Using the Property Tax to Appropriate Gains from Tourism

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Abstract

This paper describes and evaluates the merits of Kauai County's use of the property tax to capture rents from tourism and provide property tax relief to local homeowners. Because tourist accommodations are more capital intensive than other real estate, Kauai's proposal to split the standard uniform rate into two separate rates—one on land and the another higher rate on improvements—results in heavier tax burdens for the tourist industry relative to other sectors of the local economy. We conclude that such an approach works well for Kauai and communities that desire slower and lower density development but may not work as well for others that wish to encourage tourism investment.

Key words: Tourist taxes, taxation of tourism, benefits of tourism, property taxes

I. Introduction

Public support for tourism development is often based on the potential economic benefits that tourism can bring to a community. Critics of tourism development, however, often cite its negative environmental, social, and cultural impacts on the local population.

Taxing tourism (and tourists[1]) is one way for a host community to appropriate gains from tourism and to offset negative externalities (Tisdell, 1983; Bird, 1992; Mak, 2004, Chapters 11 and 12; and Mak, 2006). Mitchell (1970, p. 4) notes that if all resources employed in tourism are priced at the values in their next best uses, the base-line net economic benefit from tourism is measured by the difference between the taxes and fees levied on the sale of tourism commodities minus the cost of providing public services to tourists and resources spent by the government on tourism promotion. The hotel room (bed) tax is the most widely employed sales tax around the world to appropriate gains from tourism. International border entry and departure taxes and other types of "head" taxes are also excellent tax handles (Tisdell, 1983; and Mak, September, 2008). By contrast, the property tax is largely unused as an instrument to enhance tourism's net contribution to the local community.

This paper describes and evaluates the merits of a current proposal by the County of Kauai, Hawaii to use the property tax in order to increase the economic returns from tourism to benefit its residents. The counties in Hawaii do not have legal authority to levy their own income, sales, or hotel occupancy taxes and must rely almost exclusively on the property tax to raise own-source tax revenues. Instead of imposing a uniform rate on land and on improvements (buildings), Kauai currently levies a higher tax rate on buildings than on land. Because hotels, vacation condominiums, and timeshares are more capital (i.e.

[1] In this paper we use the terms "tourist" and "visitor" interchangeably. See Mak (2004, Chapter 1) for a discussion of the distinction.

improvements) intensive than all other property types (e. g. single family residential, commercial, industrial, and agricultural properties), Kauai's property tax structure shifts the county's overall tax burden more heavily onto tourism. The additional tax revenues collected from tourism make it possible to provide higher homeowner exemptions while remaining revenue neutral. To the best of our knowledge, no other tourist destination has yet tried to appropriate gains from tourism and redistribute the benefits to residents using the local property tax. The experiment in Kauai is ongoing and the boldest changes are still being considered by the County Council.

We evaluate the distributional effects of this novel property tax approach on different property types in Kauai. We also discuss potential differential impacts of such a split-rate property tax structure vis-à-vis a more conventional uniform property tax rate structure on investor incentives to make long-term capital improvements in tourism. Kauai's experiment may be of interest to other local tourist destinations with limited general taxing authority—especially in developing countries with highly fiscally centralized governments.

Section II provides a brief overview of resident attitudes toward tourism development in Kauai. Section III displays the capital (versus land) intensities of different property types on Kauai and shows how a higher property tax rate on buildings than on land shifts more of the local tax burden to tourism. Section IV discusses the political economy of the inverted split-rate tax in Kauai. Section V presents estimates of the tax revenue effects of Kauai's latest proposed tax changes. Section VI concludes.

II. Resident Attitudes Towards Tourism Development in Kauai

The County of Kauai is one of four counties in Hawaii. It is the second smallest geographically and the least populated (State of Hawaii, 2008, Tables 1.05 and 6.04). Year after year, readers of *Travel + Leisure* and *Condè Nast Traveler* rate Kauai as one of the best island destinations in the world (Mak, 2008, Chapter 8, p. 209)[2].

Despite its enormous popularity, in 2007, Kauai supplied 8,692 visitor accommodation units compared to 19,879 units for Maui, 11,061 units for the Big Island, and 33,588 units for Oahu (DBEDT, *2007 Annual Visitor Research Report,* p. 139).[3] In 2006, the Kauai County Council passed a resolution to oppose any further zoning changes for resort development (HTA, 2006, p. 16). The Council also proposed to reduce the density of visitor-related projects that had already received approval (HTA, 2006, p. 16). Table 1 shows the distribution of responses to the Hawaii Tourism Authority's *2007 Survey of Resident Sentiments on Tourism in Hawaii* survey question about increased hotel development. Of the four counties, residents of Kauai had the highest level of agreement with the statement: "Even if more visitors come, I don't want to see any more hotels on this island."[4]

<Insert Table 1 here>

Kauai's citizens are widely regarded as being the most anti-development in the state. The late Kauai County Mayor Bryan Baptiste acknowledged that "Kauai has had a tendency to put a lot of barriers in front of development." (Youn, 2003). In the 1990s, residents of Kauai successfully thwarted the State Department of Transportation's plan to extend the

[2] In 2008, readers of *Travel + Leisure* magazine voted Kauai the fourth best island in the world after the Galapagos Islands, Bali, and Maui; the Big Island came in seventh at http://www.travelandleisure.com/worldsbest/2008/results.cfm?cat=islands

[3] R. M. Towill Corporation, Inc. et. al. (2004, p. 68), warn that "The communities of Kauai thus face immediate decisions regarding the level of tourism growth they are willing to accept. By 2030, demand for Kauai hotel rooms will exceed existing capacity by 150%." They also note (p. 69) that reluctance to build new hotels may have the unintended consequence of channeling visitors into informal accommodations such as illegal bed and breakfast accommodations that are difficult to monitor and control.

[4] Nonetheless, 70% of the respondents indicated that "Overall, tourism has brought more benefits than problems to this island."

main island's airport runway to accommodate jumbo jets that would have facilitated direct flights to Kauai from the U.S. mainland and Japan.[5] In 2004, residents successfully obtained National Register of Historic Places designation for a 10-mile stretch of highway, making it impossible for large tour buses and trucks hauling construction equipment to get to the North Shore (Sommer, April, 2004).[6] In 2007, protesters prevented a private ferry company from offering the only inter-island ferry service between Oahu and Kauai.[7] In the same year, Kauai County Council members voted unanimously to ban the building of "big-box" stores; the council member who introduced the bill explained that a major reason for the bill was the protection of Kauai's rural character (TenBruggencate, 2007).[8] Other high profile cases of stymied development in Kauai county include a stalled resort development at Nukolii in the 1970s and 1980s (Cooper and Daws, 1985)[9] and commercial sightseeing boating on the Hanalei River beginning in the late 1980s (Mak, 2008, Chapter 6). Many Kauai residents feel that slower and less dense development is better.

III. Kauai's Unique Split-Rate Property Tax

Background

Unlike other states, government in Hawaii is highly centralized with decisions to tax and spend held largely by the state government rather than by the four county governments (Meller, 1992). The Hawaii State Constitution places responsibility for the most costly

[5] Fujii, Im and Mak (1992). Maui island residents were also successful in defeating the State Department of Transportation's plan to extend their island's airport runway (Blackford, 2001, p. 190).
[6] High end homeowners reportedly hauled in their construction equipment and materials by tugboats and barges.
[7] Tizon (2007). An extensive coverage of this controversy, including a time line beginning in 2004, can be found in the October 10, 2007 issue of the *Honolulu Advertiser*.
[8] This would prohibit any retail or wholesale establishment bigger than 75,000 square feet. Existing Costco, Wal-Mart and Kmart stores in the town of Lihue would be permitted to remain but not allowed to increase their size.
[9] Which one long-time observer of the Hawaii political scene has described as "the most raucous, violent, anti-development uprising in the history of the Hawaiian islands." (Jones, 2009).

functions of government at the state level. For example, Hawaii is the only state in which public K-12 education in Hawaii is provided by the state rather than local counties and districts. Also, the State provides the majority of expenditures on welfare, health and hospitals.

Hawaii has 17 separate tax laws, but the counties administer only the property tax, the vehicle weight tax, and the public utility franchise tax (State of Hawaii Tax Review Commission (1984). With limited expenditure responsibilities, property tax burdens in Hawaii's four counties are relatively low compared to those in other states. However, the counties bear most of the cost of public services used by tourists (ACIR, 1989). In 1989, citing the "accountability principle" that responsibility to raise revenue should go hand-in-hand with the responsibility to spend, the ACIR and the Hawaii Tax Review Commission (1989, p. 8) recommended that the State turn over the State's hotel room (i.e. transient accommodation) tax to the counties. The State Legislature did not accept the recommendation. Thus, for Kauai, the only major tax directly controlled by the County government to raise own-source tax revenues is the local property tax.

The Split-Rate Property Tax

Traditionally, the local property tax is levied as a uniform (i.e. single) tax rate on the combined value of the land and improvements (buildings). However, over 700 cities around the world have implemented a split-rate property tax system (Cohen and Coughlin, 2005, p. 359). Typically, in a split rate system, the tax rate on the value of the land is set higher than that on improvements. Consider two properties, both worth $100,000 but one property has a building worth more than the other property, which means that the value of the land under the higher valued building must be worth less. Under a uniform property tax, both properties bear identical property tax burdens. Under a split rate system with a higher tax rate on land, the property with a higher proportion of its value in land will pay relatively more property tax than an equivalently valued property with higher proportion of its value in improvements or buildings.

Economic theory suggests that switching from a uniform-rate property tax to a split-rate tax increases land use efficiency which leads to increased economic development and stimulates urban core development while preserving the environment and reducing urban sprawl. It can achieve these objectives while remaining revenue neutral and minimizing excess burden[10]. Nobel laureate in economics William Vickrey once observed that "The property tax is, economically speaking, a combination of one of the worst taxes—the part that is assessed on real estate improvements…and one of the best taxes—the tax on land or site value."[11] The split rate property tax system has a growing following.[12]

Kauai's split rate property tax is unusual in that tax rates on land values are set *lower* than that on improvements. That is, the rates are *inverted*. In this paper, we refer to Kauai's unique split rate property tax system as an *inverted property tax* system. Pollock and Shoup (1977, p. 68) demonstrate theoretically that the tax on improvements reduces the return on capital invested and hence reduces the incentive to invest in capital improvements.

Kauai's Inverted Split-Rate Tax

Because hotels, vacation condominiums, and timeshare properties are more capital intensive than land intensive, they differ fundamentally from single family homes for which

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[10] The term "excess burden" refers to the cost that a tax imposes on taxpayers in excess of the amount of tax revenues collected. It is also referred to in economics as "deadweight loss". (See any principles of microeconomics or public finance textbook on the effects of taxation for further explanation.)
[11] Quote from Cohen and Coughlin, 2005, p. 359.
[12] See, for example, Brunori, 2009; Cohen and Coughlin, 2005; England, 2003; and Hartzok, 1997.

land value is greater than the value of the buildings (i.e. improvements). Table 2 shows the ratio of building to land values for selected types of property between FY1993 and FY2009 using both gross valuations and net valuations.[13] In recent years, about three-fourths of the gross assessed values of the apartment (defined as a non-owner occupied residential unit in a multi-unit building, condominium unit, or timeshare) and hotel/resort classes are in buildings; by contrast, only one-quarter of the single-family residence class' total value is in buildings.

<Insert Table 2 Here>

Kauai County taxes improvements at a higher rate than land. For example, consider two properties worth \$500,000 each. For the average hotel room, about \$125,000 of this value is in the land and the remaining \$375,000 is in the building. For the single family residence, the reverse is true; \$375,000 of the property value is in the land and \$125,000 of the value is in the buildings. By levying higher rates on buildings than on land, the County collects more tax revenues from the hotel unit than from the single family residence, even though they are equivalently valued. Holding total revenues collected the same, Kauai's inverted property tax structure thus the shifts a greater portion of the overall tax burden on tourism related properties and away from residential and other types of properties (e.g. commercial and industrial properties).[14] Importantly, the inverted rate structure simultaneously creates incentives to reduce capital intensity of development on a given

[13] Net valuations subtract the value of exemptions.
[14] The county furthers this shift by instituting exemptions which favor residential properties: note the large difference between the gross buildings to land value ratio and the net buildings to land value ratio in the homestead category (Table 2). For dwellings occupied by their owners as their principal residence -- classified as "homesteads" -- exemptions can make a big difference in the relative values of the building and land components of their real property.

parcel of land. This policy is therefore consistent with the sentiment of Kauai residents who favor slower and less dense development (Section II).

IV. The Political Economy of Kauai's Inverted Split-Rate System

Until 2005, Kauai County had adopted the standard split rate property tax system under which land was taxed at a higher rate than improvements. However, in FY2006, the County changes its policy and instituted an inverted tax rate structure. Why?

The late 1990s saw the beginning of a dramatic run-up of housing prices in Kauai County (Figure 1).

<Insert Figure 1 Here>

Property tax assessments began to rise sharply in the early 2000s (Table 3). Kauai was not alone in experiencing this phenomenon; it was a statewide phenomenon. All over the state, residents demanded property tax relief (Schaefer, 2005).

<Insert Table 3 Here>

In Kauai, several attempts were made to curb the rise in property tax bills. Following the example of California's Proposition 13, in 2004 Kauai citizens voted to change the county charter to roll back property tax assessments and cap annual assessment increases on owner occupied homes; the vote was invalidated by the Hawaii Supreme Court in 2007 (See Sommer, October, 19, 2004; Zimmerman, 2007; Supreme Court of Hawaii, 2007). Also in 2004, the County established a nine-member Real Property Tax Task Force (RPTTF) whose mission was "to create a tax model which provides predictability, equitability, and clarity."[15]

The Task Force unveiled its recommendations in October, 2004. It suggested that the base assessed value of properties be established by the average of assessed values between 1999 and 2003. Thereafter annual increases would be indexed to the general inflation rate (Honolulu CPI-U). It also recommended that eight different property tax classes be reduced to two: (1) "Long-Term Residential" for properties which are occupied by their owners and/or long term tenants; and (2) "General" for all other properties. Tax rates on "Long-Term Residential" properties would be set at $2 for land and $6 for buildings for every $1,000 net assessed value. On "General" properties, the tax rate on land would be $4 and $12 on buildings. In sum, buildings would be taxed at rates three times that on land. Exemptions would remain unchanged. The inverted split rate property tax was seen as a way to provide property tax relief for people who own modest homes and to insulate them against sharply rising land values (Chuan, 2004).

A draft bill (DB2108) was sent to the County Council but did not receive a public hearing because council members felt that it would undermine the Council's taxing authority (Finnegan, 2008). But the rising chorus of demand for relief from soaring real estate taxes on Kauai could not be ignored by lawmakers. What ultimately emerged was a temporary fix. The County Council enacted a circuit breaker credit which capped an owner-occupant's annual property tax bill based on the owner's income, capped annual property tax bill *increases* on homes owned and occupied by residents at two percent, and six percent for residents who put their second homes into long term rentals (Eagle, June 2, 2008).

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[15] See http://www.kauai.gov/Portals/0/Finance_RP/RPT_update_041015.pdf

In addition, the mayor proposed and the Council enacted the "largest tax cuts in county history" by reducing tax rates on land on almost all property types while holding rates on buildings remained unchanged.[16] This resulted in a rate structure that imposed higher—but not much higher-- tax rates on buildings than on land for residential, commercial, hotel/resort, and industrial properties (Table 4). In announcing the proposal to cut taxes on land values, the mayor explained that he wanted to provide tax relief to all property owners and not just homeowners. Nonetheless, the move toward higher rates on buildings than on land resulted in shifting a greater share of the overall property tax burden to the capital (building) -intensive hotels/resorts and apartments from other property types.

<Insert Table 4 Here>

IV. The Future of Kauai's Inverted Split-Rate Taxation

An Examination of Bill 2274

To help craft long term property tax reform, the Council appointed an eight-person Real Property Tax Committee (RPTC) to study and recommend a durable solution. Following nearly a year of deliberation, the RPTC came up with a tax reform package which the mayor sent to the County Council for consideration in May 2008 (County Council of Kauai, Bill 2274). Bill 2274 abolishes the temporary measures enacted in 2005—including the popular two percent cap on owner-occupied homes— and replaces them with a

[16] County of Kauai, Department of Finance News Release, May 6, 2005. The property tax rate on land under single family homes was reduced by 22.2 percent from $5.20 per $1000 value to $4.00, and by 15.2 percent from $8.20 per $1000 value to $6.95 on land under apartments, commercial, industrial, and hotel/resort properties. Tax rates on conservation and agricultural lands were also reduced—by 14.2 percent and 8.6 percent respectively—but they remained higher than the rates on buildings.

"revenue neutral" package of proposed changes that includes a 3-to-1 ratio of building to land tax rates.

Table 5 compares tax shares under current rates against two hypothetical scenarios (Variants A and B), each with improvements taxed at three times the rate of land taxation. Variant A sets the tax rates on buildings at three times the current tax rates on land; Variant B sets the tax rates on land at one-third the current tax rates on buildings. Table 5 shows clearly that setting the tax rates on buildings to triple the rates on land shifts greater shares of the County's tax collections to hotel/resort and apartment properties.

<Insert Table 5 Here>

Eric Knutzen, the county facilitator to the RPTC, proposed that beneficiaries of county services should pay fully for the cost of public services consumed. He noted, "We're putting the emphasis and taxation burden on the building side. The improvements on the land are really what drive the usage of county services" (Eagle, July 10, 2008, p. A6).

We note that the calculations in Table 5 use current exemptions. As a result, the 3-1 split helps non-owner-occupied single-family homes relatively more than homesteaders. In Bill 2274 (p. 87), property tax relief "on real property owned and occupied only as the owner's principal home" is achieved by raising homestead exemptions to among the highest levels in the state (Eagle, July 10, 2008). For instance, the bill proposed raising basic homeowner (homestead) exemption from $48,000 to $300,000.[17]

[17] For those 60 and older, the exemption would rise from $96,000 to $325,000 and the current exemption of $120,000 for residents age 70 and older would rise to $350,000 (See Bill 2274, beginning at p.87).

In split-rate property taxation, the order in which exemptions to land and buildings are applied is important. The Kauai County Code mandates the homestead exemption be applied first to the value of the building. Any remaining exemptions are then applied to the land value. The much higher value of the basic homestead exemption proposed in Bill 2274 reduces the taxable building value of many properties to zero and greatly lowers the ratio of building to land value for others. Since improvements would be taxed at three times the rate on land, applying exemptions first to buildings and then to land in an inverted split rate property tax system favors homesteaders even more -- especially those who own modest structures -- than if the exemptions are divided more equally between buildings and land.

The bill further proposes to reduce the number of classifications from 8 to 4: (1) residential, which includes owner-occupied homes and long-term affordable rentals; (2) resource lands—which include conservation lands and "farmsteads" principally used for food, fuel, or fiber production; (3) "general"; and (4) resort. The resort classification is expected to bear the brunt of the change. The RPTC explicitly intends to impose higher tax burdens on hotels and resorts than on all other properties. Speaking to resorts, Knutzen warns, "Expect a change" (Finnegan, 2008).

Effects of Proposed Tax Changes on County Revenues

We estimate the tax revenue effects of the proposed property tax and exemption changes in Kauai County and ascertain which classification of property owners are likely to be winners and which are likely to be losers. Table 6 presents three sets of estimates. First, we present tax revenues generated under current tax rates and exemptions for FY2008-2009 for each of eight property classes as a baseline. Second, we derive new revenue estimates by applying the proposed 3-1 split tax rates (see Table 4) to taxable property values based on current exemptions. The third set of estimates adds the more generous exemptions and ascertains how they affect the distribution of tax burdens among property types.

<Insert Table 6 Here>

Due to variation in the exemptions claimed across individual homesteaders and a lack of parcel level microdata, we are unable to precisely estimate the property tax liability shares by property class under the proposed tax reform package. However, by taking advantage of the fact that the package of tax exemptions in the proposed Bill 2274 is similar to those already used by Maui County, we are able to calculate a rough estimate of the aggregate revenue effects of the proposed tax and exemption changes for homesteads in Kauai. To do this, we use the ratio of net to gross property valuations for homeowner properties on Maui and apply them to Kauai. In essence, we assume that the percentage of total gross value for buildings (land) in homesteads that is exempted on Maui is a reasonable approximation of the percentage of total gross value for buildings (land) exempted in Kauai.

Table 6 shows property taxes fall for homesteads, agricultural, and conservation parcels and increase for hotels, apartments (which include non-owner occupied units in multi-unit buildings, condominiums and timeshares), and non-owner occupied single-family residential parcels.[18]

In September 2008, the Council decided to defer Bill 2274 because it could not muster sufficient support to pass it. Opposition to the proposed bill came from diverse groups. The resort community argued that the 3-1 split would reduce the incentive for them to investment in their properties and would harm their competitiveness in the long run

[18] The homestead exemptions results in a further dramatic decline for this category of property owners.

(Eagle, September 5, 2008). One council member reported receiving "a lot of" negative e-mail messages from timeshare owners (Eagle, July 10, 2008, p. A6). Homeowners were apprehensive about the elimination of the two percent cap on property tax bills because they liked the "security and predictability" of the cap (Eagle, August 22, 2008; Eagle, August 19, 2008)[19].

VI. Conclusion

One common goal of tourism development is to maximize the welfare of destination residents.[20] One way to achieve this is by taxing tourists and the tourist industry. The most commonly employed tourist taxes to appropriate gains for the benefit of residents are hotel occupancy taxes and entry and departure taxes. Although Bill 2274 is not yet law, it illustrates how a property tax system can be structured to appropriate gains from tourism.

Empirical evidence suggests that the use of the split rate property tax can benefit some property owners and penalize others (Bowman and Bell, 2004.) We find evidence of this in Kauai. Kauai exploited the higher improvement intensity of hotels and resorts to design and propose a tax that disproportionately falls on the tourism industry. On the surface, Kauai's proposed inverted split rate schedule raises one rate (on the value of buildings) and lowers another (on the value of land) for each property class. Even without exemptions, the net effect of these rate changes is a lower tax burden on local homeowners. Hotels and resorts, on the other hand, shoulder a greater net tax burden due to their higher value of improvements relative to land.

[19] The two percent cap provided an estimated $13 million in property tax relief to homeowners between 2005 and 2008 (Eagle, August 19, 2008, p. A1). But the councilman who introduced the 2 percent cap in 2005 indicated that it was time to repeal the measure due to its inequity (Eagle, August 19, 2008, p. A5).
[20] This is especially true if tourists have limited political power in local government.

The property tax is a relatively nimble tool available to Kauai lawmakers to export local taxes to tourists. On the other hand, the inverted split rate property tax tends to discourage investment in capital improvements, reduce the demand for construction, and retard economic growth. Empirical studies on the actual investment effects of split-rate property taxation elsewhere have not yielded conclusive results (Schwab and Harris, 1997, and Pollock and Shoup, 1977). Furthermore, it is unlikely that the modest difference in current tax rates on building values versus land values has significantly discouraged investment in visitor accommodations in Kauai to date. However, if the ratio of the tax rate on building values rises to three times that on land values as currently proposed in Kauai, some of these effects may occur. The citizens of Kauai generally favor slow growth and low density tourism development. The *Kauai General Plan 2000* envisions Kauai will remain "rural" by 2020. The Kauai Tourism Strategic Plan goals include "retaining the rural nature of Kauai" (HTA, 2006, p. 22) and a "modest increase" in tourist arrivals (HTA, 2006, p. 26).

Kauai's approach to appropriating gains from tourism and providing tax relief to resident via the property tax may not be the only way to achieve some of the same objectives. An examination of Maui's experience may be instructive. Maui has many features that recommend it as a valid counterfactual for Kauai: both are neighbor islands, both have tourism driven economies, both have residents who want to rein in the growth of tourism, and both have near identical profiles of housing price increases over the past decade (See Figure 1).

However, Maui County levies a much higher tax rate on hotels and resorts at $8.20 per $1,000 net taxable value than on owner-occupied residences at $2.00 per $1,000 net taxable value.[21] Since FY2005, Maui County cut the property tax rate on homeowners by almost 44 percent.[22] It also extended numerous exemptions to residents such as the $300,000 basic homestead exemption. Thus, Maui County has shifted the tax burden to tourism and provided tax relief to residents through a more traditional use of the property tax.

If Kauai reverted to a single rate tax on hotels similar to the one in Maui County, the average rate on hotel/resorts would have be $9.47 per $1000 of net tax value instead of $11.25 on buildings and $3.75 on land. The average tax rate on homeowners would be $3.62 instead of $6 on improvements and $2 on land keeping the proposed structure of exemptions. Since the current weighted property tax rate on owner-occupied residences is $3.82, property tax relief to homeowners would come largely through increasing the generosity of homeowner exemptions.[23]

A single rate system on Kauai that produces the same revenues as the proposed tax changes in Bill 2274 would require higher tax rates than those found on Maui for most property classes. Average single tax rates on Kauai would have to be higher because Maui has built up its tax base by permitting rapid tourism and economic development since the 1970s (Mak, 2008, Chapter 8).

Both the Kauai and Maui tax systems are designed to shift taxes to tourism and provide homeowner tax relief. However, Maui strives to attract upscale tourism with high-

[21] To shift even more of the tax burden to tourism, Maui established a separate tax rate for the fast growing timeshare industry at $14 per $1,000 of net taxable value, the highest rate on all property types. Some Maui County council members do not want to see an expansion of the timeshare industry on Maui claiming that their occupants spend the least amount of money while visiting Maui.

[22] Also https://www.realpropertyhonolulu.com/portal/rpadcms/Reports?parent=REPORT

[23] It is worth pointing out that the circuit breaker tax relief is income tested while the basic exemption is not. While the total tax relief to homeowners in general may be higher under the proposed exemptions, the changes are regressive and benefit high income homeowners who could not have claimed the circuit breaker tax break. Exactly how much of the proposed basic exemption increase would go to high income homeowners would require further investigation that is beyond the scope of this paper.

end hotels and resorts. On Maui, 38.3 percent of the visitor plant inventory in 2007 was classified as "luxury" units, the highest percentage among the four major island destinations in Hawaii (DBEDT, *2007 Annual Visitor Research Report*, p. 138). Meanwhile, Kauai had the lowest percentage of luxury visitor lodging units at 16.7 percent. An inverted split rate tax policy would undermine Maui's long-term strategy of developing a luxury resort destination. In contrast, an inverted split rate tax policy in Kauai would help it achieve its vision of slow and low density tourism while raising revenues.

The lesson from Kauai and Maui is that the property tax can be employed creatively to accomplish different goals. It can be used in a straightforward way as in Maui to appropriate gains from tourism for the benefit of a destination's residents, but it can also be used in more complex ways to influence incentives to build and improve capital. The optimal tax structure depends on the goals of the community.

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Table 1: Distribution of responses by county to the statement "Even if more visitors come, I don't want to see any more hotels on this island."

	Oahu	Maui	Hawaii	Kauai
Strongly Agree	44%	62%	41%	62%
Somewhat Agree	23	14	15	17
Somewhat Disagree	18	9	22	10
Strongly Disagree	11	14	17	8
Don't Know/Refused	4	2	5	3

Source: 2007 Survey of Resident Sentiments on Tourism in Hawaii Volume II, HTA

Table 2: Ratio of Assessed Improvement Values to Total Property Values in Kauai: FY1993-FY2009

Property Type	1993	1997	2000	2003	2006	2009
Single Family						
Gross value	0.275	0.329	0.365	0.353	0.258	0.248
Net value	0.260	0.313	0.349	0.337	0.246	0.235
Apartment						
Gross value	0.597	0.618	0.599	0.625	0.717	0.741
Net value	0.598	0.616	0.597	0.626	0.720	0.748
Hotels/Resort						
Gross value	0.531	0.594	0.715	0.724	0.739	0.763
Net value	0.531	0.594	0.715	0.724	0.739	0.764
Homestead						
Gross value	0.393	0.461	0.522	0.538	0.417	0.405
Net value	0.254	0.330	0.391	0.421	0.318	0.316
All Properties						
Gross value	0.391	0.433	0.489	0.473	0.406	0.401
Net value	0.367	0.400	0.461	0.443	0.380	0.377
All minus Hotels/Resort						
Gross value	0.366	0.415	0.447	0.428	0.367	0.357
Net value	0.333	0.374	0.404	0.384	0.333	0.326
All minus Hotels/Resort & Apartment						
Gross value	0.318	0.383	0.429	0.406	0.321	0.309
Net value	0.268	0.329	0.377	0.352	0.277	0.269

Notes: 1. Apartment includes non-owner occupied units in multi-unit residential building, condos and timeshares.
2. Homestead properties are used as owners' principal residence.
3. Gross values do not include non-taxable properties.
4. Net values exclude exemptions.

The series begins in FY1993 (July 1, 1992-June 30, 1993) to capture property values before Hurricane Iniki devastated Kauai in late 1992.

Source: City and County of Honolulu, Department of Budget & Fiscal Services, Real Property Assessment Division, at https://www.realpropertyhonolulu.com/

Table 3: Gross Assessed Property Tax Values for Residences, Kauai County FY1993-FY2009 (Assessed Value Per Parcel, in thousands $)

Property Type	1993	1997	2000	2003	2006	2009
Single Family	207	184	195	252	528	712
Apartment	247	165	185	205	490	485
Homestead	192	181	191	207	446	575

Source: City and County of Honolulu, Department of Budget & Fiscal Services, Real Property Assessment Division, at https://www.realpropertyhonolulu.com/

Table 4: Current vs. Proposed Property Tax Rates (Tax per $1000 net taxable property)

Property Class	Current		Proposed	
	Building	Land	Building	Land
Single-Family Residential	$4.25	$3.95	$10.50	$3.50
Apartment	$7.90	$6.90	$10.50	$3.50
Commercial	$7.90	$6.90	$10.50	$3.50
Industrial	$7.90	$6.90	$10.50	$3.50
Agricultural	$4.25	$6.90	$10.50	$3.50
Conservation/Resources	$4.25	$6.90	$7.50	$2.50
Hotel & Resort	$7.90	$6.90	$11.25	$3.75
Homestead	$3.44	$4.00	$6.00	$2.00

Source: County of Kauai, *Proposed Real Property Tax Improvements* (2008), p. 22.

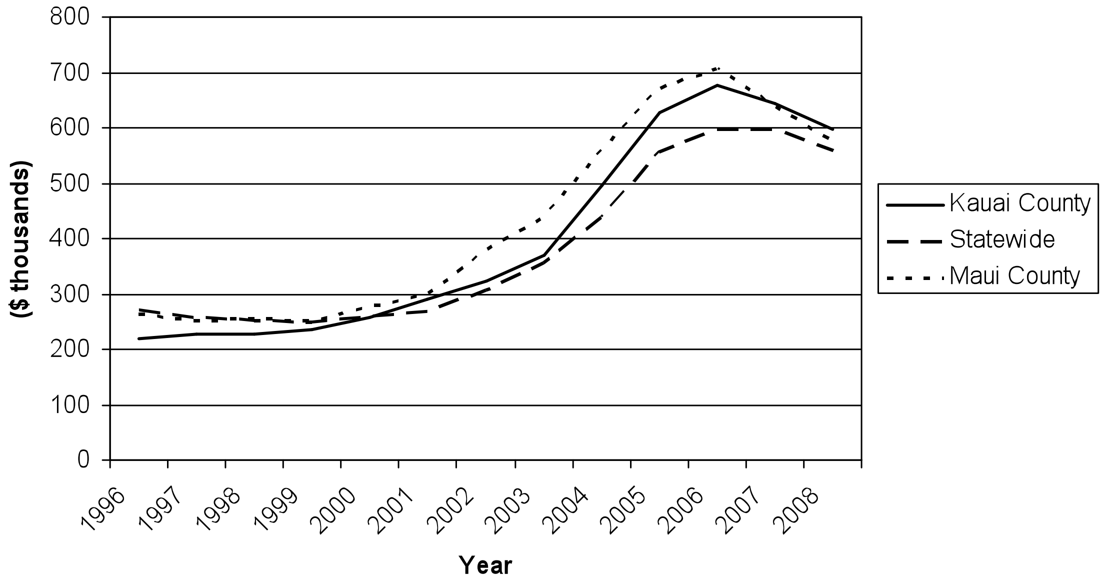
Table 5: Tax Revenue Shares Under Current Tax Structure vs. 3-1 Split: FY2008-2009

Property Type	(1) Current	(2) Variant A	(3) = (2) – (1) Difference	(4) Variant B	(5) = (4) – (1) Difference
Single Family	21.6%	17.5%	-4.1%	18.8%	-2.8%
Apartment	15.0	18.9	3.9	21.6	6.6
Commercial	7.4	7.1	-0.3	8.1	0.7
Industrial	2.3	2.2	-0.1	2.6	0.3
Agriculture	15.6	13.3	-2.3	8.1	-7.5
Conservation	2.2	1.5	-0.7	0.9	-1.3
Hotel/Resort	16.6	21.2	4.6	24.2	7.6
Homestead	19.2	18.3	-0.9	15.7	-3.5

Notes: Variant A: Tax rates on buildings are 3x current tax rates on land (Table 3)
Variant B: Tax rates on land are 1/3 x current tax rates on buildings.
Single family properties include only those which are not owner occupied. Homestead properties are used as owners' principal residence. Apartment includes non-owner occupied units in multi-unit residential building, condos and timeshares.

Sources: Tax rates are from Table 3. Current tax revenue collections and assessments are from City and County of Honolulu, Department of Budget & Fiscal Services, Real Property Assessment Division, at https://www.realpropertyhonolulu.com/

Figure 1: Annual Median Single Family
Home Prices, 1996-2008



Source: University of Hawaii Economic Research Organization Economic Information Service at http://uhero.prognoz.com/