbursements.

D. DISTINGUISHING THE THIRD PARTY TAXPAYER FROM THE DEALER TAXPAYER

In engaging in the business of repairing cars under warranty, the third party is liable for the excise tax; however, is there justification to distinguish between third parties and dealers so as to exempt dealers engaged in the same business? One possible basis suggested by the dealer in Aloha Motors for exempting the dealer is that the third party seeks additional compensation and does not come within the scope of section 237-20, *Hawaii Revised Statutes*, whereas the dealer does not seek additional compensation.⁸ This argument appears faulty because the dealer apparently does receive additional compensation in the form of an additional 25 per cent.

E. STATEMENTS IN S.C.R. NO. 113

There are several statements presented in Senate Concurrent Resolution No. 113 (see Appendix C), based on a survey conducted by the Hawaii Automobile Dealers Association of 22 states, which should be analyzed. The resolution reflects the belief that an exemption would help alleviate the rising costs of automobile parts and labor. This assumes that there is some relationship between the payment of the

excise tax on warranty credits and higher costs; i.e., the dealer is indirectly passing on the excise tax to the consumer by increasing the prices for parts and labor. While reducing the costs of automobile parts and labor is desirable, there is no assurance that an exemption on warranty credits would lead to lower prices. Warranty repair in many instances is an unprofitable business,⁹ and reducing non-warranty repair prices may not be economically feasible.

F. TREATMENT IN OTHER STATES

The Legislative Reference Bureau surveyed the other 49 states and the District of Columbia concerning the taxability of warranty work. The survey table is presented in Appendix A. Most of the jurisdictions surveyed have a sales tax complemented by a use tax. A majority of these sales tax states do not tax parts used in meeting warranty repairs, and it should be noted that in most such states the failure to tax applies across the board to all warranties and warranty activities in general. Of the 35 sales tax states which do not tax the warranty work, only 3 specifically referred to a statutory exemption. Another 23 states referred to their interpretation of the sales tax law, including 13 states which referred to rules interpreting the statutes, and 9 states did not refer to either a statute or interpretation. The prevailing reason for the sales tax nontaxation is that warranty work is considered an integral part of the original sale of the car, and as such, the warranty parts have been

included in computing the sales price of the car which is already taxed. Any further sales tax on warranty parts would be double taxation. The nontaxation of warranty transactions applies where there is a mandatory warranty; i.e., the warranty is included in and comes with the sale of the car.

The reasoning also applies to optional and separate warranties. Optional and separate warranties are warranties which are not included and do not come automatically with the sale of the car. The buyer may decide to buy or not to buy these warranties; or the dealer may offer his own warranty in addition to whatever other warranty is available. The optional warranty may extend for a longer period or cover more items than the mandatory warranty. Sales tax states withhold taxation of either the sale of the warranty or the parts used in performance of such a warranty, so that taxation of both the original sale and the parts used do not occur. Some states accomplish this by taxing the original sale of the warranty and not taxing parts used under the warranty thereafter, while other states do not tax the original sale of the warranty but do tax the parts used when warranty work is done.

Another reason offered for not taxing warranty parts by sales tax states is that the sale of the parts from the manufacturer to the dealer is really a sale for resale (to the car owner) and is thus not subject to a sales tax. This

reasoning does not seem to be persuasive because the transactions are different.

G. APPLICABILITY OF SALES TAX REASONING TO EXCISE TAXES

The sales tax is different from the excise tax, and the reasoning justifying the nontaxation under a sales tax does not seem to apply to an excise tax exemption. The sales tax is a tax on a retail sale of property which is paid by the final consumer at the time of the sales transaction. The excise tax, on the other hand, is a tax on the privilege of engaging in business (both parts and labor) which is paid by the business (e.g. seller) at periodic intervals. In the warranty sale of parts from the dealer to the customer in a sales tax state, the customer would be liable for the tax were it not for the sales tax reasoning; in an excise tax state the dealer is liable for the tax as it is a business transaction within the scope of excise taxation.

The reasoning behind nontaxation in sales tax states is basically to avoid double taxation of parts already taxed in the sale of the car. This reasoning, however, is not persuasive in discussing excise taxes. The 4 per cent excise tax rate applies to both the sale of car parts between the distributor (where the distributor does business locally) and the dealer and to the sale of car repair services between the dealer and the customer. Generally where there is a sale of goods by a local manufacturer to a dealer for resale to a customer, the manufacturer-dealer sale is subject to

only a 1/2 of 1 per cent excise tax. However, where the dealer is a service business such as a car repair business, the sale of parts to the dealer is treated as a sale for final consumption and not a sale for resale; this sale is subject to the 4 per cent excise tax rate. The sale of the same parts from the dealer to his customer is treated by the Department of Taxation as a sale of services, with the parts being merely incidental to the rendition of services. This retail service business repair situation is different from the warranty situation because the dealer in the service business situation can pass most of the excise tax on to the customer, while the dealer in the warranty situation cannot. The customer gets the warranty work done without extra charge.

Using the reasoning of the sales tax states, opponents of the general excise tax law argue that the 4 per cent rate should apply only once, at the time of the retail sale, and that the wholesaler's 1/2 of 1 per cent rate should apply to the other sale. The argument is that the 4 per cent taxation of both sales amounted to double taxation. The authors of *Hawaii's General Excise Tax: Prospects, Problems, and Prescriptions*, summarized the applicability of the reasoning in sales tax states to Hawaii's excise tax law as follows:

But the Iowa Rule, along with the other state court views on services, really deals with an essentially different problem than that which faces Hawaii. Most state courts are wrestling

with statutes which are retail sales taxes (i.e., single stage sales taxes) and which do not apply to service businesses. These courts are thus caught up in the practical problem of deciding how to rationalize the levying of the retail tax on the transfers of property at some single stage in the distribution process. Therefore, certain states have held that the tax should be levied on sales by the service business, others, that it should be levied on sales to the service business, seldom, if ever, both levels.... We offer this example to demonstrate that there is nothing particularly compelling or relevant about the application to Hawaii's tax problems of legal precedents made in other states.¹⁰

The rationale in sales tax states of avoiding double taxation is reflected in the application of a sales tax as a tax on one transaction; i.e., the final sale. The excise tax is not limited to one final transaction--it applies, and is designed to apply, to as many transactions as possible. The excise tax has a pyramiding application; i.e., it applies to different stages of the development of a product.¹¹ For example, the manufacturer must pay an excise tax in selling the product to the dealer, and the dealer must also pay an excise tax in selling the product to the consumer without any deduction for prior taxes paid on the product. The taxes build up in a pyramiding fashion as more transactions occur. Thus, the double taxation reasoning of the sales tax states generally does not appear to apply to excise taxes. Finally, it should be noted that there are a few sales tax states which do tax warranty parts; however, no reason was given by these states for such taxation.

H. GROSS INCOME TAX STATES ARE SPLIT

The other tax used in taxing warranty parts and labor, the gross income tax or the business and occupation tax, is similar to Hawaii's excise tax. The tax is levied on gross income which includes both parts and labor. Alaska, Delaware, Washington, and West Virginia tax warranty parts and labor whereas New Mexico does not. No rationale was given by these states for the taxation or nontaxation of warranty parts and labor (see Appendix A).

I. INSUFFICIENT JUSTIFICATION TO EXEMPT WARRANTY PARTS AND LABOR

One of the strongest arguments against exempting warranty parts and labor is that there is no apparently strong reason to do it. The strongest reason to exempt warranty parts and labor would be to avoid a certain inequity in double taxation under a sales tax state rationale. This reasoning applies equally well to other business transactions subject to the excise tax; i.e., the excise tax has a certain inequity built into its structure through its pyramiding effect. Since the equity argument reaches throughout the excise tax structure and applies to business transactions other than the warranty repair transaction, exempting warranty parts and labor might open the door to attempting to justify exemptions for more so-called inequitable taxation. For example, the excise tax applies to both the sale between the manufacturer and the dealer and to the sale between the

dealer and the customer. Using the same equity reasoning justifying an exemption for a warranty situation; i.e., that such a tax would be double taxation, the door would seem to be open to also exempt one of the sales, either between the manufacturer and the dealer or between the dealer and the customer.

J. TAX REVENUE LOSS

The Legislature might also be concerned with the amount of revenue that would be lost by granting an exemption for warranties whether across the board or only for car repair. An across the board exemption on equity principles might be more justifiable than an exemption applying only to car repairs since the same reasoning applies to all warranty work. The exact figures are not available because the Department of Taxation does not break down the figures showing how much revenue came from which source. The Legislative Reference Bureau conducted a survey to obtain an idea of how much revenue loss would occur. The survey was taken of three groups furnishing warranty repairs: (1) automobile dealers; (2) heavy equipment dealers; and (3) boat dealers. The survey on revenue loss, printed in Appendix B, shows that 64 per cent of the car dealers replied, while 36 per cent did not (see Appendix B). It should also be noted that there are other warranty repair dealers which were not surveyed, notably the appliance dealers, television dealers,

etc. Based on this survey, the State will lose at least \$186,649 in excise taxes from all three dealer groups, including at least \$170,157 from automobile dealers alone.

CHAPTER 4

SUMMARY OF FINDINGS

The summary of findings of this report are as follows:

- (1) The excise tax and the sales tax, both used in warranty work taxation, are different in terms of transactions covered, persons held liable (tax incidence), items included in taxable income, scope of coverage, and reasoning.
- (2) The legality of applying the excise tax to warranty work has been established in Hawaii.
- (3) The excise tax applies to warranty work as a business with the object of gain or economic benefit even though the work is nonproftitable.
- (4) Section 237-20, *Hawaii Revised Statutes*, exempts as reimbursements credits received for costs made on behalf of another where the person being reimbursed did not receive any additional monetary consideration for paying such costs. Costs are limited to direct costs.
- (5) In the Aloha Motors case, the Court held that section 237-20, *Hawaii Revised Statutes*, exempted as reimbursements any credits from the manufacturer to the dealer where the warranty work was done by a third party but not where work was done by the dealer himself. In this latter situation, the Court held

that the transaction was a sale, and the credits were not reimbursements exempt under section 237-20, *Hawaii Revised Statutes*, and the credits were taxable income.

- (6) A distinction between warranty work done by a dealer and work by a third party may be made on the basis that: (A) an exemption is practical under section 237-20, *Hawaii Revised Statutes*, where there is someone else (third party) to pay the tax but impractical where there is no third party to pay; or (B) section 237-20, *Hawaii Revised Statutes*, apparently is intended to apply where there is a three party transaction with the dealer serving as a conduit; or (C) unlike the three party transaction (manufacturer-dealer-third party), the two party transaction (manufacturer-dealer) raises the possibility of unintended substitution of costs for reimbursement exemptions.
- (7) There appears to be insufficient justification to exempt the dealer (at least in a two party transaction) from the excise tax where a third party is required to pay the tax for doing the same business.
- (8) There appears to be no assurance that exempting warranty parts and labor would lead to lower costs of automobile parts and labor.

- (9) The survey conducted shows that a majority of the states use a sales tax but do not tax warranty parts, using either the reasoning that the parts were included in the tax on the original sale of the product or that there was a sale for resale. Most states based their nontaxation on an interpretation of a statute rather than on an explicit statutory exemption itself. In the business and occupation tax (similar to Hawaii) states one state does not tax warranty credits, while five states, including Hawaii, do tax such credits.
- (10) The rationale used in sales tax states is not persuasive in discussing excise tax exemptions because of the difference between the sales tax and the excise tax.
- (11) There is no apparent justification strong enough to warrant a statutory change exempting warranty parts and labor. An exemption for warranties may open the door to other exemptions.
- (12) Based on a survey taken of three groups of dealers who do warranty work, the State may lose at least \$186,649 in excise taxes because of a warranty work exemption. Car dealers account for \$170,157 in tax revenues. The revenue loss will probably be higher, since if the exemption is applied to all warranty work, small appliance dealers and others are involved.

CHAPTER 5

RECOMMENDATIONS

The present excise tax law should remain the same, and no statutory changes regarding exemptions for credits for warranty work performed by the dealer are recommended. There does not appear to be sufficient justification for any statutory exemption in the area of warranty work, and section 237-20, *Hawaii Revised Statutes*, is sufficient to cover the reimbursement situation.

If the Legislature should decide that an exemption for warranty work is justified, then the Legislature can approach this exemption in one of two ways. The exemption could be applied only to car dealer warranties or it could be applied across the board to all warranty credits. It would appear to be more equitable to give an exemption across the board. There does not appear to be any reason to distinguish a car warranty from any other kind of warranty. The same justifications apply to both warranties.

The Legislature could exempt only the car warranty, which is the specific situation being studied. Limiting the exemption to car dealers might minimize loss of revenue, but otherwise it is hard to distinguish the car warranty from other warranty credits.

FOOTNOTES

CHAPTER 1

1. Hawaii Rev. Stat., sec. 237-9 and sec. 237-30.
2. Hawaii Rev. Stat., sec. 237-3.
3. Hawaii Rev. Stat., sec. 237-13.

CHAPTER 3

1. Hawaii Rev. Stat., sec. 237-2.
2. Brief for Appellant at 8-12. In the Matter of the Tax Appeal of Aloha Motors, Inc. and In the Matter of the Tax Appeal of Edward R. Bacon Co. of Hawaii, Ltd., 56 H.321 (1975).
3. Hawaii Rev. Stat., sec. 237-3.
4. Brief for Appellee at 25-30, In the Matter of the Tax Appeal of Aloha Motors, Inc. and In the Matter of the Tax Appeal of Edward R. Bacon Co. of Hawaii, Ltd., 56 H.321 (1975).
5. Brief for Appellant at 19-25, In the Matter of the Tax Appeal of Aloha Motors, Inc. and In the Matter of the Tax Appeal of Edward R. Bacon Co. of Hawaii, Ltd., 56 H.321 (1975).
6. Ibid., p. 19.
7. Hawaii Rev. Stat., sec. 237-3.
8. Brief for Appellant at 22-23, In the Matter of the Tax Appeal of Aloha Motors, Inc. and In the Matter of the Tax Appeal of Edward R. Bacon Co., of Hawaii, Ltd., 56 H.321 (1975).
9. Richard F. Kahle, Jr., Car Warranty Report, University of Hawaii, Legislative Reference Bureau, Report No. 1 (Honolulu: 1972), p. 29-30.
10. Arthur D. Little, Inc., Hawaii's General Excise Tax: Prospects, Problems, and Prescriptions, Report to State of Hawaii, Department of Taxation (1968), pp. 23-24.
11. Ibid., p. 47.

APPENDICES

APPENDIX A

The Legislative Reference Bureau surveyed the other 49 states and the District of Columbia asking the following questions:

1. With respect to products in general, does your state levy a sales, use, excise, or other tax on parts and labor provided by anyone in meeting the manufacturer's warranty?
2. With respect to automobiles, does your state levy such a tax on automobile parts and labor provided in meeting the manufacturer's warranty?
3. If such a tax is levied, on whom is it levied? Car dealers? Manufacturer?
4. We would also appreciate a reference to or a copy of the appropriate state tax statute and the rationale for granting a tax exemption, if any.

The results of the survey are as follows:

STATE	TAX EXEMPT WARRANTY PARTS/LABOR?	TYPE OF TAX	COMMENTS (see fn.)
Alabama	Yes (P)	Sales	1
Alaska	No	Gross Receipts	
Arizona	Yes	Sales	warranty or service contracts are taxable
Arkansas	Yes (B)	Sales	1. Information supplied by Hawaii Automobile Dealers Association
California	Yes (B)	Sales	2. for optional warranties, there is no tax on the purchase price of such warranty, but the dealer is liable for tax (sales) on parts used in performance of the warranty
Colorado	Yes	Sales	1, 2, for a warranty issued outside the original purchase where a separate charge is made, there is no tax on the purchase price of such warranty, but the dealer or the manufacturer (depending on who issued the warranty) is liable for sales tax on parts used
Connecticut	No (P)	Use	manufacturer is liable for use tax
Delaware	No	Bus. & Occup.	
Florida	Yes (B)	Sales	1, 2, for optional warranty contract, there is sales tax on price of contract, but parts used in performance of contract are exempt
Georgia	Yes	Sales	1
Idaho	Yes (P)	Sales	2, for optional, separate, or service contract warranties, there is no tax on the purchase price of such warranties but the warrantor is liable for the sales tax on parts used in performance of the warranty
Illinois	Yes (cars)	Sales	2
Indiana	No	Sales	for a manufacturer's warranty, the manufacturer is liable for the sales tax on parts used in performance of the warranty. The dealer is similarly liable where there is a dealer's warranty
Iowa	Yes	Use	2

STATE	TAX EXEMPT WARRANTY PARTS/LABOR?	TYPE OF TAX	COMMENTS (see fn.)
Kansas	Yes	Sales	1, 2
Kentucky	Yes	Sales	1, 3
Louisiana	Yes	Sales	1, 2, 3
Maine	Yes	Sales	1
Maryland	Yes	Sales	1, 2, 3
Massachusetts	Yes (B)	Sales	1, 2, 3
Michigan	Yes (P)	Sales	2
Minnesota	Yes	Sales	1, 2
Mississippi	Yes (cars)	Sales	1
Missouri	No (P)	Sales	dealer is liable for sales tax on reimbursements for parts used
Montana	---	None	---
Nebraska	Yes	Sales	1, 2, for optional warranty there is no sales tax on purchase price but dealer is liable for tax on parts used in performance of the warranty
Nevada	Yes	Sales	1, 2, 3
New Hampshire	---	None	---
New Jersey	Yes	Sales	1
New Mexico	Yes	Gross Receipts	
New York	Yes	Sales	1, 2, 3
North Carolina	Yes/No	Sales	although the manufacturer is exempt, the dealer is liable for the sales tax on parts
North Dakota	Yes/No	Sales/Excise	generally there is no exemption, and a sales tax applies to warranty parts. However, the automobile is subject to a different type of tax, automobile excise tax, and there is an exemption
Ohio	No (P)	Sales	for mandatory warranty (required as part of the sale of the product), the manufacturer is liable for the sales tax. The dealer is similarly liable where there is a dealer's warranty
Oklahoma	Yes	Sales	
Oregon	---	None	---
Pennsylvania	Yes (B)	Sales	1, 2, for separate warranty contract, there is sales tax on price of contract, but parts and labor used in performance of contract are exempt
Rhode Island	Yes	Sales	2, 3
South Carolina	Yes	Sales	1, for a subsequent and separate warranty, the dealer is liable for a sales tax on parts used
South Dakota	Yes (B)	Sales	1
Tennessee	Yes (P)	Sales	1, 2
Texas	Yes (B)	Sales	replacement parts are treated as component part of the manufactured property and thus exempt from sales tax
Utah	Yes (B)	Sales	1, 2, for a separate warranty, the result would be the same

STATE	TAX EXEMPT WARRANTY PARTS/LABOR?	TYPE OF TAX	COMMENTS (see fn.)
Vermont	No	Sales	sales tax is levied on the customer
Virginia	Yes	Sales	1, 2
Washington	No	Bus. & Occup.	the dealer is liable for a business and occupation tax on parts used
West Virginia	No	Bus. & Occup.	business and occupation tax levied on gross income of dealer. Also, West Virginia is contemplating imposing sale tax on warranty parts on the manufacturer
Wisconsin	Yes (B)	Sales	1, 2, for work not required by the original contract of sale, the dealer is liable for a use tax on part used
Wyoming	Yes	Sales	1, 2
D.C.	Yes (B)	Sales	1, 2

TAX EXEMPT WARRANTY PARTS/LABOR?

Unless otherwise noted, a "yes" answer refers to a general tax exemption applying to all types of warranty situations.

(P)--exemption specifically refers to parts. This is to be expected where there is a sales tax since sales taxes apply usually only to property and not to services.

(B)--exemption specifically applies to both labor and parts.

TYPE OF TAX

Generally the sales tax states also have a use tax to complement the sales tax.

COMMENTS

1--exemption specifically applicable where no charge is made.

2--tax exemption rationale is that the warranty parts and labor were included in the original purchase price, and as such, it had been computed in levying the tax on the price already. Any further tax would be double taxation.

3--"Sale" of parts from manufacturer to dealer is really a sale for resale, and is thus exempt from tax. Rationale used only in sales tax states.

APPENDIX B

A survey was taken of three groups of dealers who do warranty repair work asking them to state how much excise tax was paid for income due to warranty work during fiscal year 1975. The results are as follows:

GROUP	EXCISE TAX PAID IN 1975	COMMENTS
Automobile dealers	\$170,157	42 out of 66 dealers replied, including 5 who indicated they did no warranty work. The 15 dealers who did not reply could possibly account for about another \$47,000 in excise taxes. This figure was obtained by dividing the dealers who did respond into 3 categories according to the amount taxed, finding an average figure, and then applying this figure to the 15 dealers.
Heavy equipment dealers	\$ 16,019	20 out of 59 dealers replied, including 15 who indicated they did no warranty work
Boat dealers	\$ 473	4 out of 29 replied, including 2 who indicated that they did no warranty work

THE SENATE

EIGHTH LEGISLATURE, 19 76

STATE OF HAWAII

S.C.R. NO.

113

SENATE CONCURRENT RESOLUTION

REQUESTING THE LEGISLATIVE REFERENCE BUREAU TO CONDUCT A STUDY ON
STATE TAXATION OF WARRANTY PARTS AND LABOR OF AUTOMOBILES
SOLD THROUGH NEW CAR FRANCHISED DEALERSHIPS.

WHEREAS, the Hawaii Automobile Dealers Association have endeavored to secure a definitive determination of the propriety of the State's 4% excise tax on parts and labor provided by the dealer in meeting the requirements of the manufacturer's warranty of a new automobile; and

WHEREAS, Hawaii's new car dealers are confronted with a unique situation not shared by most dealers throughout the nation in the matter of the taxation of warranty parts and labor and the Hawaii Automobile Dealers Association, in cooperation with the National Automobile Dealers Association, has conducted a survey on how other States of the union deal with this matter; and

WHEREAS, the initial results show that of 22 states responding, only two levy a tax on warranty parts and in both these states the tax is a use tax and not an excise tax; and

WHEREAS, most states impose a sales tax on the initial sales transaction of a new car which includes a manufacturer's warranty which must be honored by the new car dealer; and

WHEREAS, the survey response thus far indicates that most states specifically exempt warranty parts and labor services provided by a dealer from provisions of a State sales or use tax statutes on the basis that such a tax had already been levied in the original transaction; and

WHEREAS, the Hawaii Automobile Dealers Association believes that the State of Hawaii could alleviate, to some extent, the rising cost of automobile parts and labor by imposing an exemption from the 4% excise tax of automobile warranty parts and labor; now, therefore,

BE IT RESOLVED by the Senate of the Eighth Legislature of the State of Hawaii, Regular Session of 1976, the House of Representatives concurring, that the Legislative Reference Bureau be requested to conduct a detailed study and analysis of the taxation of warranty parts and labor of automobiles; and

BE IT FURTHER RESOLVED that the Hawaii Automobile Dealers Association be requested to make available all information which it has accumulated in its on-going state-by-state survey to the Legislative Reference Bureau; and

BE IT FURTHER RESOLVED that the Legislative Reference Bureau complete its study and submit its findings, conclusions and recommendations prior to the next session of the Legislature; and

BE IT FURTHER RESOLVED that copies of this Concurrent Resolution be transmitted to the Governor of this State, the Director of the State Tax Department, the Legislative Reference Bureau and the Hawaii Automobile Dealers Association.

OFFERED BY: _____